

# [The appeal of the limited partnership assignment](https://assignbuster.com/the-appeal-of-the-limited-partnership-assignment/)

The Appeal of the Limited Partnership “ Flow Through Vehicle” in First Nation Venture Structuring Presented by: Malcolm P. MacPherson Barrister & Solicitor Principal | Vancouver Business Law —————————– Suite 1200 – 543 Granville Street Vancouver, BC, V6C 1X8 Tel: 604. 629. 8904 Cell: 604. 928. 4202 Fax: 604. 629. 8523 Email:[email protected]ca Website: www. vancouverbusinesslaw. ca 1. Introduction 1. 01General Overview In British Columbia, there are three forms of partnership that may be entered into, namely: general partnerships, limited partnerships, and limited liability partnerships.

For today’s purposes, I will focus on the limited partnership, which is less commonly used than the corporation or general partnerships, but which has become increasingly popular in the structuring of business transactions for First Nation communities owing to certain unique characteristics which we will discuss. For the purposes of today’s discussion, references to the “ Act” refer to Part 3 of the Partnership Act, R. S. B. C. 1996, the section which deals with limited partnership provisions and requirements. 1. 2Legislative Beginnings Limited partnerships first appeared in England in 1860 pursuant to the Bovill’s Act, 28 & 29 Vict. , c. 26. This said, the Limited Partnerhips Act, 1907 (7 Edw. 7, c. 24) did not come into force in England until 1907. Notwithstanding their long history, limited partnerships remained relatively rare in common law jurisdictions until the early 1980s when they began to be used more frequently to take advantage of the favourable tax treatment available in certain transactions. Today, limited partnerships are most ften employed for raising capital and for their tax benefits. The BC Partnership Act, Consolidated Acts of B. C. 1888, c. 92, was one of the earliest pieces of Canadian legislation to recognize the limited partnership. Every Canadian province and territory has now enacted legislation recognizing the limited partnership. 2Comparing Limited Partnerships and General Partnerships 2. 01What is the Difference Between a Limited Partnership and a General Partnership? A limited partnership is a creature of statute.

It is based upon many of the same concepts underlying the general partnership, but is different to the extent that the concept of limited liability is incorporated into the statutory language giving rise to its existence. In a general partnership, each partner is liable jointly with the other partners for all debts and obligations of the partnership incurred while he or she is a partner, whether in contract or in tort. By contrast, the legislative provisions respecting limited partnerships have largely mitigated exposure to this liability by the limited partners of a limited partnership.

The following is a list of some of the significant characteristics of a general partnership, which characteristics are modified by the limited partnership: (i) all partners may take part in the management of the partnership and its business; (ii) each of the partners has the authority to bind the partnership or act as its agent; and (iii) the partners are jointly and severally liable for all partnership obligations, whether in contract or in tort.

Limited partnerships differ from general partnerships primarily for the following reasons: (i) general partners whose liability for the debts and obligations of the firm is unlimited; and (ii) limited partners whose liability for such debts and obligations is limited to the amount of their investment. Limited partners are supposed to be passive investors, and must not participate in the management of the business, otherwise they jeopardize their limited liability status. 2. 02Limited Liability

Before recommending the use of a limited partnership, one needs to give careful consideration to the roles of the respective partners therein. One of the key attractions of a limited partnership is that it provides the limited partners with the protection and security of limited liability. Accordingly, if there are potential liabilities surrounding a business enterprise, it makes sense to consider using a limited partnership as opposed to a general partnership. It is worth spending a few moments discussing the role of the certificate of partnership in the limited partnership.

This is because the certificate of partnership sets out contributions which are to be made by limited partners pursuant to the limited partnership. As it happens, the liability of a limited partner is limited by the amount of their contribution set out in the partnership certificate, and not, as one might expect, in accord with the actual amount of their contribution. Accordingly, the liability of a limited partner for the obligations of the partnership will be limited to the contribution made or agreed to be made by the limited partner pursuant to what is actually set out in the certificate of partnership.

So, for example, in the event the partnership incurs significant liability, if a limited partner contributes more money than what is set out in the certificate of partnership, then this partner will be liable for that amount in excess of the stated amount on the certificate of partnership. Similarly, if the partnership incurs significant liability, and if a limited partner has not yet fully invested their contribution set out in the certificate of partnership, this limited partner will be liable to the creditors of the partnership for that portion of the unfunded contribution.

