# CPA BEC - STUDY UNIT 2
# Noncorporate Limited Liability Entities: Core Concepts

## A. Limited Partnerships

1. A **limited partnership** is a separate legal entity formed by two or more persons under a state statute. It has one or more general partners and one or more limited partners. A **general partner** assumes management of the partnership and has full personal liability. A **limited partner** is an investor who makes a contribution of cash or other property to the partnership in exchange for an interest. This investor is not personally liable for partnership debts and not active in management.
2. **Formation.** A written **certificate of limited partnership** must be filed as a public record. A **certificate of amendment** may be filed for "any proper purpose" determined by the general partners. It is filed after admission or withdrawal of a general partner or continuation of the business after an **event of withdrawal of a general partner**.
    a. A **limited partnership agreement** is commonly executed by the partners. A limited partnership may **carry on any business** that a general partnership may conduct, with statutory exceptions (e.g., banking).
3. **Capitalization.** A limited partnership may be financed by the partners' **contributions** of cash, property, services, or promises to make contributions. Absent a written **partnership agreement**, profits, losses, and distributions are shared in proportion to the **value of the partners' contributions** received (and not returned).
    a. **Partnership interests** (general and limited) are assignable. They are rights to share in profits and losses and to receive distributions. **Assignment** does not dissolve the limited partnership or entitle the assignee to become a partner.
4. **Taxation.** The limited partnership is a pass-through (nontaxable) entity.
5. **Rights.** A **general partner** in a limited partnership has the same rights, duties, liabilities, and authority as a partner in a general partnership. A **limited** partner cannot **participate in management and control** of the business without losing limited-partner status. A limited partner has rights that protect the position as a passive investor, e.g., (a) voting on any matter; (b) inspecting and copying the partnership records; (c) obtaining financial information, tax returns, and possibly other partnership information; and (d) receiving the fair value of the partnership interest upon withdrawal.
6. **Termination.** A limited partnership goes through **dissolution and winding up** before termination. A **certificate of cancelation** is filed either after dissolution and the beginning of winding up or at any time when there are no limited partners. Dissolution may be upon (a) occurrence of an agreed-upon event, (b) unanimous agreement, (c) a court order, or (d) an **event of withdrawal** of a general partner. However, the agreement may provide that the business will be carried on by the remaining general partners. Moreover, all partners may agree to continue the business. Winding up is done by a general partner who has not caused the dissolution. Remaining assets, if any, are distributed first to creditors.

## B. Limited Liability Partnerships (LLPs)

1. An LLP is a general partnership that has been changed to LLP status under state law. Most states have now enacted laws that provide for a broad personal liability shield. Except for the filing requirements, an LLP is ordinarily treated as a legal entity.
2. Changing to LLP status is equivalent to **amending the partnership agreement**. Thus, the partners must elect to make the change. Partners must register by filing a **statement of qualification** with the secretary of state. An LLP also must file an **annual report** containing substantially the same (but updated) information. The end of the LLP's **name** must indicate the liability shield.
3. **Capitalization.** An LLP is financed by contributions and the entity's borrowings.
4. The rules governing **profits, losses, distributions, taxation, and assignment of LLP interests** that apply to general partnerships ordinarily also apply to LLPs. The **rights, duties, and authority** of partners in an LLP also are similar to those of general partners.
5. **Liability.** The partners, including those who manage the business, are shielded from personal liability for any partnership obligation incurred while the partnership was an LLP. However, a partner who personally incurs an obligation in the conduct of partnership business is fully liable. Moreover, the supervisor of a person who commits a wrongful act within the scope of supervision is liable.
6. **Capitalization.** Funding is from **members' contributions**.
7. **Termination** of an LLP involves the same process (dissolution and winding up) as in a general partnership.

## C. Limited Liability Companies (LLCs)

1. An LLC is formed under a **state statute** as a separate legal entity. It combines the limited liability of the owners and managers of a corporation with the tax advantages of a general partnership.
2. **Formation.** An LLC is formed by **one or more persons** who file **articles of organization** as a public record. Most state statutes permit single-member LLCs. The **name of the LLC** must indicate by words or abbreviations that it is an LLC. The articles should include certain basic information, provide for existence for a specified **term** or **at-will**, indicate whether management will be by owners or managers, and state whether one or more members will be liable for the LLC's obligations.
    a. The members' **operating agreement** is not legally required and may be oral. It may address matters such as management arrangements, voting rights, profit sharing, transfer of interests, and dissolution.
3. **Taxation.** Members may elect to be taxed as partners or as a corporation.
4. **Management.** An LLC is deemed to be member-managed unless the articles provide otherwise. In a **member-managed LLC**, all members have a right to participate, and most matters are decided by the majority. Members are agents.
    a. In a **manager-managed LLC**, each manager has equal rights, and most matters are decided by the manager or by a majority of managers. Managers are agents.
    b. Members must **unanimously agree** about some matters, e.g., amending the operating agreement or the articles, dissolution, merger, and admission of new members.
5. **Termination.** Generally, subject to the LLC's solvency, a member is entitled to a return of his/her capital contribution upon dissolution. If dissociation of a member does not cause dissolution, the LLC must purchase the member's interest at **fair value**.