

## ENTITY OVERVIEW OF LLCs, LPs AND LLPs

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### A. SUMMARY OF RELEVANT STATUTES AND ENTITY TYPES

1. The Limited Liability Company ("LLC"). An LLC is an unincorporated legal entity organized under a state limited liability company act that offers limited liability to all of its owners, who are called "members." In Massachusetts, LLCs are governed by the Massachusetts Limited Liability Company Act (G.L. c. 156C) (the "Mass. LLC Act"). The LLC form is flexible and can provide for centralized or decentralized management, free or restricted transferability of interests, and perpetual or limited existence. Accordingly, LLCs may have both partnership and corporate features. LLCs were first authorized by statute in Massachusetts effective January 1, 1996 (St. 1995, c. 281, §18). All 50 states have now enacted LLC statutes, although the provisions of certain of such statutes vary significantly from the Mass. LLC Act. "Foreign" LLCs organized under the laws of other states which wish to conduct business in Massachusetts must register in Massachusetts under §48 of the Mass. LLC Act.

For "domestic" LLCs, the Mass. LLC Act provides as follows:

Organization. Although a bill is now being considered by the Massachusetts legislature which would permit the formation of single-member LLCs (as

are now permitted under the laws of all 49 other states), the Mass. LLC Act still requires that an LLC organized under Massachusetts law have at least two members. Until that bill is enacted into law, parties wishing to conduct business in Massachusetts through single-member LLCs need to organize those LLCs under the laws of other states (often Delaware) and qualify them as foreign LLCs in Massachusetts.

In Massachusetts, an LLC is created by the filing of a certificate of organization with the Massachusetts Secretary of State containing the information specified in §12 of the Mass. LLC Act. The certificate of organization is required to provide public record of only certain basic information about the LLC, and most LLCs are governed by comprehensive written operating agreements which need not be part of the public record. The certificate of organization may be signed by an “authorized person,” and therefore lawyers preparing the organizational documents for an LLC may sign the certificate of organization (as contrasted to a certificate of limited partnership, which must be signed by a general partner) .

The filing fee for an LLC’s certificate of organization is \$500, but the LLC is required to pay an additional \$500 fee each year upon the filing of an annual report required under §12(c) of the Mass. LLC Act. The annual report is required to be filed within 12 months of the date on which the certificate was filed and not by a specified calendar date (as in the case of the annual report required to be filed for a business corporation). As a condition to the adoption of the Mass. LLC Act, the Massachusetts legislature required the payment of the \$500 annual fee because it realized

that many business owners would find the LLC an attractive alternative to a corporation (which, unlike an LLC, must pay at least at least a minimum annual tax to Massachusetts for each year). The required annual report for an LLC updates all of the information required in the certificate of organization as originally filed, and therefore there is no printed form of annual report for an LLC similar to the printed form of annual report required by the Massachusetts Secretary of State for corporations.

Because the annual report updates all of the information required in the LLC's certificate of formation, the annual report can serve as an amendment to the certificate (thus avoiding the separate \$100 filing fee required for an amendment). To the extent the annual report is used as an amendment to the certificate, the annual report should recite at its beginning the sections of the certificate of organization which are being amended. This facilitates the updating of the data base of the Secretary of State which is publicly available on-line at [www.state.ma.us/sec/cor](http://www.state.ma.us/sec/cor) and which is used by the Secretary of State's office when issuing certificates as to legal existence and persons authorized to sign documents on behalf of an LLC.

Management. An LLC may be managed by its members in a manner similar to a general partnership, or by one or more "managers," who may but need not be members, in a manner similar to a corporation or limited partnership. If the members so elect in the operating agreement for an LLC, the LLC can also have officers, although the Mass. LLC Act does not specifically provide for officers. The owners of an LLC

therefore may decide upon the degree of centralization of management that they wish to have for the LLC.

Liability of Owners. None of the members or managers of an LLC is personally liable for any debts, obligations or liabilities of the LLC. (G.L. c. 156C, §22). Unlike a limited partner of a limited partnership, a member of an LLC may therefore take part in the control of its business without thereby becoming personally liable for its debts.

Continuity of Existence. Under §43 of the Mass. LLC Act, an LLC is dissolved and its affairs wound up upon the first to occur of the following: (i) the time specified in the operating agreement; (ii) the happening of an event specified in the operating agreement; (iii) written consent of all members; (iv) except as provided in a written operating agreement, the death or retirement of a member or other event which terminates such member's membership in the LLC, unless the LLC is continued either by the consent of the remaining members within 90 days after the withdrawal or pursuant to a right to continue stated in a written operating agreement; or (v) a decree of judicial dissolution. The existence of an LLC is therefore limited in the same manner as a limited partnership as described below, unless the parties otherwise provide in a written operating agreement. By eliminating the events of dissolution in the operating agreement, it is possible for an LLC to have in effect a perpetual existence.

Transferability of Interests. A member's interest in an LLC is freely assignable in whole or in part except as provided in a written operating agreement and as may be required under applicable federal and state securities laws. However, an assignee

has no right to participate in the management of the LLC or otherwise exercise a member's rights (e.g., rights to receive information from the LLC and to vote or consent to various LLC matters) except upon compliance with procedures set forth in a written operating agreement or with the approval of all members. (G.L. c. 156C, §39(b)).

2.     The Limited Partnership ("LP"). An LP is a partnership formed by two or more partners under a state limited partnership statute, having one or more "general partners" and one or more "limited partners." The basic distinction between a general partnership and an LP arises from the presence and status of the limited partners. The status of a limited partner differs from that of a general partner in two principal respects: (i) the liability of each limited partner is limited to the amount of his capital contribution to the partnership; and (ii) a limited partner may not participate in the "control of the business" without jeopardizing such partner's limited liability status.

In Massachusetts, LPs are governed by the Revised Uniform Limited Partnership Act. (G.L. c. 109) (the "Mass. ULPA"). All 50 states have LP statutes, and the provisions of such statutes differ less than in the case of LLC statutes. "Foreign" LPs organized under the laws of other states must register to do business in Massachusetts under G.L. c. 109, §49.

For "domestic" LPs, the Mass. ULPA provides as follows:

Organization. An LP is formed by substantial compliance with two requirements: (i) each of two or more persons desiring to form the LP must have the general partner or general partners thereof execute a certificate of limited partnership

containing the information specified in §8 of the Mass. ULPA; and (ii) the certificate must be filed with the Massachusetts the Secretary of State. The current filing fee in Massachusetts is \$200. Unlike for LLCs, there is no requirement for the filing of subsequent annual reports or the payment of annual fees.

As in the case of the certificate of organization filed by an LLC, the certificate of limited partnership is required to provide public record of only certain basic information about the LP. Most LPs are governed by comprehensive limited partnership agreements which need not be part of the public record.

