2.2 PARTNERSHIPS

ADVANTAGES
✓ Simple and inexpensive to establish and maintain
✓ Has advantages of sole proprietorship but permits multiple owners of enterprise
DISADVANTAGES
☒ No limited liability for general partners; each partner is responsible for the debts and obligations of the business
☒ Generally not suitable for accessing outside capital
CASE STUDY
Sustainable Asset Fund II, LP (SAF II) is a Delaware limited partnership that invests in real assets that are sustainable; that is, they use renewable inputs or are fundamentally more efficient than conventional real assets. These can include assets such as solar and wind energy production facilities, water storage capacity and wetlands that generate mitigation credits. SAF II seeks to make investments that, in addition to producing a financial return, mitigate or reduce greenhouse gas emissions, provide green jobs, provide capital to underserved businesses and industries and protect open spaces. SAF II uses the limited partnership form to provide limited liability to its investors while maintaining favorable tax characteristics. SAF II is managed by Vision Ridge Partners, LLC. For more information, please visit http://www.vision-ridge.com.

a) Overview

A partnership is a form of business structure whereby two or more parties, or partners, agree to form and carry on a business. Each partner in a partnership provides funding, assets, labor or skill and receives a share in the profit and losses of the partnership.

There are several forms of partnership structures, with the most prevalent forms being:

- General partnership
- Limited partnership
- Limited liability partnership, or LLP
- Limited liability limited partnership, or LLLP

A general partnership is the simplest form of partnership. Absent specific agreement to the contrary, each partner in a general partnership generally (i) has equal rights, responsibilities, powers and obligations in the management and governance of the business; (ii) shares equally in the profits and losses of the business; (iii) is personally liable for the liabilities of the partnership; and (iv) has the ability to dissolve the partnership. No formal state filing or documentation is typically required by law to form a general partnership in its most basic form.

A limited partnership consists of one general partner and one or more limited partners. The general partner manages the limited partnership and has similar rights, responsibilities, obligations and liabilities

to a partner in a general partnership. The limited partners are passive investors who contribute capital (or other assets) to the partnership, typically do not participate directly in the management of the business and generally have limited liability up to their individual investment amount. A formal state filing is required to form a limited partnership.

An LLP is similar to a general partnership except that (i) a formal state filing is required for formation and (ii) its partners enjoy limited liability protection. State laws regarding LLPs vary, particularly in regard to the types of entities that are allowed to operate as LLPs (if any) and the extent of limited liability coverage provided. Use of LLPs is often restricted to certain professions, such as accountants and attorneys, and, as such, this type of structure is inapplicable to many types of businesses.

An LLLP is similar to a limited partnership except that the liability of a general partner in an LLLP is typically limited in a manner similar to that of partners in an LLP.[6] The LLLP is a relatively new structure, and only half of the states have laws enabling the creation of LLLPs. As a result, use of the LLLP structure is not prevalent, particularly for organizations that operate in multiple states, as it is often unclear if states other than the state of organization will recognize the limited liability protection of the LLLP.

As explored in greater detail below, certain attributes are fairly uniform across partnership structures, such as the ability to elect for pass-through taxation. Further, in comparison to other forms of business structures, partnerships generally have greater management, governance, distribution and ownership flexibility and fewer statutory formalities and requirements. However, other attributes, including (i) the liability of members, (ii) required documentation and corporate formalities and (iii) structure and governance, vary among partnership structures and from state to state.

b) Organizational Structure

The governance, management, distribution and ownership structure of a partnership is flexible and can be tailored to an organization's desired structure. Many states set forth default background rules relating to such topics. However, unlike with a corporation (and similar to an LLC), in most cases, such rules and requirements can be adjusted by agreement for a partnership.[7] As such, this structure is typically set forth in reasonable detail in the partnership's partnership agreement.