As a result, in the event a limited partner receives a return of a contribution from the limited partnership, they remain liable to the limited partnership’s creditors to the full extent of the returned contribution unless the certificate of partnership is amended to show the reduced contribution and that the obligations were incurred after the date of the amendment of the certificate of partnership.

It is, as a result, important to review the certificate of partnership from time to time to ensure that each limited partner’s contribution is accurately recorded on the certificate of partnership. 3. General Partners and Limited Partners 3. 01Rights and Duties of General Partner Every limited partnership needs to have at least one general partner who is fully liable for all of the debts and obligations of the limited partnership. As a result, the general partner will have authority over the management of the partnership.

This authority is very broad, and the general partner has all of the rights and powers over the management and operations of the limited partnership, and is subject to all of the restrictions and liabilities of a partner in a general partnership, with only the following exceptions which are set out in section 56 of the Act: (i) to do an act that makes it impossible to carry on the business of the limited partnership; (ii) to consent to judgment against the limited partnership; (iii) to possess limited partnership property, or to dispose of any rights in limited partnership property, for other than a partnership purpose; (iv) to admit a person as a general partner or to admit a person as a limited partner unless the right to do so is given in the certificate; or (v) to continue the business of the limited partnership on the bankruptcy, death, retirement, mental incompetence or dissolution of a general partner, unless the right to do so is given in the certificate. It is worth noting that the rights and powers of the general partner may be further restricted by the limited partnership agreement. Under general partnership law, partners owe each other certain duties and obligations.

In addition to the common law obligations, the Act establishes the following primary duties owed between partners: (i) the duty to act with the utmost good faith and loyalty towards other partners; (ii) the duty to disclose information and render full information with respect to the partnership; (iii) the duty to account for any benefits obtained by unapproved business in the firm’s name; (iv) the duty not to exploit partnership property for personal benefit; and (v) the duty not to engage in competing business without the consent of the partners. The aforesaid duties apply equally to partners in a limited partnership as to those in a general partnership. Given the vulnerability of partners in a partnership that arises due to the ability of one partner to exercise unilateral discretion or take unilateral action affecting another’s rights and interests, the primary duty which the common law imposes on partners is one of good faith. In BC, s. 22(1) of the Act expressly recognizes this duty of good faith.

It states that: A partner shall act with the utmost fairness and good faith towards the other members in the business of the firm. Accordingly, partners owe a duty of loyalty to their fellow partners and must not allow themselves to be placed in a position where their private interests might come into conflict with their duties to the partnership and to their fellow partners. This fiduciary principle applies, similarly, to partners in a general partnership and in a limited partnership. 3. 02Fiduciary Duties of General Partners to Limited Partners The obligations of general partners to limited partners have been considered by several judgments of the courts of British Columbia and the Supreme Court of Canada.

The duty of a general partner to one or more limited partners has been held to be similar to the duty owed by a director to their corporation. 3. 03Dissolution of General Partner A limited partnership dissolves upon the bankruptcy, retirement, death, withdrawal or dissolution of a sole general partner. Consequently, care should be taken to ensure that the limited partners do not continue the business of the partnership where the sole general partner has become bankrupt, retired, died, withdrawn or dissolved, as the continuation of the business will be viewed as a general partnership and the limited partners will be jointly and severally liable for partnership debts as general partners.

Section 67 of the Act provides that the business of the limited partnership may only be continued as a limited partnership where a remaining general partner continues the business under a right specified in the certificate or with the consent of the remaining limited partners. 3. 04Rights and Duties of Limited Partner The role of limited partners is to contribute capital or other property to the limited partnership. Section 55 of the Act provides that limited partners may not contribute their services. In exchange for their capital contribution, the limited partners are afforded relief from any liability for the obligations of the limited partnership beyond the amount that they contributed or agreed to contribute to the limited partnership.

However, the cost of this limited liability is the limitation imposed on the involvement that a limited partner may have in the conduct of partnership business. If a limited partner wishes to enjoy the benefit of limited liability, the partner must refrain from taking part in the affairs of the partnership and the management of its business. For example, section 64 of the Act provides that: A limited partner is not liable as a general partner unless he or she takes part in the management of the business. A finding that a limited partner participated in the management of the partnership is a risky proposition for a limited partner. Where a limited partner is found to have participated in management, he or she becomes jointly and severally liable for all partnership obligations.

