**Checklist for Drafting a Partnership Agreement**

I. INTRODUCTORY CLAUSES

\_\_\_ Names of all partners, including addresses and county of residence.

\_\_\_ Are any partners not natural persons?

\_\_\_ Include name of agent and address for service of process of entities.

II. TYPE AND GENERAL CHARACTERISTICS OF BUSINESS TO BE CONDUCTED

This information is vital to determine whether compliance with certain licensing requirements will be necessary; what accounting method should be employed; and what, if any, special provisions should be included in a buy-sell agreement.

III. NAME

\_\_\_ If partners' names will not be used, what fictitious business name will be adopted?

\_\_\_ Which partners' names will be retained after death or retirement?

\_\_\_ Will it be necessary to file a fictitious name certificate?

\_\_\_ Is the name deceptively similar to any other business?

IV. TERM OF PARTNERSHIP

\_\_\_ Will the entity be a term or "at will" partnership?

\_\_\_ What date will partnership commence?

\_\_\_ How long will partnership continue?

\_\_\_ Specified period, or

\_\_\_ Until dissolved by agreement, or

\_\_\_ Until specified undertaking is completed, or

\_\_\_ Until dissolved by some specific act or event.

\_\_\_ Coordinate with transfer, buy-sell, and continuation of business provisions.

V. INITIAL CAPITAL

\_\_\_ Will any partners be making capital contributions other than in cash?

\_\_\_ How will such contributions be valued?

\_\_\_ Percentage interest is important since many agreements provide that voting power varies with percentage interest. In addition:

\_\_\_ Describe property in detail.

\_\_\_ Specify the value to be attributed to property on partnership books.

\_\_\_ To what extent are tax issues included?

\_\_\_ What is contributing partner's adjusted income tax basis for property?

This information will help to determine the contributing partner's initial tax basis for the partnership interest, the partnership's initial income tax basis for the contributed property and whether the partnership agreement should provide for special allocations of gain, loss, depreciation, or income.

\_\_\_ Would there be any reason to allocate losses differently from profits?

Subject to contrary provision in the partnership agreement, partners share losses in the same proportion they share profits. If the partners' distributive shares of partnership profits are not specified in the partnership agreement, profits are shared equally.

VI. ADDITIONAL CAPITAL

\_\_\_ Must partners make additional capital contributions?

\_\_\_ Will there be any arrangement for a partner to loan property or cash to the partnership?

\_\_\_ If the business goes badly and more capital is needed to avoid substantial loss of the initial capital, must all partners agree a cash call should be made?

A vote of all the partners owning a majority of the percentage interest of the partnership may be preferable to unanimity on a contribution vote to avoid deadlock.

\_\_\_ Are all partners equally liable for contributions?

\_\_\_ Does contribution of additional capital affect voting percentage and rights to profits?

\_\_\_ What about the effect upon dissolution?

Using the same percentage as initial capital for additional contributions may not be fair. Each additional dollar may be worth less because the business may be worth less.

VII. TAXES

\_\_\_ What is each partner's taxable year?

This information will help determine the partnership taxable year.

VIII. ACCOUNTS

There are usually two sets of equity accounts: capital and income. Partnership assets minus liabilities equals the sum of the partners' equity accounts.

\_\_\_ Provide a separate capital account for each partner.

\_\_\_ Define capital account: each partner's initial capital contribution increased by any additional contribution.

\_\_\_ Should partners be allowed to make withdrawals from capital accounts?

\_\_\_ If not, should a unanimous vote of all partners be required to allow a partner to make a withdrawal? See section on substantial matters and changes.

\_\_\_ What about payments to third parties? How is this reflected in capital accounts?

\_\_\_ Since each partner is liable for the obligations of the partnership to third parties, one partner may pay such obligation and then seek contribution from the other partners according to their percentage interests. If another partner cannot pay and is judgment proof, would this be reflected in capital accounts?

IX. INCOME ACCOUNTS

\_\_\_ Provide for periodic allocation of profits and losses to each partner's income account, generally according to each partner's percentage interest.

\_\_\_ Will there be an allocation of money for taxes on profits?

A partner may be taxed on his or her distributive share of profits even if no money is actually allocated. Allocated profits are not the same as cash flow.

\_\_\_ Will interest be paid on income accounts?

\_\_\_ It is sometimes a good idea to allow for interest on income accounts.

\_\_\_ Should a partner be allowed to withdraw the credit balance in income account?

\_\_\_ How often will partners require accountings of partnership affairs?

\_\_\_ How will partners' distributive share of net partnership profits and losses be allocated?

