



Partnerships

A partnership exists when two or more people share in the ownership of a business. By agreement, they determine the amount of time and money each partner will invest in the business and the percentage of the profits that each will receive. The extent of each partner's authority and liability also must be made clear.

To avoid misunderstandings later, everything that has been agreed upon should be put in writing, preferably with the assistance of an attorney. The importance of a written partnership agreement cannot be overemphasized. In the absence of such a document, the courts will resolve any disputes that arise, even though the outcome might not be to your liking.

Some of the information that should be included in your partnership agreement:

- ❖ Each partner's responsibilities and authority.
- ❖ The extent of each partner's liability.
- ❖ The amount of capital each partner is investing in the business.
- ❖ How profits and losses are to be shared.
- ❖ How disputes between the partners are to be resolved.
- ❖ Arrangements for the withdrawal or admission of partners.
- ❖ How assets are to be distributed, should the business be dissolved.

Advantages of a Partnership

Two heads are better than one. In a partnership, you have the advantage of being able to draw on the skills and abilities of each partner. Ideally, the contributions each partner is able to make to the business complement those of the other partners.

It's easy to get started. Starting a partnership is relatively easy. Although it entails additional cost and more planning than a sole proprietorship (selection of partners, preparing the partnership agreement and so on), red tape is minimal.

More investment capital is available. Your company's ability to increase capital can be enhanced by simply bringing in more partners. Unlike a sole proprietorship, which can draw on the financial resources of only one individual, in a partnership you have the combined resources of the partners.

Partners pay only personal income tax. Partnerships are taxed much the same as a sole proprietorship. In a partnership the gross profit of the business is distributed to the partners based upon their percentage of ownership. It is given to each partner on a Schedule K-1.



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Disadvantages of a Partnership

Partners have unlimited liability. Like sole proprietors, partners are responsible for all debts or legal judgments against the business. This liability is even worse for partners than it is for sole proprietors because, as a partner, you are responsible not only for your own debts, but for those of your partners as well. Should they incur liabilities, you could be left holding the bag. Remember, even though your investment in the business may be minimal, your losses could be substantial. Your liability extends beyond the amount of your investment to include your personal assets, as well.

Profits must be shared. All profits resulting from the partnership must be distributed among the partners in accordance with the partnership agreement. What percentage of the profits is to be reinvested in the company must be decided by the partners. Your wishes in this matter represent only one viewpoint.

The partners may disagree. Disputes among partners literally can destroy a partnership. One partner's desire to expand the business can go against another partner's goal of cutting costs. Should your money be spent on improving your service or on promoting it? When key decisions must be made, the feelings of trust and admiration that drew you together as partners can disintegrate. If this is to be avoided, you must give your full attention to selecting partners and drawing up the partnership agreement.

The life of the business is limited. As with a sole proprietorship, the life of a partnership is limited. Should one of your partners withdraw from the business or die or become too ill to carry on, the partnership is automatically dissolved. Though it is possible for the remaining partners to reorganize the business, the financial interest of the departing partner must first be paid. Furthermore, any time a new partner is admitted to the business, dissolution of the partnership is mandatory. A new partnership, reflecting the addition of the new partner, must be formed.

Limited Partnership

In a limited partnership there is usually one general partner and a number of limited partners. What are the roles for each one? The general partner is the one responsible for the day-to-day operations of the partnership and is liable for any partnership debts, taxes or situations that arise. The limited partners are only liable up to the amount of their investment. They invest money and the general partner uses that money to try to make a profit. If a profit is made, the limited partners receive a percentage of that profit commensurate with the percentage of the partnership they own. For example, there might be a general partner who owns 50 percent of a business and two limited partners who each own 25 percent. Those limited partners are only financially liable for 25 percent of that partnership. Conversely, each limited partner only can share up to 25 percent of the profits.