Management. Except for the exercise of certain specified voting and consent rights allowed by §19 of the Mass. ULPA, a limited partner may not take part in “control of the business” without risking the loss of limited liability. Accordingly, virtually all limited partnership agreements vest exclusive power over the general conduct of the partnership’s business in the general partner or general partners. The general partners of an LP have all the powers and duties of partners in a general partnership. (G.L. c. 109, §24).

Liability of Owners. In every LP, there must be at least one general partner with full personal liability for the LP’s obligations. (G.L. c. 109, §§1(7) and 24). However, the general partner of an LP may be a corporation or LLC. Prior to the adoption of the IRS’s “Check-the-Box” Regulations which became effective on January 1, 1997, the general partner of an LP (particularly an LP with passive investors as limited partners) normally was required to have significant net worth in order to ensure that the

LP would be treated as a “partnership” for tax purposes. (See “B. Advantageous Uses - 4. Pass-Through Tax Treatment” below). However, since January 1, 1997, this concern has not been relevant for federal tax purposes, and LPs often now have as general partners either corporations or LLCs with limited net worth.

Unlike a general partner, a limited partner of an LP is not liable to the creditors of the LP beyond the amount of his contribution to the LP unless, as indicated above, he takes part in the control of the business. (G.L. c. 109, §19).

Continuity of Existence. Under §§44 and 45 of the Mass. ULPA, an LP is dissolved and its affair shall be wound up upon the happening of the first to occur of the following: (i) the time or upon the happening of events specified in the certificate of limited partnership; (ii) written consent of all partners; (iii) an event of withdrawal of the general partner unless at the time there is at least one other general partner and the agreement of limited partnership permits the business of the LP to be carried on by the remaining general partner and that partner does so, but the LP is not dissolved and is not required to be wound up by reason of any event of withdrawal, if, within 90 days after the withdrawal, all partners agree in writing to continue the business of the limited partnership and to the appointment of one or more additional general partners if necessary or desired; or (iv) entry of a decree of judicial dissolution. Unless the agreement provides otherwise, however, the withdrawal of a limited partner does not bring about a dissolution of the LP. (G.L. c. 109, §44).

Transferability of Interests. Except as provided in the limited partnership agreement, a limited partnership interest is assignable in whole or in part. An assignment of a limited partnership interest does not dissolve a limited partnership or entitle the assignee to become or to exercise any rights of a partner. (G.L. c. 109, §40). The assignee may be substituted as a limited partner only if and to the extent that (i) the assignor gives the assignee that right in accordance with authority described in the partnership agreement, or (ii) all other partners agree. Unless the assignee is substituted as a limited partner, an assignment entitles the assignee to receive, to the extent assigned, only the distributions to which the assignor would be entitled. Except as provided in the partnership agreement, a partner ceases to be a partner upon the assignment of all his partnership interest. (G.L. c. 109, §§ 40 and 42).

3. The Limited Liability Partnership (“LLP”). In Massachusetts, an LLP is a general partnership which files with the Secretary of the Commonwealth a brief registration form and pays a \$500 filing fee. (G.L. c 108A, §45). Unlike an LLC or an LP, an LLP is not a different form of legal entity than a general partnership and most of the legal rules applicable to general partnerships continue to be applicable after the partnership has filed the registration form. However, provided the general partnership has been registered as an LLP through such filing and thereafter maintains its LLP status through the filing of annual reports (each with a \$500 fee), each partner in an LLP is not liable for the debts, obligations or liabilities of the LLP, except to the extent such liabilities arise in whole or in part out of such partner’s own negligence, wrongful acts,



errors or omissions. (G.L. c 108A,§15(2)). In particular, the partners in a professional firm organized as an LLP remain liable for their own malpractice.

LLPs were first authorized in Massachusetts by legislation effective January 1, 1996 (St. 1995, c 281, §13). Many law and accounting firms formerly organized as general partnerships have converted to the LLP form. Although Massachusetts law does not limit the LLP form of entity to professional firms, most of the firms utilizing such form in Massachusetts are professional firms. See “C. Use of the LLP and LLC for Professional Firms” below. This is because LLPs are general partnerships, and many of the rules which are applicable to general partnerships (such as those applicable to management and continuity of life in the absence of carefully drafted partnership agreements) are not suitable for many business enterprises. See “Entity Overview of General Partnerships and Joint Ventures” later in this presentation.

In Massachusetts, LLPs are governed by various provisions of the Uniform Partnership Act (G.L. c. 108A) (the “Mass. UPA”), particularly §§45-47. “Foreign” LLPs organized under the laws of other states are recognized in Massachusetts and are required to register with the Secretary of the Commonwealth in the same manner as domestic LLPs.

For “domestic” LLPs, the Mass. UPA provides as follows:

Organization. An LLP must file a simple registration form with the Secretary of the Commonwealth containing the information set forth in §45(1) of the Mass. UPA and pay a \$500 filing fee. In order to retain its status, an LLP must also file

an annual report with the Secretary of the Commonwealth and pay an annual \$500 fee (G.L. c. 108A, §45). Special requirements apply in the case of an LLP which provides professional services, including a requirement that such LLP carry professional liability insurance or provide an escrow or letter of credit in an amount designated by the appropriate regulatory board. (G.L. c. 108A, §45).

Management. Although an LLP is not required to have a written partnership agreement, it is usually desirable to define the rights and duties of the partners to one another in a written partnership agreement. In the absence of an agreement to the contrary, each partner has an equal voice in the management and control of the partnership; in the event of disagreement, a numerical majority of the partners would therefore control.

Liability of Owners. Each partner in an LLP, unlike those in a general partnership, has no personal liability for the debts, obligations or liabilities of the LLP so long as it is registered, except to the extent such liabilities arise in whole or in part out of such partner's own negligence, wrongful acts, errors or omissions. (G.L. c. 108A, §15(2)). However, lawyers, accountants and other professionals operating as partners in an LLP therefore cannot thereby limit their own personal liability for malpractice.

Continuity of Existence. When any partner ceases to be a member of an LLP, whether through withdrawal, expulsion or death, a technical dissolution of the partnership occurs. (G.L. c. 108A, §§29 and 31). Dissolution may also be occasioned by a number of other events, including, in some instances, a court decree. Thus, the LLP

does not, at least theoretically, possess perpetual life. However, the partnership agreement of an LLP may provide that the LLP will be reconstituted and its affairs continued by the remaining partners (sometimes upon an affirmative vote of a specified percentage of the remaining partners) in the event of a dissolution of the LLP arising from events such as the withdrawal or death of a partner.