Governance and Management Structure

One important area of flexibility for a partnership relates to its governance and management structure. Unlike a corporation, which is governed by its board of directors and managed by its officers (rather than directly by its shareholders), a partnership is governed and managed directly by its partners or by a subset of partners. Absent agreement to the contrary in the partnership's partnership agreement, such management rights are shared equally by all partners, each partner has the ability to bind the partnership in dealings with third parties and, most important, management decisions are to be made by the majority of the partners. Further, partnerships also have the option to appoint officers, such as a chief executive

6. See, e.g., Delaware Limited Partnership Act §17-214. Cf. https://www.ftb.ca.gov/businesses/structures/limited-liability-limited-partnership.shtml (California does not have an enabling statute for the creation of a California LLLP, but requires foreign LLLPs to register in the state prior to transacting business and pay certain annual fees).

7. Certain background governance rules cannot always be modified or eliminated.See, for example, Delaware Revised Uniform Partnership Act § 15-103(b) and California Uniform Partnership Act of 1994 § 16103(b).

officer or chief financial officer, to run the day-to-day operations of the partnership, or they can leave such duties to the partners directly or to a subset of partners. Even if the organization is governed or managed by a smaller group of individuals, partners of the partnership will generally have the ability to vote on certain fundamental decisions for the partnership absent specific agreement to the contrary.

Distribution and Ownership Structure

A second important area of flexibility for a partnership relates to its distribution and ownership structure. Partnership ownership interests are called "partnership interests" and entitle partners to certain corporate (e.g., voting and management) and capital (e.g., distribution, income and appreciation) rights. Partnerships have wide latitude to allocate the relative corporate and capital rights of partnership interests and can structure corporate approvals, processes and procedures as well as the economic rights in a manner that suits the partnership's goals. For example, if one investor in a partnership is interested more in the operating profits and losses of the partnership, while another investor is interested more in the appreciation of the partnership and its assets, the parties could structure an operating agreement that entitled the former partner to a larger share of the partnership's operating income and the latter partner to a larger share of the partnership's capital appreciation.

Partnership Agreement

Through its partnership agreement, a partnership can set forth who, how and in what manner the partnership will be owned, governed or managed, and how a partnership's profits and losses will be allocated and distributed, including, among other things:

- Who will govern and manage the partnership (e.g., all partners, a select group of partners or separately appointed officers).
- How such individuals will be appointed and removed.
- The rights, powers and responsibilities such individuals will have.
- The indemnification rights such individuals will have.
- Who is entitled to vote on major governance, management, distribution and ownership issues.
- The relative weight of votes.
- The procedures that will be followed for decisions.
- The level of approval needed for general issues.
- Whether any issues require specific higher levels of approval or the approval of specific parties.
- Whether any partners or groups of partners have special rights, privileges or preferences.
- The fiduciary duties partners owe to each other and to the partnership.
- The current ownership structure of the partnership.
- The forms of investment (e.g., cash, property, services) allowed in the partnership.
- Restrictions imposed upon, and procedures required, to raise future internal and external capital.
- How profits and losses are allocated among the partners.

- How, when and in what amount distributions will be made among the partners.
- How the proceeds from a sale or liquidation of the partnership will be distributed among the partners.
- The restrictions, if any, relating to the transfer of partnership interests.
- What occurs on the death, withdrawal or removal of a partner or the liquidation of the partnership.
- Any penalties if partners fail to act in accordance with the partnership agreement.

Impact of State Law

If substantive and procedural rules governing the partnership are not addressed in the partnership's partnership agreement, many state statutes governing partnerships set background default rules. For example, if the partnership's partnership agreement does not specify specific voting rights, generally (i) each partner (regardless of such partner's contribution to a partnership) generally has an equal vote in matters; (ii) the consent of a majority of partners is required for many decisions; and (iii) the consent of all partners is required for certain key events, such as a merger of the partnership.[8] Further, if the partnership agreement is silent regarding the circumstances in which the partnership will dissolve, generally each partner has the unilateral right to dissolve the partnership.[9] While these default rules may provide some guidance if such issues are not addressed in the partnership's partnership agreement, such rules often vary from state to state in terms of scope, detail, procedure and substance and may not reflect the parties' desired structure. Social entrepreneurs should consult with legal advisors to obtain further information on rules in specific states.