\_\_\_ Stated percentages to remain unchanged, or

\_\_\_ Stated percentages to vary with partnership taxable year, or

\_\_\_ Division based on units of participation in partnership business, or

\_\_\_ Division based on proportion of business brought in and amount of work performed by each partner, or

\_\_\_ Partners' retention of percentage of income earned by them before net profits are computed and distributed.

\_\_\_ In what manner will each partner's distributive share be paid?

\_\_\_ What portion, if any, is to be paid as salary?

X. SALARIES AND DRAWS

\_\_\_ What about provision for salaries? Draws?

\_\_\_ Differentiate salaries from draws. Will some partners require regular draws?

Unless there are salary provisions in the partnership agreement, partners are not entitled to remuneration for acting in the partnership business.

\_\_\_ What basis will be used for making salary determination (e.g., amount of time devoted to business)?

\_\_\_ Alternatively provide for payment of salaries upon a written agreement signed by a majority in interest of the partnership. You can provide here that each partner may withdraw the credit balance of his or her income account.

\_\_\_ Will salaries be deducted before computing net profits or charged against partners' shares of net profits?

\_\_\_ To determine portion, if any, of distributive share to be available as a draw, consider the following:

\_\_\_ Amounts required by each partner for living expenses.

\_\_\_ Each partner's anticipated income taxes.

\_\_\_ Anticipated income of partnership business.

\_\_\_ Growth potential of partnership business.

\_\_\_ A business with good growth potential may require a large portion of partnership cash flow to be plowed back into the partnership operations.

XI. MANAGEMENT OF PARTNERSHIP

\_\_\_ To what extent is centralization of management desirable?

\_\_\_ Will the agreement provide for managing partners?

\_\_\_ How will successor managing partners be named?

Subject to contrary provision in the partnership agreement, all partners have equal rights in the management and conduct of the partnership business.

\_\_\_ If managing partners are to be responsible for day-to-day operations, when will decision of other partners be necessary?

\_\_\_ Is requirement for a vote of all partners on "substantial matters and change" too vague?

\_\_\_ Use more specific examples of substantial matters and change depending on the exact nature of the partnership business.

\_\_\_ Would it be better to provide a list of nonexclusive exceptions?

\_\_\_ Require unanimity for action on substantial matters and changes.

\_\_\_ Will this bring unacceptable risk of deadlock since each partner then has veto power?

\_\_\_ What limitations will be placed on acts of partners other than managing partners?

\_\_\_ May the partners have other business activities?

\_\_\_ When might partners compete with the partnership?

\_\_\_ Clarify in agreement what types of business activities would be permitted.

\_\_\_ Would a noncompetition agreement be enforceable?

\_\_\_ The general rule is that only noncompetition agreements with reasonable provisions are enforceable, but the definition of what is reasonable varies greatly by state.

Often no partner other than managing partners may endorse any note, act as an accommodation party, or become surety. Nothing authorizes the managing partner or other partners to do anything detrimental to the best interest of the partnership or which would make it impossible to carry on the ordinary business of the partnership.

\_\_\_ What special duties, if any, will each partner perform?

\_\_\_ Must a division of labor according to each partner's level of skill, training, or other factors be specified?

XII. VOTES

\_\_\_ When will a vote be required for certain administrative and/or business matters, including ordinary matters?

Subject to contrary provision in the partnership agreement, ordinary partnership matters may be decided by a majority of the partners. Acts in contravention of the partnership agreement, however, require the unanimous consent of the partners, such as expulsion of partners or admission of new partners. Subject to contrary provision in the partnership agreement, no person can become a member of the partnership without unanimous consent of the partners.

\_\_\_ What weight will be accorded each partner's vote?

Ordinarily, each partner's vote will count equally toward resolution of a partnership question. The partners may wish to weigh some votes more heavily than others and may do so in the partnership agreement (e.g., apportion voting power based on amounts of capital contributions).

XIII. BANKING

\_\_\_ Should one managing partner be able to sign checks to make withdrawals regardless of amount?

\_\_\_ Authorize execution of any partnership certificate as required by a financial institution.

XIV. BOOKS AND RECORDS

\_\_\_ To what extent will requirements be different from those provided by statute?

Partners are fiduciaries and have rights to access to books and records, full information, and to a full accounting. They are accountable as fiduciaries for any benefit received without the consent of all the partners.

XV. TITLE TO PROPERTY

\_\_\_ Will any real property be owned by a partner and leased to the partnership?

A general clause may allow the title to any property owned by the partnership to be held in such manager as the partners may determine.

XVI. LIMITATIONS

\_\_\_ To what extent may a partner mortgage, pledge, assign, or sell any part of its interest in the partnership?

\_\_\_ Is written consent of a majority in interest required?

