

# The Elusive Meaning of ‘Partnership’— Understanding Who Controls What and Where the Money is Going

By Stuart L. Pachman

When Alpha, sole owner of a business, sends an email to Beta, an employee, saying, “I want you to be my partner,” just what is being offered?

1. If Alpha is the sole shareholder of a corporation, and either or both parties have the good sense to consult business lawyers, counsel will ask how many shares will Beta receive? Are the shares to come from Alpha or the corporation? What percentages of ownership result from the transfer? The answers will inform how much of the corporation’s equity is being given and the potential tax consequences to Beta and to either the corporation or Alpha. The answers will also clarify how corporate profits and losses will be allocated for tax purposes as well as division of any dividends. Assuming Alpha remains in control, counsel for Beta should also inquire whether there is to be any restriction on business decisions, primarily those relating to salary and bonuses, and, assuming the corporation does not “zero out” each year, the prospect of retained earnings being distributed as dividends. Alpha should be advised that once Beta becomes a “partner”—even for less than 50%—Beta will enjoy the rights (i) to inspect books and records (and discover Alpha’s close-to-the-line personal expenses) and (ii) to claim minority oppression.
2. If the entity were a limited liability company (LLC), an offer to admit Beta raises more issues for counsel to explore. The parties likely will have different unexpressed ideas of what a membership interest in an LLC represents. Is Beta being offered an interest in current equity? An interest in equity only

going forward? A pure-profits interest? Something else? An LLC, more a creature of contract than of statute, allows for greater flexibility. The division of profits or of losses is not necessarily controlled by the percentages in the LLC’s equity. To avoid misunderstanding and future conflict, the lawyer’s job is to explain the various possibilities and memorialize what the parties agree upon.

3. If Alpha is a sole proprietor, both parties need to understand the terms of their prospective partnership, particularly the division of control and of profits and losses. Beta should be advised as to what liabilities are being assumed.

Whatever the form of entity, “partners” must understand not only their legal rights and duties and the consequences of their relationship, but also what each expects of the other.

The questions posed above are not exclusive.<sup>1</sup>

A business lawyer can save an unwitting client future uncertainty, cost, and anguish. That parties with stars in their eyes at the time of “marriage” often later fall out is undeniable, a fact providing the basis for your response when the client asks: “Do I really need a [shareholders, partnership, or operating] agreement?” ■

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## Endnotes

1. Some of the issues they raise are illustrated in *Funsch v. Procida Funding, LLC*, 2020 WL 7062293 (N.J. App. Div. 2020); *DeCandia v. Anthony T. Rinaldi, LLC*, 2020 WL 588837 (N.J. App. Div. 2020); *Estate of Barbuto v. Boyd & Boyd*, 462 N.J. Super. 580 (App. Div. 2020); *Messner v. Cotz*, 784 Fed. Appx.70 (3<sup>rd</sup> Cir. 2019); and *Iacono v. Capano, C.A. No. 11841-VCL* (Del. Ch. June 29, 2020).