Impact of Flexibility

The flexibility afforded to partnerships to restructure state default rules,[10] together with the variations of the default rules themselves, can serve to remove restrictions regarding corporate actions and limit the rights of partners. This can be an advantage for an organization that wants to make decisions quickly by allowing it to streamline the decision-making process regarding certain corporate actions by removing procedural hurdles such as the consent of partners. However, these attributes can also serve to raise issues for minority investors, who may have fewer rights available to protect their interests[11] if the partnership agreement removes background rights or explicitly provides certain partners with more favorable rights. As protection against abuses of power, certain state statutes do provide limited partners in a limited partnership with the right to initiate derivative suits on behalf of the partnership.[12] However, due to the flexibility partnerships have in structuring governance duties and responsibilities, the opportunities for such actions may be limited in certain cases.

8. See, e.g., Delaware Revised Uniform Partnership Act § 15-401(f), California Uniform Partnership Act of 1994 § 16401(f), Delaware Revised Uniform Partnership Act § 15-902(b) and California Uniform Partnership Act of 1994 § 16911(a).
9. See, e.g., Delaware Revised Uniform Partnership Act § 15-801 and California Uniform Partnership Act of 1994 § 16801.
10. State default rules are the background rules of law that are established by state law.
11. Including voting rights or the right to financial and ownership information regarding the partnership.
12. See, e.g., Delaware Limited Partnership Act §17-1001 et. seq.

c) Establishment and Documentation

Documentation

The documentation requirements for the formation and operation of partnerships differ among the different partnership forms and from state to state. All partnerships will typically:

- Apply for federal and state employer identification numbers;
- Draft a partnership agreement; and
- Complete other standard documents (such as employment agreements) necessary or desired to run the business.

Additionally, limited partnerships, LLPs and LLLPs will also likely need to:

- File a short charter document in the partnership's state of organization (often called a Certificate of Limited Partnership or Certificate of Limited Liability Partnership);
- Qualify to do business in any states in which the partnership will transact business; and
- File federal and state securities filings related to the issuance of partnership interests.

Charter Documents and Qualifications to Do Business

Partnerships must comply with the requirements of their state of formation, which is generally the state in which the enterprise or its owners is located. General partnerships typically are not required to file a formal charter document in their state of organization. Many states, such as Delaware and California, allow for a permissive filing[13] of a charter document for a general partnership (called a Certificate of Existence), but they do not require such filing.[14] A general partnership may want to make such a filing to substantiate to a third party the existence of the partnership or a partner's authority to act on behalf of the partnership.[15]

Each state has a slightly different form and requirements for a partnership's charter document and documents related to qualifying to do business in such state. However, these documents are typically fairly simple and straightforward. Through the charter document, the partnership selects a name (which usually must contain the name "limited partnership," "LP," "L.P." or "LTD" (for limited partnerships) and a "limited liability partnership," "LLP" or "L.L.P." (for LLPs)), sets forth the name and address of its registered agent in the partnership's state of organization, sets forth the name and address of its general partner(s) and may be required to provide certain other information such as the partnership's business address, the partnership's business purpose, the names of the partners and the duration of the partnership (i.e., if perpetual or for a limited number of years). The partnership must also provide similar information in filings (typically annually) in each state in which the partnership transacts business.

Partnership Agreement

As described above, the principal organization document for any form of partnership is a partnership agreement. Although a written partnership agreement is not generally required by state law, the

13. Permissive filings are filings that an entity can but is not legally required to make.
14. Delaware Revised Uniform Partnership Act §15-202 and California Uniform Partnership Act of 1994 § 16303.
15. See, e.g., Delaware Revised Uniform Partnership Act §15-303.

partnership agreement is generally advisable. Absent a partnership agreement, the partnership's structure is dictated by default rules under state law, which may not cover all pertinent issues or reflect the parties' desired allocations of rights, privileges, preferences and obligations. For example, absent agreement to the contrary, the general background rule in many states is that, notwithstanding such member's differing investment amounts in the partnership, each partner (i) has equal rights in the management and conduct of the partnership; (ii) is entitled to an equal share of partnership profits; (iii) is chargeable with an equal share of the partnership's losses; and (iv) has no preemptive right to subscribe to any additional issue of partnership interests.[16] If a partnership wishes to be governed by different principles or allocate profit and losses other than equally among the partners, a partnership agreement will be required.

