Partnerships: General Partnership, Limited Partnership and Corporations

Introduction

A partnership is the simplest form of partnership to set up. It requires at least two individuals willing to share the burdens and benefits of their business. A partnership provides the benefit of single taxation. This means that the percentage of the businesses profit is the income for the year. The only downside of a partnership is that the partners are not shielded from liability. This means that if the partnership is held responsible for someone's injury, then they are responsible for their entire damages, even if it means paying out of them and their partner's pockets. To avoid losing personal assets, most partnerships may own liability insurance.

A partnership is commonly formed where two or more people wish to come together to form a business. Perhaps they have a common business idea that they wish to put to the test or have realised that their skills and talents compliment each others in such a way that they might make a good business team. Forming a partnership seems like the most logical option. Running a small business with a reasonably low turnover, a partnership is quite often a good choice of legal structure for a new business. The way a partnership is set up and run as well as the way it is governed and taxed often make it the most appealing form of business.

Advantages of Partnership

Being a partnership, the business owners necessarily share the profits, the liabilities and the decision making. This is one of the advantages of partnership, especially where the partners have different skills and can work well together. So, some of the major advantages of partnership are discussed below:

Capital – Due to the nature of the business, the partners will fund the business with start-up capital. This means that the more the partners, the more money they can put into the business, which will allow better flexibility and more potential for growth. It also means more potential profit, which will be equally shared between the partners.

Flexibility – A partnership is generally easier to form, manage and run. They are less strictly regulated than companies, in terms of the laws governing the formation and because the partners have the only say in the way the business is run (i.e. without interference by shareholders) they are far more flexible in terms of management, as long as all the partners can agree.

Shared Responsibility – Partners can share the responsibility of running the business. This will allow them to make the most of their abilities. Rather than splitting the management and taking an equal share of each business task, they might well split the work according to their skills.

Decision Making – Partners share the decision making and can help each other out when they need to. More partners mean more brains that can be picked for business ideas and for solving of problems that the business encounters.

Disadvantages of Partnership

Partnership can obviously have some problems. Over the years, many partnerships have turned sour. Family and friends go into business together and end up falling out on a personal or business level and it all ends badly. This is one of the major disadvantages of partnerships over other business models. Disadvantages of partnerships are deeply discussed below:

Disagreements – One of the most obvious disadvantages of partnership is the danger of disagreements between the partners. Obviously people are likely to have different ideas on how the business should run, who should be doing what and what are the best interests of the business. This can lead to disagreements and disputes which might not only harm the business, but also the relationship of those involved. That is why it is always advisable to draft a deed of partnership during the formation period to ensure that everyone is aware of what procedures will be in place in case of disagreement and what will happen if the partnership is dissolved.

Agreement – It is mandatory to make an agreement because the partnership is jointly run, it is necessary that all the partners agree with things that are being done. This means that in some circumstances there are less freedoms with regard to the management of the business, especially when compared to sole traders.

Liability – Ordinary Partnerships are subject to unlimited liability, which means that each of the partners shares the liability and financial risks of the business. This can be countered by the formation of a limited liability partnership, which benefits from the advantages of limited liability granted to limited companies, while still taking advantage of the flexibility of the partnership model.

Taxation – One of the major disadvantages of partnership is taxation. Taxation laws mean that partners must pay tax in the same way as sole traders, each submitting a Self Assessment tax return each year. They are also required to register as self employed with HM Revenue & Customs. The current laws mean that if the partnership brings in more than a certain level, then they are subject to greater levels of personal taxation than they would be in a limited company. This means that in most cases setting up a limited company would be more beneficial as the taxation laws are more favourable.

Profit Sharing – Partners share the profits equally. This can lead to inconsistency where one or more partners are not putting a fair share of effort into the running or management of the business, but still reaping the rewards.

General Partnerships

Partnerships are the most common type of business structure for businesses with more than one owner. A business partnership is a for-profit business established and run by two or more individuals. The individuals are partners and serve as co-owners of the business. There are actually different types of business partnerships. The most common is the general partnership because it's the easiest, most straightforward and least expensive to form. It is a partnership where all partners have responsibility for the business and unlimited liability for business debts. This means that each general partner shares both the benefits and the obligations of the business.