Transferability of Interests. Partners in an LLP have three types of property rights: (i) rights in specific partnership property; (ii) interests in the LLP (i.e., their respective shares of partnership capital and profits); and (iii) rights to participate in management (G.L. c. 108A, §24). A partner's rights in specific partnership property are not assignable except in connection with the assignment of the rights of all the partners to the same property. (G.L. c. 108A, §25 (2)(b)). A partner's interest in the LLP (i.e., his share of the partnership capital and profits) may be assigned but, in the absence of agreement by the other partners, the assignment does not entitle the assignee to participate in the management or administration of the partnership business or to require any information or account of partnership transactions or to inspect the partnership books. These rights of assignment are further limited in the case of professional firms organized as LLPs because of the licensing requirements applicable to each partner in such LLPs.

## **B. ADVANTAGEOUS USES**

1. Limitation of Liability. Subject to certain exceptions, LLCs, LPs and LLPs allow their owners to conduct business without personal liability beyond the risk of

their investment in and earnings from such entities. The principal exceptions are as follows. First, lenders to and landlords of such entities may (and often will) require personal guarantees by certain or all of the owners in order to induce such lenders and landlords to make loans to or enter into leases with such entities. Second, in the case of LPs, there must be at least one general partner which has personal liability for all of the liabilities of the entity, although such liability can be limited as a practical matter through the use of a general partner which is a corporation or LLC and which has limited net worth. Third, professionals operating through such entities cannot limit their personal liability for their own negligence, and malpractice insurance must therefore still be carried by such entities to limit the personal liability of such professionals against malpractice claims and to comply with state licensing requirements.

2. Raising Capital from Investors. Because the personal liability of the owners of LLCs and LPs is limited, such entities are suitable for raising capital from passive investors. In particular, LLCs and LPs are often formed to acquire assets (such as real estate projects) which require significant investment capital but with respect to which the investors are willing to delegate management control to a manager or general partner which is either a firm (or an affiliate of a firm) with significant experience and a “track record” with respect to the type of project involved. LLCs and LPs (as opposed to S Corporations) may be particularly suitable for raising investor capital for such ventures because LLCs and LPs may have (i) more than one class of equity interests outstanding and (ii) an unlimited number of investors, all without adversely affecting the ability of

such entities to qualify for “pass-through” tax treatment as described below. This is particularly relevant where the managers and the investors will participate in the profits from such ventures on a basis disproportionate to their respective equity investments. For example, an LLC or LP organized to acquire, finance, own and ultimately sell a real estate project will often have investors entitled to receive back all of their investment (often with a cumulative annual priority return) prior to the receipt of a “carried interest” by the manager organizing and managing the venture. If a corporation is to provide “pass-through” tax treatment, it must comply with all of the requirements of Subchapter S under the Code which, among other limitations, currently prohibit the entity from having more than one class of outstanding capital stock and more than 75 stockholders.

Although LLCs and LPs may raise significant amounts of investor capital through either private or public offerings of their interests, the outstanding interests in such entities are not normally publicly traded for two reasons. First, the transfer of outstanding interests in LLCs and LPs which are treated as partnerships for tax purposes involve greater tax complexity (including the preparation and provision of Form K-1 annual reports to each investor) than the transfer of stock in C Corporations. Second, an LLC or LP whose interests are publicly traded may be treated as a C Corporation for tax purposes as a result of the “publicly-traded partnership” provisions of the §7704 of the Code. However, entities organized originally as LLCs or LPs which subsequently wish to conduct public offerings and thereafter have public trading in their interests can usually convert to corporate form prior to the public offering on a tax-free basis under

§351 of the Code. For example, The Boston Beer Company, Inc., which makes Samuel Adams Beer, was originally organized and operated as an LP and then converted on a tax-free basis to a C Corporation shortly prior to its public offering in 1995.

3. Flexibility of Operations. Under the Massachusetts Business Corporation Law (G.L. c. 156B) (the “Mass. BCL”), a business corporation must have articles of organization and by-laws, and both the Mass. BCL and provisions of such articles of organization and by-laws which are required under the Mass. BCL set forth numerous requirements which affect the day-to-day operations of the corporation. For example, a corporation wishing to authorize additional amounts of common or preferred stock or to merge with another entity must comply with numerous procedural and other requirements (such as the need to obtain certain specified levels of shareholder approval), and failure to comply with such requirements will invalidate such actions. In addition, Massachusetts corporations must hold annual shareholder meetings, and any shareholder approvals required for various actions may be obtained only at annual or special meetings or by unanimous written consent of all of the shareholders, as opposed to only those shareholders (e.g., the holders of a majority or two-thirds of the outstanding shares) whose approvals are required for such corporate actions.

In contrast, LLCs, LPs and LLPs are subject to only limited statutory requirements in connection with their operations. For example, there is no requirement in the Massachusetts statutes governing LLCs, LPs and LLPs that any meetings of members or partners take place, and the operating or partnership agreements of such entities may

therefore provide varying terms for both the percentage of member or partner approval required for certain actions and the procedures for obtaining such consents by meetings and/or written consents.

However, because of the greater flexibility and lessened statutory requirements applicable to LLCs, LPs and LLPs as opposed to corporations, there is a correspondingly greater need that the operating or partnership agreements of LLCs, LPs and LLPs be prepared with care. This is particularly true in order to avoid certain results (in particular, premature dissolution) which may arise from the provisions of such statutes which apply if written operating or partnership agreements do not otherwise provide. The legal costs of establishing an LLC or LP are therefore normally considerably higher than those for establishing a corporation, for which readily available samples or forms of articles of organization and by-laws (coupled with the more detailed provisions of the Mass. BCL) are more likely to produce a result which will be satisfactory to the owners of such entities.

4. Pass-Through Tax Treatment. “Pass-through” tax treatment means that a business entity is not taxed but rather its owners are taxed as if items of income, loss, deduction and credit were earned or incurred directly by the owners. A pass-through entity therefore avoids “double taxation” at both the entity and owner level, and can distribute money or property to its owners on a tax-free basis unless the distribution exceeds the owner’s adjusted tax basis in his interest in the entity. (I.R.C. §731(a)). A pass-through entity must still file annual tax returns with the federal and applicable state

taxing authorities and provide a Form K-1 to all of the members or partners of the entity showing their respective shares of the entity's income, loss, deductions and credits. In addition to the avoidance of double taxation, pass-through tax treatment allows the members or partners to be taxed on their shares of the entity's long-term capital gains at the lower rates now available under both federal and Massachusetts tax laws and regulations for long-term capital gains.