Other Filings and Agreements

In addition to these partnership-specific agreements, a partnership will also typically enter into standard agreements relating to the conduct of its business at the time of formation, such as employment agreements, proprietary information and invention assignment agreements and consulting agreements, as well as make federal, state and local tax and regulatory filings and, in the case of limited partnerships, LLPs and LLLPs, securities filings.

Other Considerations

Any form of partnership can be established with two or more members. In the case of a limited partnership or LLLP, at least one partner must be a general partner and at least one partner must be a limited partner.

Cost

The cost for establishing a partnership varies. The main cost components include attorney fees for the preparation of documents; any accounting-related fees for taxation related advice and services and, in the case of limited partnerships, LLPs and LLLPs, state filing fees for organization, qualification and securities filings; and statutory representation fees for the partnership's agent for service of process. Attorney fees are affected by the type of partnership, the complexity of the partnership's management, governance, distribution and ownership structure (as reflected in the partnership's partnership agreement) and the number of additional documents required to set the partnership up for business (e.g., employment agreements, securities and regulatory filings). For limited partnerships, LLPs and LLLPs, state filing and statutory representation fees are affected by the numbers of states and specific states in which the entity organizes, transacts business or sells securities. State filing fees vary from state to state. Organization and qualification-related fees typically range from $50 to $500; however, certain states charge a fee per partner or have publication requirements that can increase fees for domestic or foreign limited partnerships, LLPs or LLLPs substantially.[17]

Selecting a State of Organization

When selecting a state of organization for a partnership, many factors should be considered, including:

- The organization's principal place of business and states in which it transacts business;

16. See, e.g., Delaware Revised Uniform Partnership Act §15-401 and California Uniform Partnership Act of 1994 § 16401.

17. See https://direct.sos.state.tx.us/help/help-corp.asp?pg=fee for an example of a state that charges a fee per partner; See New York Revised Limited Partnership Act § 121-201 and New York Registered Liability Limited Partnership Act § 121-1502 for an example of a state that has a publication requirement.

- Flexibility and predictability of state statutes and legal precedent;
- State taxation issues;
- State filing fees, including organization and annual maintenance fees (franchise tax and secretary of state); and
- Nature of limited liability protection (for limited partnerships, LLPs and LLLPs).

The lowest-cost option for partnerships is typically to organize in the state in which the partnership's principal place of business is located, which may help reduce attorney fees (as the partnership will likely be subject to certain of such state's laws regardless of where it is organized), and, in the case of limited partnerships, LLPs and LLLPs, may help the partnership avoid duplicate state filing fees and additional statutory representation fees.

However, cost alone should not dictate the state of organization. Initial and annual costs need to be weighed against strategic considerations. For example, many parties prefer the predictability and familiarity of Delaware as a state of organization. Further, some states have more limited legal precedent relating to partnership-specific issues and disputes or have unique aspects in governing statutes that may not be suitable for a particular organization. In addition, the degree of limited liability protection for limited partners in a limited partnership and partners in an LLP and LLLP vary by state; many states strictly limit the types of business that can operate as LLPs and many states do not allow for the creation of LLLPs.[18] Social entrepreneurs should consult with legal advisors to understand the best state for their particular enterprise.

d) Liabilities

The liabilities of a partner in a partnership vary by partnership structure. The general rules for each type of structure are briefly described below.