XVII. WITHDRAWAL

\_\_\_ What is the effect of withdrawal of a partner?

\_\_\_ Will the partnership continue?

\_\_\_ Consider whether the vote to continue must be unanimous.

\_\_\_ If the remaining partners desire to continue, but not together, you may provide for liquidation.

\_\_\_ Specify when a partner may withdraw, i.e., at the end of a fiscal year.

\_\_\_ How will the withdrawing partner be compensated for his or her interest?

\_\_\_ How will the value of the interest be computed?

\_\_\_ Define as the sum of the partner's capital account plus the partner's proportionate share of accrued net profits, which may be the balance set forth in the income account.

\_\_\_ What if the partnership has incurred a net loss to the date of withdrawal?

\_\_\_ Provide the withdrawing partner's share of such loss is deducted from that partner's accounts.

\_\_\_ Will the partner receive any value for goodwill?

\_\_\_ How will you assure that the partnership will have liquid funds available to pay an outgoing partner?

\_\_\_ How will outgoing partner's interest be disposed of?

\_\_\_ By sale to remaining partners, or

\_\_\_ Liquidation of interest.

\_\_\_ If a cross purchase occurs, what valuation method will be used to set the purchase price?

If cross-purchase is to be funded by insurance, ascertain whether arrangements for insurance have already been made; or whether each partner will carry insurance on all other partners; or the partnership will carry insurance on all partners.

XVIII. EXPULSION

\_\_\_ What are the grounds for expulsion?

\_\_\_ Breach of the partnership agreement?

\_\_\_ Disability over a period of time?

\_\_\_ Bankruptcy?

\_\_\_ Conduct reflecting adversely on the partnership, or disciplinary action by a professional organization?

\_\_\_ What is the importance of partnership continuity to the partners and tax consequences attending partnership dissolution?

\_\_\_ What notice period required before resignation, expulsion, or retirement will be effective?

XIX. LIQUIDATION

\_\_\_ What procedure will be followed upon voluntary dissolution?

\_\_\_ Should managing partners be responsible for winding up?

\_\_\_ Provide priority for asset distribution

\_\_\_ first to partnership debts;

\_\_\_ then to debts of partnership to partners, including the amounts owed partners for undistributed net profits; and

\_\_\_ finally the capital contributions of partners as reflected in their capital accounts.

\_\_\_ What proportion will be used for gain or loss on disposition of partnership properties in the process of liquidation? In proportion to their interest in profits or losses?

\_\_\_ If property is distributed in kind, provide a valuation method.

\_\_\_ What happens if any partner has a negative balance in its capital account?

\_\_\_ Will the negative balance represent an obligation from such partner to the other partners to be paid in cash within a specified period of time (i.e., six months to a year)?

\_\_\_ Will written demand for payment by other partners be required?

XX. ARBITRATION

\_\_\_ Will an arbitration clause be included?

Arbitration is a two-edged sword. On the one hand, it may be cheaper and quicker than litigation, though that has been disputed. If it is possible to agree to select an arbitrator with specific technical expertise and sophistication, that may be preferable. A less adversarial setting would make it easier for the partners to work together in the future.

On the other hand, arbitration may be slow and expensive if there is more than one arbitrator. The successful party may have to go to court anyway to enforce the arbitration agreement. Use of arbitration means the loss of some procedural safeguards, so the arbitration award cannot be challenged in court on the grounds of mistakes of law or fact.

XXI. MISCELLANEOUS PROVISIONS

Amendment

\_\_\_ Must the amendment be in writing? Must it be signed by all partners?

\_\_\_ Is affirmative vote of a majority of partners sufficient? Is a supermajority required for certain changes?

Other standard provisions are useful boilerplate: binding nature, choice of law -- reference the state and its Partnership Act, except to the extent modified by the agreement.

Clauses regarding section headings, notices and agreement to execute further documents are also useful. Failure to include any boilerplate may raise the issue of whether the parties actually did not intend for them to apply.

XXII. SIGNATURES

\_\_\_ Correct name of each general partner.

\_\_\_ Must the signatures be verified or acknowledged?

XXIII. DOCUMENTS

\_\_\_ What documents are necessary?

\_\_\_ If property other than cash is contributed to the partnership, obtain

\_\_\_ Instrument (e.g., deed) conveying title to contributing partner.

\_\_\_ Documents of title to motor vehicles.

\_\_\_ Leases affecting contributed property.

\_\_\_ Licenses and permits (if any).

\_\_\_ Franchise agreements (if any).

\_\_\_ Financial statements for any going businesses contributed.

\_\_\_ Insurance policies on all real and personal property contributed to the partnership.

\_\_\_ Insurance policies, if already issued, to be used in funding cross purchase agreements.