For many years, the question of whether a non-corporate entity with limited liability (e.g., an LLC or LP) would be classified as a corporation or a partnership for tax purposes was complex, and required that each such entity be carefully analyzed from the standpoint of four corporate attributes (limited liability, continuity of life, free transferability of interests and centralization of management). In addition, several published IRS rulings and revenue procedures established certain tests (at least for partnerships seeking advance rulings as to partnership status) respecting the minimum net worth of the general partners of limited partnerships. However, effective January 1, 1997, the IRS's "Check-the-Box" Regulations eliminated the four factor and minimum net worth tests and substituted a simple elective system, under which most business organizations other than corporations may elect to be classified either as a partnership or a corporation for federal income tax purposes. (Treas. Reg. §§301.7701- et seq.). Under these Regulations, certain entities are always taxable as corporations: these include domestic corporations, certain entities engaged in specialized industries (such as banking and insurance) and certain foreign entities. Business organizations that are not so



classified as corporations (so-called “eligible entities”) can elect their tax classifications. An eligible entity with more than one member or partner can elect either to be taxed as a corporation or a partnership. An eligible entity with only one member (such as a single-member Delaware LLC) can elect either to be taxed as a corporation or to be disregarded for tax purposes. Significantly, the “Check-the-Box” Regulations contain certain “default” rules under which an eligible entity will be deemed to be a partnership if it has more than one member.

IRS Form 8832 (Entity Classification Election) may be used by an eligible entity to elect classification as a corporation or partnership by “checking-the-box” on the form. An election on Form 8832 may be made any time, but an election can take effect no earlier than 75 days prior to filing and no later than 12 months thereafter. The default rules provide that general partnerships, LLCs, LPs and LLPs will automatically be classified as partnerships in the absence of an election to the contrary on Form 8832. Since partnership tax treatment is usually desired for most or all entities for which it is available, the “Check-the-Box” Regulations should probably be more accurately referred to as the “Don’t-Check-the-Box” Regulations.

## **C. USE OF THE LLP AND LLC FOR PROFESSIONAL FIRMS**

1. Problems with General Partnerships. In the past, many professionals, and in particular lawyers and accountants, traditionally practiced in general partnerships. However, under §15 of the Massachusetts UPA (G.L. c.108A), every partner in a general partnership is either jointly or jointly and severally liable for all obligations and liabilities incurred by the partnership, including liabilities arising from any wrongful act or omission by any employee or any other partner acting in the ordinary course of business of the partnership. (G.L. c. 108A, §§ 13 and 15.) Professionals have therefore become increasingly concerned about their vicarious personal liability. Large malpractice awards, the increasing cost of malpractice insurance, and the bankruptcy of several well-known law and accounting firms in recent years have spurred many professionals to seek ways to insulate themselves from personal liability. Widely-publicized recent cases such as those in which Arthur Andersen LLP is now involved will almost certainly accelerate this trend.

2. Choice of Professional Limited Liability Entities.

Professional Corporations (“PCS”). Since 1963, many professionals in Massachusetts have organized their firms as PCS under the Massachusetts Professional Corporation Law (G.L. c.156A). Incorporation as a PC does generally protect the non-negligent professional from liability for the malpractice of other employees of the firm, as well as from contractual obligations of the firm such as leases and bank loans in the absence of personal guarantees. However, neither a PC nor any other form of business

organization will protect a professional from personal liability for his or her own malpractice, because a professional is always responsible for his or her personal actions even when carried out as an agent for another entity.

Although PCS remain a common form of limited liability entity for professionals, the use of a PC may not be available or may pose significant concerns for several reasons, including the following. First, a PC typically chooses S Corporation status to obtain “pass-through” tax treatment as previously discussed. However, some PCs are ineligible for S Corporation status because: (i) they have more than 75 shareholders; (ii) they provide for more than one class of stock; or (iii) they have certain types of subsidiaries not currently permitted in S Corporations. If S Corporation status is not available to a PC for one or more of the foregoing reasons, the corporate tax on the PC may still be minimized by paying out substantially all of its income as salaries and bonuses. However, issues of reasonable compensation and difficult year-end planning may arise. Moreover, even an S Corporation may be liable for Massachusetts corporate tax if its gross receipts exceed \$6 million. Second, under the Massachusetts Professional Corporation Law, the use of PCS involves many of the same corporate governance issues which are mandated by the Mass. BCL for business corporations. Third, there is a substantial tax cost for liquidating a PC which is taxed as a C Corporation if converting to another form of entity ever becomes desirable.

As described above in this outline, LLPs and LLCs, if properly organized, are not taxed as corporations and protect their partners or members from most vicarious liability.

Most jurisdictions in which LLPs can be registered (including Massachusetts) allow their professionals to use both LLPs and LLCs. However, particularly because of the ease of converting an existing general partnership into an LLP (as opposed to an LLC) as described below, the LLP has generally become the entity of choice for many accounting and law firms.

3. Regulation of Professional Limited Liability Entities. In addition to Massachusetts laws and regulations generally affecting the organization and operation of corporations and other limited liability entities, the Massachusetts Secretary of State has adopted regulations regarding professional PCs, LLPs and LLCs. See 950 C.M.R. §§ 105.000, 111.00 and 112.000. Under these regulations, every professional regulating board is required to adopt minimum malpractice liability insurance requirements for such entities. With respect to lawyers, SJC Rule 3:06 sets forth the relevant requirements. With respect to accountants, the Massachusetts Board of Registration in Public Accountancy has established minimum professional liability insurance requirements in 252 C.M.R. § 4.00.

4. Converting a General Partnership to an LLP or LLC. As described above, law and accounting firms organized as general partnerships may convert into either an LLP or an LLC, but conversion into an LLP is far more common.

Conversion to an LLP. Converting a general partnership into an LLP does not require formation of a new entity or transfer of any assets, but rather requires only that the partnership file a simple registration form with the Secretary of State and pay a

\$500 fee (plus \$500 each year thereafter to maintain LLP status). The form includes the employer identification number, the name and address of the partnership, the profession in which the partnership engages, the names of each of the partners who practice a profession in Massachusetts at the time of filing, and a statement that the firm complies with the liability insurance requirements of the applicable regulating board. The form may also include the names of one or more partners who are authorized on behalf of the LLP to execute deeds and other recordable instruments affecting real property. In the case of law firms, the registration must be accompanied by a certificate of good standing from the SJC for each partner. The words “Registered Limited Liability Partnership,” “Limited Liability Partnership” or “Professional Limited Liability Partnership” or the letters “L.L.P.” or “LLP” must also be added to the partnership’s name, and this name change reflected on the letterhead and business cards of the firm. Because some of the default provisions of the Mass. UPA contemplate personal liability for all partners, the firm’s partnership agreement should be reviewed to see if any changes should be made regarding liability and indemnification provisions. Prior to registration, a law firm should also amend its partnership agreement to add the provisions required by SJC Rule 3:06(2) relating to the control and ownership of the firm by properly licensed lawyers.