General Partnership

Partners in a general partnership are personally liable for the debt, obligations, actions and liabilities of a partnership. This means that if the liabilities of the partnership exceed the partnership's assets, a party can seek damages from the personal assets of each partner. Thus, unlike shareholders of a corporation or members of an LLC, a partner in a general partnership can be held liable for damages above and beyond such partner's investment in the partnership. With limited exceptions (such as liabilities incurred before a party's admission as a partner), this liability is generally joint and several[19] for all liabilities that a partnership sustains.[20] This means that a party can seek damages from the individual partner responsible for the liabilities of the partnership, or from any one or more of the other partners in the partnership (even if they did not participate in the creation of the liabilities).

18. See New York Registered Liability Limited Partnership Act § 121-1500 and California Uniform Partnership Act of 1994 §16101(8) for examples of state restrictions on the types of businesses that can operate as LLPs.
19. Joint and several liability means that each party is liable for the entire liability and a person who is harmed by such parties could bring a potential claim against any or all such parties for the full amount of such liability.
20. See, e.g., Delaware Revised Uniform Partnership Act §15-306 and California Uniform Partnership Act of 1994 § 16306.

Limited Partnership

General partners in a limited partnership have similar liability to partners in a general partnership. Limited partners, in contrast, typically enjoy limited liability. This means that if a limited partnership's debts or liabilities exceed its assets, each general partner of the limited partnership can be held liable for damages above and beyond such general partner's investment in the partnership, while each limited partner will generally only stand to lose such limited partner's investment in the partnership and will generally not be held personally liable for such debts.[21] Such limited liability typically does not apply to the extent that a limited partner actively participates in the control or management of the business, with respect to acts or omissions of the limited partner (e.g., fraud or receiving distributions from a limited partnership in contravention of state law or the limited partnership's operating agreement), or with respect to personnel guarantees or contractual obligations by the limited partner either in the limited partnership's partnership agreement or with a third party (e.g., if a limited partner personally guarantees a limited partnership's bank loan or other obligation).

LLP and LLLP

Partners in an LLP, similar to shareholders of a corporation or members of an LLC, typically enjoy the benefit of limited personal liability for the business debts, judgments and actions of the LLP.[22] There are certain exceptions to this rule. Such limited liability typically does not extend to acts or omissions of a partner or personal guarantees or contractual obligations by a partner in either the partnership agreement or with respect to a third party.

While state statues vary, liability for general partners in an LLLP is typically limited in a manner similar to that of partners in an LLP, while liability for limited partners in an LLLP is typically limited in a manner similar to liability for limited partners in a limited partnership. One exception is that many state statues provide that the carve out from limited liability described above for limited partners in a limited partnership regarding active participation in the management of the partnership's business does not apply to limited partners in an LLLP.[23]

Please note that due to the (i) relatively new nature of LLPs and LLLPs; (ii) lack of legal precedent; (iii) variance among governing statutes; (iv) lack of enabling statutes in many states (for LLLPs); and (v) ability of parties to expand, diminish or eliminate protections afforded by statues (such as fiduciary duties), the limited liability of partners of an LLP or LLLP may be much less predictable and complete than for shareholders, officers and directors of a corporation.[24]

As with a corporation and LLC, the scope of the exceptions to limited liability for limited partners in a limited partnership, partners in an LLLP and partners in an LLP can be reduced through prudent planning and attention to corporate formalities. In addition, as with other entity structures, the partnership itself will remain liable for all company liabilities.

21. See, e.g., Delaware Limited Partnership Act §17-303 and §17-403 and California Uniform Limited Partnership Act of 2008 §15303 and §15404. Please note that the limited nature of such limited liability varies by state (see Thomas A. Humphreys, Limited Liability Companies and Limited Liability Partnerships (2nd ed. 2011)).

22. See, e.g., Delaware Revised Uniform Partnership Act § 15-306 and California Uniform Partnership Act of 1994 § 16306(c).