The Act identifies the following primary rights of a limited partner: (i) the right to inspect and make copies of the books, and to be given full information of all things affecting the limited partnership; (ii) the right to obtain dissolution and winding up of the limited partnership by court order; (ii) the right to a share in the profit of the business and to have his or her contribution to the partnership returned; (iv) the right to loan money to, borrow money from, or transact business with the limited partnership; (v) the right to have his or her share of the capital returned (in cash) upon the winding-up of the business once all the liabilities of the limited partnership have been paid; (vi) the right to ask for the winding-up of the limited partnership where the limited partner has been unsuccessful at getting his or her contribution returned, the other liabilities of the partnership have not been paid, or there is a bankruptcy, retirement, death, withdrawal or dissolution of a sole general partner; (vii) the right to assign his or her interest in the limited partnership with the consent of all the general partners or where there is provision for an assignment in the limited partnership agreement; and (viii) the right to pass on his or her rights in the partnership to an executor or administrator.

The primary duties that the Act assigns to a limited partner are: (i) the duty to contribute the amount stated in the certificate; (ii) the duty to hold certain property as trustee for the partnership; and (iii) the duty to account to the limited partnership for partnership liabilities that arose before the return of a capital contribution. In addition to the rights and duties of limited partners specified in Part 3 of the Act, it should be remembered that the statutory rights and duties of partners in a general partnership also apply to the extent they are not inconsistent with Part 3. One of the main attractions of the limited partnership as an investment vehicle is the limited liability it offers to investors. Limited liability may be lost where: i) the surname or corporate name of a limited partner appears in the firm name of the limited partnership; (ii) a certificate is not filed under s. 51 of the Act; (iii) a limited partner is aware of a false statement in the certificate; or (iv) a limited partner takes part in the management of the business. The loss of limited liability by taking part in the management of the business is the greatest concern for most limited partners. Limited partners must be wary of any involvement in the business matters of the partnership. Even the review of managerial decisions may be enough to qualify as taking part in the “ management” or the “ control” of the business.

It should be noted that participation by limited partners in the affairs of the business is permitted by the Act in certain limited circumstances: for example, limited partnership agreements may permit limited partners to admit an additional general partner or require a general partner to retire from the partnership, and limited partners may inspect and make copies of the partnership’s books and demand to be given full information on all matters affecting the limited partnership. For these reasons, it is unlikely that a limited partner has the authority to bind the partnership or act as its agent. 4. Key Issues For Consideration 4. 01Tax Considerations Generally, all types of partnership are attractive forms of business association, providing tax advantages not available in a company structure. The most significant distinction which may be drawn between the tax treatment of corporations and partnerships is that a corporation is taxed as a separate legal entity while a partnership is a conduit through which income flows to be taxed in the hands of the partners.

Consequently, it may be desirable in certain situations to use a partnership so that income or losses flow through to the individual partners and thus avoid the imposition of tax at the level of the business organization. This may be a considerable advantage in the case of a new business which is expected to incur losses in the first years of operation, in cases where one or more of the participants have losses for tax purposes which can be used to off-set the income earned in the new business, or where financing costs are incurred at the participants’ level rather than by the business structure itself and it is desirable to match the interest costs with the revenue stream.

In addition, for First Nation clients, limited partnerships can often be the ideal vehicle, given their tax exempt status. So, for example, instead of having some of the business income be taxed at the level of the business organization (i. e. the company), which net proceeds would subsequently flow to the First Nation business owner(s), by utilizing the limited partnership, the business proceeds would flow directly to the First Nation. Despite the obvious tax advantages a limited partnership may offer, it is important to weigh these against the potential exposure to liability and other risks associated with this form of business association. 4. 02The Limited Partnership’s Inherent Flexibility

Unlike the Business Corporations Act, S. B. C. 2003, c. 70, there are relatively few provisions in the Act governing the relationship between the partners in a limited partnership or prescribing their respective rights and obligations. There are, for instance, no statutory counterparts to the provisions in the Business Corporations Act that require shareholder approval for certain actions or which grant statutory rights or remedies upon the occurrence of certain events. Consequently, limited partnerships offer a considerable amount of flexibility to the parties to structure their relationship to reflect the negotiated terms of their business relationship. 4. 3Annual Filings? Additional administrative costs may be encountered in the use of limited partnerships. Although in BC there are no required annual filings for limited partnerships, records for the limited partnership should be maintained independently from those of the partners. Often a new, specific purpose corporation is used to act as general partner with the associated cost of incorporation and maintenance. 4. 04How to Form a Limited Partnership A limited partnership is formed by creating a partnership if one does not already exist, and then by filing a limited partnership certificate with the BC Registrar of Companies pursuant to s. 51 of the Act.