Conversion to an LLC. When a general partnership is converted into an LLC, a new entity must be formed, specified assets and liabilities transferred, and a form of operating agreement prepared and signed. Provided that certain requirements of the Code are met (see “D. Tax Issues - 1. Formation” below), such a conversion should not,

however, ordinarily result in adverse federal tax consequences. The name of the new entity must contain the words “limited liability company,” “limited company,” or the abbreviation “L.L.C.,” “L.C.,” “LLC” or “LC.”

#### **D. BASIC TAX ISSUES**

The following summary of the principal federal and Massachusetts tax issues affecting LLCs, LPs and LLPs assumes that such entities are treated as partnerships rather than as corporations for tax purposes. Since the effective date of the “Check-the-Box” Regulations on January 1, 1997, most of the complicated issues which were formerly associated with whether such entities would qualify for partnership tax treatment have been resolved. See Section B.4 of this outline above. As used in this summary, the word “partnership” generally refers to an LLC, an LP or an LLP, and the word “partner” generally refers to the members of an LLC or the partners of an LP or an LLP. As long as the entity itself is treated as a partnership for tax purposes, the applicable provisions of federal and Massachusetts tax law and regulations generally do not distinguish among those types of entities and their respective owners. Instead, federal and Massachusetts tax law and regulations consistently use the terms “partnership” and “partner” irrespective of the legal status of the entity and its owners for state law purposes.

1. Formation. No gain or loss is generally recognized to a partnership or any of its partners in connection with the contribution of cash or property to the partnership in exchange for an interest in the partnership. (I.R.C. § 721(a)). However, certain property

transfers between a partner and the partnership may be characterized as a sale or exchange of property and not as a nontaxable contribution and distribution. (See I.R.C. § 707(a)(2)). The basis of property received by a partnership in exchange for an interest in the partnership is generally the same as that of the contributing partner. (I.R.C. § 723).

A partner's initial basis in the partner's interest in the partnership is equal to the amount of money and the adjusted basis of property contributed by the partner to the partnership. (I.R.C. § 722). Any increase in a partner's share of partnership liabilities, or any increase in the partner's personal liabilities by reason of the partner's assumption of any partnership liabilities, is considered a contribution of money by such partner to the partnership, thereby increasing that partner's basis. (I.R.C. § 752(a)). A partner's share of recourse liabilities equals the extent to which such partner bears the economic risk of loss for that liability. Reg. § 1.752-2(a). Partners generally share nonrecourse liabilities in accordance with their interests in partnership profits. Reg. § 1.752-3(a).

2. Method of Taxation. As a "pass-through" entity, a partnership is not a taxable entity for federal or for Massachusetts purposes. Instead, it serves as a conduit through which various items of income, gain, loss, deduction and credit are passed to its partners. This is true whether the partnership actually distributes property or cash to partners. Thus, income from the partnership's operations is taxable to the partners, at the federal and Massachusetts rates applicable to the partners, regardless of whether such income is actually distributed.

In a partnership, profits and losses may be allocated differently to different partners provided the tax allocations meet the “substantial economic effect” test of I.R.C. 704. Reg. § 1.704-1(b) sets forth several “safe harbors” with respect to such allocations which will not be challenged by the IRS. Only the partnership form allows this flexibility in deciding which owners will absorb the entity’s tax benefits or burdens, which is a major difference between a partnership and an S Corporation.

3.     Nonliquidating Distributions. In the case of a distribution by a partnership to a partner, gain is generally not recognized by the partner except to the extent that the amount of the distribution exceeds the adjusted basis of such partner’s interest in the partnership immediately before the distribution. (I.R.C. § 731.) Any decrease in a partner’s share of the liabilities of a partnership is considered a distribution to the partner. (I.R.C. § 752(b)). With certain exceptions, unlike in the case with a corporation, a partnership’s distribution of appreciated property is generally not a taxable event.

4.     Limitations on Losses. A partner’s losses from partnership operations are limited to the partner’s tax basis in the partner’s interest in the partnership. (I.R.C. § 704(d)). Losses which a partner cannot use currently can be carried forward for use in other tax years. However, as described above, a partner’s tax basis may include a portion of the debt incurred by the partnership. This makes it possible for a partner to recognize losses for tax purposes allocated to such partner by the partnership which are in excess of the partner’s cash investment in that partnership.



5. “At Risk” Rules. Special limitations govern the deductibility of partnership losses from almost all activities, including real estate activities. (See I.R.C. § 465.) Losses from these activities are limited to the amount which a partner has “at risk” in the activity, namely the amount contributed by the partner plus any borrowed amounts for which the partner is personally liable or which are secured by other property of the partner.

With respect to real estate held by a partnership, a taxpayer is also considered at-risk for “qualified nonrecourse financing” which is secured by the real property (I.R.C. § 465(b)(6)). “Qualified nonrecourse financing” is generally nonrecourse financing borrowed from a government instrumentality or a “qualified person” with respect to such real property. A “qualified person” is a person or entity engaged in the activity of lending money (such as a bank) that is not related to the taxpayer (except where the loan is commercially reasonable), is not the seller of the property, and does not receive a fee with respect to the partnership’s investment in the property.

6. Passive Loss Rules. Another limitation on the deductibility of losses is the passive activity loss limitation rules in Code § 469. Under § 469, a partner will generally not be able to offset against income from other sources “passive losses” (those losses resulting from an activity in which the taxpayer does not materially and actively participate) except to the extent that the partner has “passive income” (income derived from other passive activities). Thus, where a partner does not materially participate in the conduct of the partnership’s business, the partner will generally not be able to offset

losses from that business against other income unless such other income is from passive sources. The taxpayer may, however, offset such “suspended” passive losses against other income in the year in which the partnership is terminated or the taxpayer disposes of his interest in the partnership.

7. Taxable Year. Subject to certain limited exceptions, the taxable year of a partnership must conform (in order of priority) to: (i) the taxable year of one or more of its partners who have an aggregate interest in partnership profits and capital of greater than 50 percent; (ii) the taxable year of all its principal partners; or (iii) the calendar year. This usually means that a partnership must have a calendar fiscal year if a significant portion of its partners consist of either individuals or entities with calendar fiscal years. (I.R.C. §706(b)).

8. Liquidation and Dissolution. With certain exceptions, no gain or loss is recognized by a partnership upon a distribution to a partner. (I.R.C. § 731 (b)). Gain is generally not recognized by a partner upon receipt of a distribution upon liquidation of a partnership except to the extent that such distribution exceeds the partner’s adjusted basis in the partner’s interest immediately before the distribution. (I.R.C. § 731 (a)). To the extent a partner’s share of a partnership liability (including a nonrecourse liability) is reduced, the partner will be deemed to have received a distribution from the partnership. (I.R.C. § 752(b)). As a result, partners in partnerships holding leveraged real estate or other assets may incur significant “phantom income” (without corresponding cash

distributions) if title to such real estate or other assets is transferred to lenders through foreclosure.