23. See, e.g., Delaware Limited Partnership Act §17-214.

24. Thomas A. Humphreys, Limited Liability Companies and Limited Liability Partnerships (2nd ed. 2011).

e) Governance and Regulatory Obligations

Governance Obligations

Many of a partnership's ongoing governance obligations are determined internally by the partnership through the partnership's partnership agreement. As a general rule, there are fewer statutory governance requirements for a partnership than for a corporation or LLC, and most decisions can be made informally. Those requirements that do exist often provide for a choice by the partnership or provide explicitly that such requirements can be contracted around through the partnership's partnership agreement.

Partners generally owe fiduciary duties of loyalty and care to other partners.[25] Limited partners in a limited partnership or LLLP generally do not have any fiduciary duties to fellow partners except for the requirement to exercise their rights and discharge their duties consistently with the obligation of good faith and fair dealing.[26] While the boundaries and enforceability of such modifications vary from state to state, the explicit right many state statutes provide to modify such fiduciary duties provides more flexibility for partnerships than for corporations in this respect.[27]

Regulatory Obligations

Partnerships, like other entities, are subject to federal, state and local regulatory requirements applicable to the type of business they operate. Regardless of the type of business, the partnership will have certain ongoing federal, state and possibly local filing requirements. Depending on the states in which the partnership operates, its business and its tax elections, such filings can include:

- Federal, state and local income and employment tax-related filings; and
- Federal, state and local regulatory filings (e.g., environmental permits, manufacturing licenses).
- Additionally, if the partnership is a limited partnership, LLP or LLLP, the partnership may have:
    - Annual state informational filings (with the secretary of state in the state of the partnership's incorporation and any state in which the partnership is qualified to do business);
    - Annual state franchise tax filings (with the franchise tax board in the state of the partnership's incorporation and any state in which the partnership is qualified to do business); and
    - Federal and state security filings (relating to the issuance of partnership interests).

The exact filings, format, timing, substance and cost will vary based on the type of business operated, the state in which the partnership is organized and the state (or states) in which the partnership transacts business. For example, certain states consider limited partnership, LLP and LLLP interests to be securities, while others do not take that position.[28] As such, partners should carefully review the applicable rules and regulations in states in which the partnership solicits investors and operates.

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25. See, e.g., Delaware Revised Uniform Partnership Act § 15-404 and California Uniform Partnership Act of 1994 § 16404.
26. See, e.g., California Uniform Limited Partnership Act of 2008 §15-903.05.
27. See, e.g., Delaware Revised Uniform Partnership Act § 15-103(f). Please note that certain states place greater limitations on a partnership's ability to modify or eliminate such duties (see, for example, California Uniform Limited Partnership Act of 2008 § 16013).
28. Thomas A. Humphreys, Limited Liability Companies and Limited Liability Partnerships (2nd ed. 2011).

f) Tax Treatment

A partnership typically can elect to be treated either as a pass-through entity or corporation for income tax purposes. Absent an affirmative election otherwise, a partnership automatically will be taxed as a pass-through entity for federal income tax purposes. A partnership treated as a pass-through entity is not subject to a separate tax on its income. Instead, owners of the partnership will report and pay tax on their share of the partnership's income, gains, deductions, losses and credits on their personal income tax returns.[29] In addition and subject to certain limitations, distributions of cash or other property from the partnership to the partners generally are not subject to a separate tax.

On the one hand, pass-through treatment can prove advantageous in many circumstances through the avoidance of double taxation and the ability to deduct losses of the business on the tax returns of the partners (subject to certain limitations). On the other hand, pass-through taxation can lead to cash flow issues for partners, as each partner's share of the partnership's taxable income is taxable to that partner whether or not actually distributed by the partnership to such partner. In addition, partners generally cannot be employees of their partnership (partners will have to pay periodic estimated taxes in lieu of being subject to wage withholding), and taxable income allocated to partners of a partnership often is subject to self-employment (i.e., Social Security and Medicare) taxes. Further, corporations historically have enjoyed advantages with respect to certain business incentives enacted in the U.S. federal tax code.

Notwithstanding a partnership's pass-through treatment for federal income tax purposes, certain states, such as California, may still impose annual taxes, such as franchise and gross receipts fees, on the entity itself. In addition, a partnership, like other businesses, must pay other forms of tax, such as sales and use, excise, employment, property and transfer taxes.

