

Partnership Agreement Guidelines

These guidelines serve as a checklist of items that should be covered by most partnership agreements and don't constitute legal advice. It is recommended that an attorney is consulted to draft a formal agreement, and that each partner retain his/her own personal attorney to represent their interests.

These guidelines are also applicable for multi-member limited liability companies (LLCs), replacing the term "partner" with "member".

In addition to a partnership agreement, it might be beneficial for the partners to draft a values agreement. Although not legally binding, this document would serve as an ethical commitment to each other and could force a conversation around strategy, company culture, and philosophies that drive day-to-day actions.

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1. Date and location of formation.
2. Legal form of entity (e.g. general partnership, LLC, etc.)
3. Purpose: Describes the nature and purpose of the business.
4. Termination: Determines when partnership can or will be dissolved. This should include any contingencies that will cause termination.
5. Partner identification: List full name and address of each partner in Appendix A.
6. Percent ownership: Defines the percentage of interest each partner owns of the business, listed in Appendix A. This section also states that a partner's interest in the business is considered the partner's personal property, and that the partner has no interest in specific company property.
7. Decision-making and dispute resolution: Identifies voting power, how major decisions that materially impact the business are made (simple majority, unanimous vote, etc.), and how disputes will be resolved. This includes how to move forward when no consensus can be reached. It is recommended that no "ties" are allowed in order to avoid gridlock.
8. Capital contribution: States the amount of capital (physical property or cash) each person is initially putting into the business, listed in Appendix A. This also should cover any planned future contributions and how unplanned needs for capital will be addressed.

Note that the relative proportion of capital contribution doesn't necessarily define the % of business ownership or decision-making authority. Each of these can be determined independently of the other.

9. Partner salaries: Defines the regular salary, if any, which will be paid to each partner. This section also addresses how future salary increases and/or decreases will be determined.
10. Allocation of profits and losses: Determines the percentage of interest each partner owns of the profits and losses of the business.

Note that taxes may be calculated based on the allocation of profits and losses, not the actual distribution of those profits/losses if this is the case. Each partner should ensure they have sufficient cash flow to pay income and self-employment taxes in the event the business is profitable but the distribution is insufficient to pay those taxes.

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Caution: Care must be taken if the % allocation of profits and losses doesn't match the % of ownership for each partner. The IRS is wary of disproportionate allocations devised to avoid income taxes.

11. Distribution of assets to partners: This section determines when owners' equity (accumulated profits) or other assets of the business will be distributed (paid out) and how assets will be allocated. It will likely require a definition of trigger points that will result in a distribution. This section should also identify any reserve funds to be maintained in owners' equity.
12. Expense reimbursements: Any payment for reimbursement of expenses incurred by any partner will not be considered a distribution or change in partner interest in the company. All expense reimbursements will be made in accordance with company policy.
13. Death of one or more partners: Determines what will happen in the event of one or more partners dies. This section identifies how ownership will be revised and how the deceased partners' equity will change hands and to whom.
14. Disability: Determines how responsibilities will change when one of the partners is unable to work due to physical or mental impairment.
15. Insurance: Stipulates the minimum insurance that will be maintained by the company.

It is recommended that life insurance is taken out on all partners. Proceeds from the insurance payout to be used to pay off the deceased partner's interest to his/her estate or otherwise execute the partnership agreement.

Disability insurance should also be required for each partner to compensate the company if critical duties need to be outsourced during a partner's absence.

16. Change in partnership structure:
 - a. Dissolution: Identifies what will happen if one or more of the partners wants to leave the business.
 - b. Voluntary exit of a partner: What is required of a partner in order to exit the business.
 - c. Expulsion of a partner: States how a partner can be involuntarily removed, approval requirements, and how to calculate his/her share of interest.
 - d. Addition of a new partner: States the criteria for when a new partner can be admitted, approval requirements, and how to calculate required capital contribution.
 - e. Sale of business: States how a decision to sell the business is reached, how to determine the value of the business, who will negotiate terms on behalf of the partnership, and approval requirements.
17. Roles, responsibilities, and authorities of partners:
 - a. Duties: Identifies the titles and general duties of each partner.
 - b. Hours: The number of hours per week that will typically be expended for the benefit of the business by each partner, usually stated in average hours over an extended time.
 - c. Authorities and responsibilities: Identifies which partner(s) has signature authority to commit the partnership to certain liabilities, sign checks, hire and fire employees, and other significant actions.

It is recommended that one partner be designated Chief Executive Officer or leader of the firm. This person should have decision-making authority for major decisions that

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are within guidelines established by this agreement. The CEO position can be rotated among willing partners to provide more balance in the relationship – the rotation period should be one year or more.

The definition of authority can include limits of authority for an individual partner, such as dollar limits on purchase orders before brought to a vote by the entire partnership.

- d. Conflict of interest: Requires all partners to disclose any interest they may have that could potentially result in a conflict of interest. If a conflict of interest does arise, the conflicting interest must be fully disclosed. If the conflict involves a major decision, the partner with the conflicting interest must be recused from voting on the decision.
- e. Non-compete: restricts partners from participating or benefitting from a competitive business. The definition of a competitor can be as broad or as narrow as required.

The non-compete restriction can extend to any business or commercial activity – essentially preventing other partner interests from competing with the business.

18. Liabilities of each partner and of the partnership:

- a. Partnership's liabilities to each partner: States that the liabilities that a partnership has to each of its partners is defined in the partnership agreement.
- b. Partnership's liabilities to third parties:
- c. Partners' liabilities to third parties and to each other: States that the partners do not have any liability to each other or to third parties except as defined in the partnership agreement, when a partner has signed a legal contract stating otherwise, or in the case of misconduct.
- d. Partners' liabilities not related to the partnership: States that the partnership is not liable for the acts of individual partners except as stated in the partnership agreement.

19. Accounting practices:

- a. Accounting methods: States whether the firm is using accrual or cash method, defines the fiscal year and accounting periods, states the applicable laws and regulations under which the accounting method is compliant, and determines when books are balanced and an accounting period is closed.
- b. Taxation: If the firm is an LLC, defines the taxation election for federal tax purposes (taxed as partnership or S-Corp).
- c. Maintenance of books and records: Identifies who is responsible for maintaining the accuracy of the company's official books.
- d. Open books: States that the company's books will be maintained on the company's premises and will be available for view by any partner at any time.
- e. Honesty and integrity: Requires each partner to act with honesty and integrity when conducting or recording business transactions. Identifies actions that will be taken if this clause is breached.
- f. Audit: Identifies when and how audits will be initiated and conducted.

It is recommended that any partner be allowed to initiate a special audit of company books, to be paid for in full by initiating partner.

20. Meetings: Identifies minimum frequency and agenda of formal partnership meetings, provision for special meetings – including who can call the meeting, minimum time of notice, and what constitutes a quorum.

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21. Amendments: Defines how the partnership agreement can be amended.
22. Assignment: States whether a partner's interest in the company can be assigned to a third party, and whether such assignment causes the third party to become a partner.
23. Unresolved disputes: Defines how disputes that cannot be resolved are handled.

It is recommended that arbitration be the option of choice in this instance, as lawsuits could bankrupt the business.