Loss may generally be recognized by a partner upon receipt of a distribution in liquidation of a partnership to the extent of the excess of the partner's adjusted basis in the partner's interest in the partnership over the amount received in liquidation. (I.R.C. § 731 (a)).

#### **E. BASIC OPERATIONAL ISSUES**

Because of the great flexibility available under Massachusetts law for LLCs, LPs and LLPs, the selection of the appropriate form of entity and the preparation of the organizational documents require a thorough review with the owners or sponsors about how they anticipate and desire their entity's operations to be conducted. The following are certain of the major operational issues which must be reviewed and reflected in both the choice of entity and the organizational documents:

1. Business and Liabilities. Will the entity be organized for a specific purpose (such as to acquire, develop, operate and ultimately sell a specific real estate project) or for the conduct of a more general business? What liabilities to creditors of the entity are likely to arise as a result of such anticipated business? To which extent will those creditors (in particular, bank lenders and lessors of real estate) demand personal guaranties from at least certain of the owners or their affiliates?
2. Management and Control. Will the entity's business be managed by one or more managers or by the owners themselves and, if by the owners themselves, will

there be a management committee and/or certain owners to whom management functions will be delegated? If there will be one or more managers, will the other owners still want to be able to participate to some extent in the control of the business, or will the limited voting and consent rights permitted to limited partners in an LP by §19 of the Mass. ULPA be sufficient?

3. Organizational and Operating Costs. Under the Massachusetts statutes governing LLCs and LPs, the use of an LLC requires a \$500 initial filing fee and a subsequent \$500 annual fee, whereas the use of an LP requires only a \$200 initial filing fee and no subsequent annual fee. Will any advantages which the LLC form may have over the LP form in light of the anticipated operations of the entity (including in particular the rights of all of the owners of an LLC to take part in the control of the business) justify the payment of such higher fees? If an LP form will be used, does a suitable corporation or LLC already exist which will serve as the general partner, or will it be necessary to incur additional organizational and operating costs in connection with the formation and operation of an entity which will serve as general partner?

4. Capital and Liability of Owners. What will be the amount and terms of the initial capital contributions by the owners? Will some or all of the owners be obligated to provide additional funds through, for example, making loans, providing personal guarantees, or making additional capital contributions under certain circumstances? Will any of the owners be required or permitted to make capital contributions in a form other than cash and, if so, how will such contributions be valued

and any unrealized appreciation associated with them be treated for economic and tax purposes?

5. Anticipated Term. Will the entity in effect have a perpetual life and, if not, under what circumstances will it be dissolved and liquidated?

6. Distributions and Allocations. Under what circumstances will the owners be entitled to receive distributions? Must all distributions be made in cash? How will such distributions be allocated among the respective owners? In particular, will the manager (if any) be entitled to share in such distributions in a manner (in particular, through the provision of a “carried interest” to the sponsor) which will not be in proportion to the manager’s respective capital contributions?

7. Tax Matters. How will profits and losses for tax purposes of the entity be allocated among the owners? How will any disputes with applicable tax authorities arising from the entity’s operations be resolved?

8. Withdrawal and Replacement of a Manager. Will the manager (if any) be permitted to withdraw voluntarily from the entity? Under what circumstances can the manager be removed by the other owners? What will be the manner of replacing the manager in the event of a voluntary or involuntary withdrawal?

9. Transfer of Ownership Interests. Under what circumstances will the owners have the right to assign their interests in the entity? What restrictions (if any) will be placed upon the admission to the entity of an assignee of such interests as a substitute member or partner?

10. Fiscal Matters. What will be the fiscal year of the entity? Will the entity's books and financial statements be maintained on an accrual or cash basis?

11. Informational Matters. What rights will the respective owners have to receive reports and other information from the entity? Will audited financial statements be prepared and delivered?

12. Amendments. What will be the procedure for amending the operating or partnership agreement of the entity? In particular, what consents of the existing owners will be required in order to admit additional owners of the same class of interests (and/or owners of a different class of interests) which will result in the "dilution" of the ownership interests of the existing owners?

#### **F. DRAFTING CONSIDERATIONS**

1. General Considerations. After the basic operating issues (including in particular those described in the preceding section of this outline) have been resolved, the appropriate form of entity can be selected and a draft of its organizational documents prepared. While available forms or copies of organizational documents for entities engaged in similar businesses are helpful, significant modifications will be required in almost all cases to reflect differences in the relevant facts, the objectives of the owners, and changes which have occurred in applicable law and regulations (especially changes in the Code and IRS Regulations) since such other documents were prepared.

2. Sample Organizational Documents. Attached to this outline are two sets of sample organizational documents (one for an LP and one for an LLC). The assumed facts upon which these documents are based upon are as follows:

A. The Limited Partnership – Maritime Lane Limited Partnership.

(i) Shipshape Yachts, Inc. (“Shipshape”) has leased for several years from Winthrop Landowner a boatyard (the “Boatyard”) at 100 Maritime Lane in Marblehead, Massachusetts. Because Mr. Landowner desires to move to California and open a vineyard, he has decided to sell the Boatyard, and Shipshape has negotiated and entered into a purchase and sale agreement (the “Purchase Agreement”) with him at a price of \$1.0 million (which Shipshape believes to be a favorable price). Shipshape plans to finance \$600,000 of such amount through a mortgage loan (the “Mortgage Loan”) and needs approximately \$500,000 of equity capital to finance the balance of the purchase price and to pay related fees and expenses (including, among others, the transaction costs of acquiring the Property, obtaining the Mortgage Loan, and forming a new limited liability entity (“NewCo”) to raise the equity capital).

(ii) The president of Shipshape and four of his friends and business acquaintances (collectively the “Investors”) have agreed to the following terms with respect to NewCo: (a) Shipshape will assign the Purchase Agreement to NewCo and NewCo will purchase the Boatyard

from Mr. Landowner; (b) Shipshape will lease the Boatyard from NewCo under a 10-year lease (the “Lease”) providing for rent sufficient to provide on a quarterly basis a 12% cumulative annual return (the “Priority Return”) on the \$500,000 cash investment by the Investors in NewCo; (c) the manager of NewCo will be Boatyard Management, Inc. (“BMI”), which is a corporation with minimum net worth controlled by the President of Shipshape; (d) when NewCo ultimately sells the Boatyard, the net proceeds will be distributed to the Investors in an amount equal to their \$500,000 cash investment and any deficiency in their 12% Priority Return; and (e) any remaining net proceeds from such sale will then be distributed 70% to the Investors, 1% to BMI, and 29% to Shipshape.