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General Partnership

A general partnership involves two or more partners who each own a percentage of the business, but are each 100 percent liable for what happens in the partnership. For instance, suppose a business has a 50 percent partner and two 25 percent partners in a general partnership and the business owes \$100,000. If the creditors cannot collect the amount owed from the general partner, they can legally require payment of the \$100,000 by one or more of the limited partners. The partners have equal say in the business, which can be positive, but if any of the partners incurs any debt or liabilities, all are responsible, even though they may have had no knowledge of what was done.

That's why in any partnership, whether it be limited or general, it is important to have a very strong, iron-clad, written partnership agreement which details who's going to do what, who's responsible for what and who's liable for what. An attorney should draw up all partnership agreements.

Taxes for a Partnership

Taxation for a partnership generally involves any local sales or use tax; the Federal Income Tax and self-employment tax for the partners; and, if the partnership hires employees, payroll withholding taxes.

Sales or Use Tax:

Because you are a service business, it is possible that you do not have to collect, pay or report sales tax on the service you are providing to your clients. You should contact your state sales tax agencies to find out what the law requires in your area. The taxation laws vary from state to state. (e.g., the State of New Mexico has what is called a gross receipts tax. It doesn't matter if you are selling tires or if you are a lawyer, the gross receipts tax applies to the gross receipts of your sales from whatever source. However in contrast, the State of California doesn't charge tax on services and that includes the services rendered by a personal chef.)

When you make an inquiry to any tax agency, you must carefully explain the following points:

- ❖ You are providing a service to your clients only.
- ❖ Your service is performed in their home just like a maid service.
- ❖ You are not selling any products, only your service (groceries used are purchased by the client.)
- ❖ You consult with clients regarding their meals and dinner routine much like a personal fitness trainer consults regarding exercise and a fitness routine.

Due to the fact that the service you are providing is new and innovative, most government agencies have not established a category for personal cheffing. For this reason, the clerk might try to put your business into a "catering for food sales" category. You do not want this to happen because if you're a "caterer", it will then be assumed that you are purchasing raw goods at wholesale prices, marking the price up and reselling to your customers.



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In many municipalities there are added tax codes and cumbersome formalities to regulate this type of wholesale business activity. Experiences reported by other Personal Chef Service business owners indicate that when they keep the description of their service very simple and explain it as similar to a maid service or a personal fitness trainer, the application process does not turn into an ordeal.

Federal Income Tax:

Believe it or not, a partnership does not pay any Federal Income Tax. When IRS Form 1065: U.S. Partnership Return of Income is prepared, each partner will receive what is called IRS Schedule K-1: Partner's Share of Income, Credits, Deductions, etc. The K-1 will show the distribution of all profits and losses of the business to each partner based upon their percentage of ownership. Once the partners receive their K-1, they are individually responsible for self-employment tax and filing the partnership information on their IRS Form 1040.

Self-employment Tax:

Self-employment tax for the partners is equivalent to a payroll deduction for Social Security and Medicare taxes. Self-employment tax for each partner will be calculated on IRS Schedule SE based upon the allocated income or loss from the partnership. Your self-employment tax amount is derived from the net profit from the partnership shown on your K-1. (The self-employment tax rate is generally around 15%). We recommend that you get specifics on the required taxes and forms from your accountant.

Personal State Income Tax:

If your state has a Personal Income Tax, you will file this return based upon the information from your Federal Individual Tax Return. Verify this with your accountant.

Payroll Withholding Taxes:

This is where you get into the alphabet soup of tax forms. If you decide to hire employees and put them on your payroll, you will have to withhold appropriate Federal and State taxes from your employees' pay checks and submit them to the IRS regularly. It is highly recommended that you have an accountant set up your forms and procedures, or you can hire the services of a professional payroll service company.

NOTE: The Culinary Business Institute is NOT a substitute for a tax professional. Please seek qualified legal advice. And over time the IRS does make adjustments to partnership agreements, wording and abilities. Our information is current to the best of our knowledge, however, if you elect a partnership, you are highly advised to do further research.