Each general partner must contribute something to the partnership business. The partner can contribute funds, property, skills, labour or any kind of involvement with the business. In return, each general partner shares the business profits. However, general partners also share the business' liabilities and losses.

Advantages of general partnership

General partnerships, like all partnerships, are popular due to the advantages they provide. The main advantage of all partnerships is that the partnership is not separately taxed.Instead, the profits flow through directly to the partners. The business profits become the partners' income. The partners then file their own individual tax returns and pay their own individual income taxes.

Though tax treatment is the main advantage, keep in mind that general partnerships are also popular because they grant broad powers to the partners. The partners share responsibility for the management of the business and act as their own bosses.

Disadvantages of general partnership

Unlike other forms of partnership, all general partners have unlimited liability for partnership obligations. This means that all general partners can be held personally responsible for all business debts and liabilities, including financial commitments and court judgments. This means that, unless there's an agreement otherwise, any general partner has authority to transact business on behalf of the business, and therefore obligate the business.

Limited partnership:

A limited partnership is a partnership consisting of some partners whose liability is limited to the amount of capital contributed by each. The personal property of a limited partner is not liable for the firm's debts. One cannot take part in the management of the firm. Their retirement, insolvency, lunacy or death does not cause dissolution of the firm. There is at least one partner having unlimited liability. A limited partnership must be registered.

Limited partnership is now allowed in India under the Limited Liability Partnership Act. In England limited partnership can be formed under the Limited Partnership Act, 1907 and in the USA under the Partnership Act, 1890. Therefore, the chief characteristics of a limited partnership are as follows:

- There must be at least one partner with unlimited liability.
- The limited partner cannot take part in the management of the firm.
- The limited or special partner cannot assign their share to an outsider without the consent of the general partner.
- The limited partner cannot withdraw any part of their capital.
- A limited partnership must be registered.

Advantages of limited partnership

Limited partnership offers the following benefits:

- It enables people to invest in a business without assuming unlimited risk and without devoting much time and attention in management of business.
- It permits the mobilisation of larger financial resources from cautious and conservative investors.
- It provides an opportunity to the abled and experienced persons to manage the business without any interference from other partners.
- It is more stable than general partnership because it is not dissolved by the insolvency, retirement, incapacity or death of limited partner.

Disadvantages of limited partnership

Limited partnership suffers from the following drawbacks:

- The limited partners are deprived of the right to manage. They remain at the mercy of the general partner.
- The general partner may misuse his power to exploit the limited partners.
- A limited partnership enjoys little credit standing as the liability of some partners is limited.

Corporation

A corporation is a business or organization formed by a group of people, and it has rights and liabilities separated from those of the individuals involved. It may be a nonprofit organization engaged in activities for the public good; a municipal corporation, such as a city or town; or a private corporation which has been organized to make a profit.

In the eyes of the law, a corporation has many rights and responsibilities similar to that of a person. It may buy, sell, and own property; enter into leases and contracts; and bring lawsuits. It pays taxes. It can be prosecuted and punished often with fines if it violates the law. The chief advantages are that it can exist indefinitely, beyond the lifetime of any one member or founder, and that it offers its owners the protection of limited personal liability.

Advantages of corporation

The advantages of corporation are as follows:

- Generally, a corporation's shareholders are not liable for any debts incurred or judgments handed down against the corporation.
- Corporations may be able to raise additional funds by selling shares in the corporation.
- Corporations may deduct the cost of benefits it provides to the employees and officers.
- Some corporations may be able to elect treatment as an S corporation, which exempts them from federal income tax other than tax on certain capital gains and passive income.

Disadvantages of corporation

The disadvantages of corporation are as follows:

- Forming a corporation requires more time and money than forming other business structures.
- Governmental agencies monitor corporations, which may result in added paperwork.
- Corporate profits may be subject to higher overall taxes since the government taxes profits at the corporate level and again at the individual level, if such profits are distributed to the shareholders.

Conclusion

A partnership is commonly formed where two or more people wish to come together to form a business. It requires at least two individuals willing to share the burdens and benefits of their business. A partnership provides the benefit of single taxation. Forming a partnership seems like the most logical option. Running a small business with a reasonably low turnover, a partnership is quite often a good choice of legal structure for a new business. The way a partnership is set up and run as well as the way it is governed and taxed often make it the most appealing form of business.