Under these assumed facts, the principals decide that an LP rather than an LLC is the preferred form of legal entity for NewCo primarily because the principals believe that any potential advantages of an LLC over an LP under the assumed facts would not justify the higher filing fees. As an LP, NewCo is required to pay only an initial \$200 (rather than a \$500) filing fee and there will be no subsequent \$500 annual filing fees. Since BMI, a suitable corporate general partner for NewCo, already exists, there are no additional fees in forming and maintaining an additional limited liability entity to serve as the general partner of NewCo. Although as general partner, BMI will be liable for all of NewCo’s obligations, this is not a significant problem since BMI has minimal assets. Furthermore, BMI’s liability on the Mortgage Loan could be eliminated by providing in



the documents for the Mortgage Loan that such loan is non-recourse if the lender is willing to make the loan on that basis and, if the lender is not willing to make the loan on a non-recourse basis, the lender may also require a guarantee from Shipshape whether NewCo is an LP or an LLC.

Irrespective of whether NewCo is an LP or an LLP, the investors will have limited liability as either limited partners or members. Because NewCo is an LP, the partners will be prohibited from participating in the control of NewCo's business. However, NewCo won't conduct an active business but rather is being formed to own a real estate asset. Therefore, the voting and consent rights (as permitted by §19 of the Mass. ULPA) with respect to certain matters (including any amendment of the terms of the Lease and any sale of the Boatyard) are sufficient for the investors.

B. The LLC – Maritime Images, LLC.

(i) After a period of successful ownership of the Boatyard, the president of Shipshape and two of the investors in Maritime Lane Limited Partnership decide to set up a new business to distribute and sell maritime maps and photographs. In addition to investing \$100,000 each, all three of them want to actively participate in the business. Although they believe \$300,000 of capital will be sufficient to launch the business, they want to build in the possibility of contributing additional capital as the business grows and perhaps admitting new investors and managers, all potentially at a different "pre-money" valuation than used in connection with forming NewCo.

(ii) In addition to providing for the potential for raising new capital and the admission of new investors, the three principals want the organizational documents of NewCo to provide for various features which are more common to a corporation actively conducting a business rather than an entity formed solely to make a real estate investment. In particular, they want to provide for pre-emptive rights in connection with subsequent offerings of equity interests in NewCo, a “take-along” right should one of the three original principals want to sell his interest, and a “drag-along” right should two of the original principals want to sell the business

Under these assumed facts, primarily because of the desire of all three principals to actively participate in the business of NewCo, the principals decide that an LLC rather than an LP will be used despite the higher initial and subsequent filing fees for an LLC. Because the members and managers of an LLC have limited liability under the Mass. LCC Act, the principals elect to serve individually as the initially managers of NewCo rather than having a separate entity serve as general partner. The Operating Agreement of NewCo provides for the potential admission of additional members and managers, for pre-emptive rights, and for first-refusal, take-along and drag-along rights similar to those in the organizational documents of many corporations which conduct active businesses similar to that to be conducted by NewCo.

## ENTITY OVERVIEW OF GENERAL PARTNERSHIPS AND JOINT VENTURES

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### **A. SUMMARY OF RELEVANT STATUTES AND ENTITY TYPES**

1. Massachusetts Partnership Law. General partnerships organized under Massachusetts law are governed by the Massachusetts Uniform Partnership Act (the “Mass. UPA”) (G.L. c. 108A). In addition to “domestic” general partnerships organized under Massachusetts law, general partnerships organized under the laws of other states may conduct business in Massachusetts. There is no requirement under the Mass. UPA that such “foreign” general partnerships qualify to do business in Massachusetts by making filings with the Secretary of the Commonwealth as is required for foreign limited liability companies (“LLCs”), limited partnerships (“LPs”), or limited liability partnerships (“LLPs”). However, as in the case of domestic general partnerships, the Mass. UPA does not provide any limitation on the liability of the partners of a foreign general partnership conducting business in Massachusetts.

For “domestic” general partnerships, the Mass. UPA provides as follows:

Organization. A general partnership consists of an association of two or more persons or entities to carry on as co-owners a business for profit. (G.L. c. 108A, §6). A general partnership may be formed either by agreement or by conduct of the parties, express or implied. Although no written agreement is required to form a general

partnership, it is usually desirable to have a written partnership agreement in order to clearly state the respective rights and duties of the partners to each other.

Management. In the absence of an agreement to the contrary, each partner has an equal voice in the management and control of the partnership and, in the event of a disagreement, a numerical majority of the partners would control. (G.L. c 108A, §18). This general principle may be varied by agreement by, for example, providing that the voting rights of the respective partners will be in proportion to their respective capital contributions to the partnership and/or that certain management rights and responsibilities will be delegated to one or more managing partners or a management committee of the partners.

Liability of Owners. Under §15 of the Mass. UPA, each partner in a general partnership has either joint or joint and several personal liability for all of the partnership's obligations. However, newly admitted partners are personally liable only for the partnership's obligations which arise after their admission, and retired partners are generally liable only for the partnership's obligations arising prior to such partners' withdrawal. (G. L. c. 108A, §§17 and 36).

Continuity of Existence. When any partner ceases to be a partner of a general partnership, whether through withdrawal, expulsion or death, a technical dissolution of the partnership occurs. (G. L. c. 108A, §§29 and 31). Dissolution may also be caused by a number of other events, such as a court decree. However, the partnership agreement of a general partnership may provide that the partnership will be reconstituted

and its affairs continued by the remaining partners (sometimes upon an affirmative vote of a specified percentage of the remaining partners) in the event of a dissolution of the partnership arising from events such as withdrawal or death of a partner.

Transferability of Interests. Partners in a general partnership have three types of property rights: (i) rights in specific partnership property; (ii) interests in the partnership (i.e., their respective shares of partnership capital and profits); and (iii) rights to participate in management (G.L. c. 108A, §25). A partner's interest in the partnership (i.e., his share of the partnership capital and profits) may be assigned but, in the absence of agreement by the other partners, the assignment does not entitle the assignee to participate in the management or administration of the partnership business or to require any information or account of partnership transactions or to inspect the partnership books. In the case of professional firms organized as general partnerships, the rights of assignment are further limited because of the licensing requirements applicable to the partners of such partnerships.

2. Joint Ventures. Although the term “joint venture” is often used to refer to a general partnership organized for a specific purpose, the term is also sometimes used to refer to a legal entity other than a general partnership which is organized for a specific purpose. Accordingly, in addition to being organized as a general partnership, a “joint venture” may also be organized as an LLC, an LP, an LLP, or a corporation. To the extent that a legal form other than a general partnership is selected for purposes of a joint venture, the principal characteristics of such joint venture will be as described in other

portions of this manual. See, in particular, “I. ENTITY OVERVIEW OF LLCs, LPs AND LLPs.” Because the principal characteristics of legal entities other than general partnerships are described in other portions of this manual, the references to “joint ventures” below in this outline assume that such joint ventures have been organized as general partnerships.