Section 51(2) of the Act requires that the following information be included in the partnership certificate: (i) the business name under which the limited partnership is to be conducted; (ii) the general nature of the business carried on or intended to be carried on; (iii) the full name and residential address of each general partner or, in the case of a general partner other than an individual, the name and address in BC; (iv) the term for which the limited partnership is to exist; (iv) the aggregate amount of cash and the nature and fair value of any other property to be contributed by all of the limited partners; (vi) the aggregate amount of any additional contributions agreed to be made by limited partners and the times at which or events on the happening of which the additional contributions are to be made; (vii) the basis on which limited partners are to be entitled to share profits or receive other compensation by way of income on their contributions. Section 51(4) of the Act requires that where a partnership agreement contains certain provisions respecting other prescribed matters, the partnership certificate must also mirror provisions respecting those matters. Failure to include this information may result in a certificate, and therefore the formation of the limited partnership, being defective, with a consequential loss of limited liability. 4. 05Limited Partnership Agreement The relationship between partners and their respective rights and obligations will normally be set out in a limited partnership agreement.

It is generally advisable to make such an agreement fairly comprehensive. It should address matters which are not covered by the Act and should also include provisions dealing with matters covered by the Act which can be varied by agreement where the statutory provisions are not satisfactory in the particular circumstances. Since the Act does not prescribe requirements with respect to meetings, partnership procedures or other matters, it may be necessary to address these in the partnership agreement. It may be appropriate to include many of the provisions typically found in the Articles of a company for the internal management of its affairs plus analogous provisions to those found in a shareholders’ agreement.

Even where the Act contains provisions governing the relationship between partners, these can often be varied or amended by the limited partnership agreement. For example, s. 27 of the Act, which sets out the rights of partners with respect to capital and profits, indemnification, remuneration, admission of new partners and other matters, is expressly subject to any agreement between the partners. Similarly, s. 61 of the Act provides that limited partners shall share in partnership assets in respect of their claims for capital and profits in proportion to their respective claims but states that where there is more than one limited partner the partnership agreement may provide that one limited partner has greater rights than other limited partners.

Limited partners may want the agreement to include an indemnity from the general partner (or from its individual investors if a general partner is a corporate shell) to protect them in the event that the limited partners’ limited liability is lost as a result of an act or omission of another party. It should, however, be remembered that an indemnity is only as good as the financial strength of the party giving it. Since the general partner will be fully liable for all partnership obligations, it is likely that any claim made against a limited partner will have first been brought against the general partner and the limited partner will only be pursued for the unsatisfied portion of the claim.

In summary, a limited partnership agreement must deal with the information required under s. 51(2) of the Act and should in most cases include provisions regarding matters set out in s. 51(4) of the Act. Usually the agreement will also address the following issues: (i) the relationship between the partners; (ii) responsibility for management and decision-making; (iii) contributions and return of contributions; (iv) indemnification and remuneration; (v) rights to capital; (vi) allocation of profits and losses; (vii) requirements for meetings and other internal procedures; (viii) admission of new partners; (ix) transfer and issue of partnership interests; x) the right to continue the partnership on the bankruptcy, retirement, death, mental incompetence, or dissolution of a general partner; (xi) the right of a partner to carry on a competitive or other business; and (xii) dissolution. 5. Conclusion Limited partnerships have proven to be an increasingly popular “ flow through” vehicle for First Nation businesses. As discussed, they offer significant tax advantages while providing limited liability to certain participants involved in the limited partnership. Prior to contemplating using such corporate structures, however, one must be careful to properly consider the roles of the various partners involved in the limited partnership with a view to maintaining the advantages available through the usage of the limited partnership without inadvertently triggering adverse consequences inherent in their makeup.