Under some circumstances, a partnership may wish to affirmatively elect to be taxed as a corporation, including if the partnership:

- has foreign or tax-exempt partners that want to avoid being treated as engaged in a trade or business in the United States;
- has foreign partners resident in a country with whom the United States has a treaty under which distributions from a corporation would be subject to reduced or no withholding taxes;
- is more than 80% owned by a corporation that wants to include the partnership as a corporation within its consolidated return; or
- is owned by partners that want to avoid being treated as doing business in a state or being subject to taxation in such state.

If a partnership elects to be treated as a corporation, it generally will be taxed in accordance with the discussion under *Tax Treatment* for corporations below.

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29. *See* Internal Revenue Code § 704(b) and Treasury Regulation § 1.704-1(b) *et seq.* While partnerships generally have flexibility to determine how the partnership's tax items are allocated among the partners, such allocations must have substantial economic effect or otherwise must be in accordance with the partner's economic interest in the partnership.See Internal Revenue Code § 704(b) and Treasury Regulation § 1.704-1(b) *et seq.*

g) Financing

The attributes of partnerships often make them attractive structures for small, tightly-knit groups of partners that do not anticipate needing to raise additional outside capital, as such partners can choose to allocate the relative corporate and capital rights of contributors with great flexibility. Further, subject to compliance with federal and state securities laws and any restrictions contained in the partnership's partnership agreement, partnerships have few formal restrictions on financing and raising funds.

However, certain factors greatly limit the types of investors interested in investing in partnerships. Most sophisticated investors consider general partnerships too risky given the lack of limited liability. Tax exempt and venture capital investors are less inclined to invest, or may be contractually prohibited from investing, in operating partnerships with pass-through taxation, as this can lead to unrelated business income for such entities. Further, venture capital and sophisticated angel investors may shy away from partnership investments due to issues relating to (i) the complexity of addressing multiple rounds of funding or a diverse ownership structure in a partnership's partnership agreement; (ii) complications relating to transferring partnership interests and survivorship issues;[30] and (iii) reduced flexibility in offering employees standard equity incentive awards[31] (crucial for many high-growth companies in which such investors invest). Also, partnership interests do not qualify as "qualified small business stock," and do not receive the favorable tax treatment such stock can provide to investors under the U.S. Internal Revenue Code, and it is very challenging (although not impossible) for a partnership to conduct an initial public offering and become a public company.[32] In addition, in the case of limited partnerships, such investors may want to play an active role in the governance or management of the business, which can potentially impact the limited liability protection a limited partnership provides limited partners.

For these reasons, and the simple fact that many investors are more experienced and comfortable with investing in Delaware "C" corporations, many outside investors (notably, venture capital investors) simply may not be willing to invest in the partnership or may require the partnership to convert to a corporation prior to investing, which can lead to additional legal fees and tax issues for current owners. As a result, a partnership likely is not a good fit for organizations that anticipate raising meaningful amounts of outside capital or want flexibility in future fundraising.

h) Resources

For additional information, visit:

http://www.irs.gov/Businesses/Partnerships.

http://www.sba.gov/content/partnership.

30. Many state statutes provide that certain partnerships can be dissolved by the will of any partner or, in certain cases, by specific events, such as the death, bankruptcy or incapacity of a partner.See, for example, Delaware Revised Uniform Partnership Act § 15-801. Further, a partnership may terminate for tax purposes notwithstanding that the partnership continues under state law if (i) no part of any business, financial operation or venture of the partnership continues to be carried on by any of its partners or (ii) 50% or more of the interest in partnership capital and profits are sold or exchanged within a 12-month period (see Internal Revenue Code § 708(b)).

31. While partnerships can adopt equity compensation plans to incentivize employees, partnerships, like LLCs, cannot issue incentive stock options, and the structure and terminology of such plans may be unfamiliar to prospective employees.

32. Internal Revenue Code § 1220.