## **B. CIRCUMSTANCES IN WHICH GENERAL PARTNERSHIPS OR JOINT VENTURES MAY BE SUITABLE**

Because a general partnership does not provide any limited liability protection to its partners, a general partnership will usually be a suitable form of entity only if the owners of such entity conclude that their potential liability arising from the entity’s operations will not be a significant concern or, if they do have some concern about such potential liabilities, that the benefits of using a limited liability entity will not be sufficient to justify the formalities and costs associated with forming and operating a limited liability entity. All forms of limited liability entities available in Massachusetts require the preparation and filing of organizational documents and the payment of fees to the Secretary of the Commonwealth. Such minimum fees are currently: a \$500 initial fee and a \$500 annual fee for an LLC or an LLP; a \$200 initial fee and no annual fee for an LP; and a \$200 initial fee and an \$85 annual fee for a corporation (although a corporation, unlike an LLC, LP or LLP, must also pay at least a minimum annual tax to Massachusetts). The use of a general partnership may avoid the payment of such fees and the public disclosure regarding the entity which occurs as a result of the required filings.

Some examples of circumstances in which the use of a general partnership may be suitable are as follows:

1. Investment Entities. Except under relatively rare circumstances (such as the possible violation of applicable securities laws), an entity organized solely to invest in the securities (exclusive of general partnership interests) of other issuers is not subject to significant risks of liability to third parties arising from such investment activities.

Because the investment entity will itself have the benefit of the limited liability status of the entities in which it will invest, the principal risk to the owners of the investment entity is therefore that their respective capital contributions will be lost if the entity's investments are not successful. Although the LP and LLC forms are also common for investment entities, investment entities are therefore sometimes organized as general partnerships, particularly if the number of investors in the investment entity will be small and they have a significant prior relationship with each other. However, even if an investment entity is organized as a general partnership, it is still desirable to negotiate and prepare a partnership agreement to set out the rights and obligations of the respective partners, and the procedures and costs of preparing tax filings for the entity and the partners do not differ significantly from those which would be encountered if the entity had been organized in a limited liability form.

2. Entities Involving Solely Limited Liability Entities. In some cases, it may be advantageous for parties proposing to enter into joint ventures to create their own limited liability entities and then have the joint venture consist of a general partnership

between those entities. For example, the joint development of a software program by two companies may not involve significant potential liabilities to third parties while the program remains in the development stage, but the two companies may want to establish their own wholly-owned subsidiaries to which they will respectively contribute the necessary intellectual property and capital required for the program's development. The joint venture agreement between the two subsidiaries will then spell out in detail the respective rights and obligations of the two partners therein.

3. Entities With Only Limited Activities. In some cases, the owners of partnerships or ventures with only limited activities (or with a short anticipated term) may decide that the potential benefits from the use of a limited liability entity do not justify the organizational and operating costs involved. For example, two brothers practicing public accounting together without a written partnership agreement may conclude that their potential benefits from having a professional corporation (a "PC") or an LLP will not justify the related formalities and costs. This assumes that the only significant potential liabilities which the brothers now anticipate will arise from their accounting practice are rent and equipment lease obligations (for which the lessors will require their personal guarantees in any event) and malpractice exposure (for which they will maintain malpractice insurance). However, the costs of organizing and maintaining either a PC or an LLP are not significant. In light of our currently litigious business climate (such as the possibility that a client of one of the brothers will sue the firm for malpractice in an amount in excess of the insurance now available at reasonable costs),



the brothers would be well advised to consider carefully whether the use of a PC or LLP might be more advisable in their situation.

### **C. BASIC TAX ISSUES**

Under federal and Massachusetts tax law and regulations, general partnerships are treated as “pass-through” entities. This means that the general partnership is itself not taxed but rather that the partners thereof are taxed as if the partnership’s items of income, loss, deduction and credit were earned or incurred directly by the partners. The tax treatment of general partnerships is generally the same as for LLCs, LPs and LLPs which qualify for treatment as partnerships rather than as corporations for tax purposes. See “I. ENTITY OVERVIEW OF LLCs, LPs and LLPs - D. Basic Tax Issues.”

### **D. BASIC OPERATIONAL ISSUES**

The basic operational issues associated with LLCs, LPs and LLPs described above under “ENTITY OVERVIEW OF LLCs, LPs and LLPs - E. Basic Operational Issues” are also generally relevant to general partnerships. However, because general partnerships do not provide limited liability for their partners and are therefore not suitable for raising capital from passive investors, the operational issues associated with establishing the appropriate relationship between the sponsor and the investors in a limited liability entity are not relevant to a general partnership. Instead, a general partnership normally involves a limited number of partners who will structure the partnership agreement for their partnership in a manner which reflects their own objectives and the limited purpose for which the partnership is being formed.

## **E. DRAFTING CONSIDERATIONS**

Except for certain provisions which are relevant to protecting the limited liability of the limited partners in an LP (principally those provisions delegating authority and control of the LP's business exclusively to a general partner and prohibiting the limited partners from participating in the control of the LP's business), the issues associated with drafting a general partnership agreement are similar to those involved in preparing the operating agreement of an LLC or the partnership agreement of an LP. See "ENTITY OVERVIEW OF LLCs, LPs and LLPs - F. Drafting Considerations." However, because of certain differences between a general partnership and an LLC or LP, certain drafting issues correspondingly arise. These issues involve, in particular, the provisions relating to the purpose and operation of the general partnership, the obligation of the partners to make capital contributions, and the provisions relating to withdrawal of a partner and the dissolution or continuation of the partnership.

With respect to the purpose and operation of the partnership, the partnership agreement must describe carefully how much authority will be delegated to any managing partner and when and how the consents of other partners must be sought for business decisions (in particular, decisions relating to borrowing money or entering into leases by the partnership for which the other partners will be liable). With respect to the obligations of the partners to make capital contributions, the partnership agreement must describe carefully the amount, timing and nature of the partners' obligations, but the partnership agreement will not need to address the numerous issues which must be

addressed in the operating or partnership agreement of an LLC or LP associated with raising capital from investors and describing the relationship of the manager with the investors. With respect to the withdrawal of a partner and the dissolution or continuation of the partnership, as described above under Section A. 1 of this outline, a general partnership technically dissolves when any partner ceases to be a partner whether through withdrawal, expulsion or death, and dissolution may also result from other circumstances such as a judicial decree. (G. L. C. 108A, §§ 29 and 31). Upon the dissolution of a general partnership, liquidation of the partnership's assets would normally occur unless the partnership is reconstituted and its business continued by agreement of the partners. Except in the case of a general partnership which is intended to dissolve upon the death or withdrawal of one of the partners, it is therefore essential that the partnership agreement accurately describe the procedures which will be followed in the event of a technical dissolution of the partnership.