The National Agricultural Law Center

Business Organizations Reading Room

Limited Liability Partnerships

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Introduction

A limited-liability partnership is a partnership in which a partner is not responsible for acts committed by another partner or by an employee not under that partner's supervision. Every state as well as the District of Columbia has enacted some form of legislation allowing for the creation of this business entity. This type of business organization is normally used with professionals such as attorneys and accountants who share office space and staff, but do not wish to be liable for the actions of other partners, however it may be used in virtually any type of business.

Formation

To form a limited-liability partnership the members must file the requisite papers and pay a fee to the state agency that registers new business entities. Unlike a sole proprietorship or a general partnership, a limited-liability partnership cannot be created without filing the necessary paperwork with a state agency. The agency in charge of registering and creating new businesses varies from state to state and a list of these agencies and their contact information may be found at the National Agricultural Law Center under Forms and Filing Information: Business Organizations. In addition to filing the necessary paperwork, some states require that the LLP buy and maintain an insurance policy that will cover the obligations of the business in case it fails or is otherwise unable to meet its financial burdens.

Liability

Liability protection is one of the primary benefits of the LLP over the general partnership, but the liability protection provided by the LLP structure varies significantly throughout the country. In some states the protection afforded by a LLP is slight and only protects against the misconduct of other partners, specifically excluding protection from contracts entered into by those partners. Other states' LLP statutes provide limited protection from another partner's errors, mistakes, misconduct, or incompetence. These states are called "partial shield statute" states, because the protection that they provide does not cover the most important risk to the partners- the personal liability that they risk for business debts. States that were late-adopters of the LLP form of business, were much more likely to extend protection from personal liability to partners even for debts incurred by the business. These states are often called “full shield statute” states and often protect the partners from personal liability of the debts of the business no matter how the debts were incurred. Because of the wide range in liability protection between the states it is important to carefully examine the law of the state in which the business is to be formed.

Other issues, such as personal liability for the actions of employees, may also be important. The general rule is that the partner in direct control and supervision of the employee is personally liable for that employee’s actions. A final potential problem that confronts partners in a LLP is whether or not the partnership will do business outside of their state. A LLP formed in a “full shield statute” state may not have the complete protection afforded to it by that statute if it does business in a different “partial shield statute” state. Because of the various factors that influence whether a partner in a LLP will be personally liable for actions of other partners, employees, or for the debts and responsibilities of the partnership, many businesses chose to form a limited-liability company or a corporation to avoid much of this. The relative newness of the LLP form of business structure also causes problems when determining liability, because there is little case law in existence. Whatever case law exists is limited in value because many states’ LLP statutes vary significantly from one another.

Example: Consider a group of attorneys who want to cut down on overhead costs. To do this they file the necessary papers to create a limited-liability partnership with the state in which they plan to practice. The new group of partners then goes out to find an office building to rent and staff to hire (secretaries, janitors, etc…) and split the costs amongst themselves. The attorneys typically do not work together and may even oppose one another in the courtroom. If one attorney in the partnership is sued for malpractice, none of the other attorneys are responsible for his actions.

Tax Structure

The tax structure for limited liability partnerships are exactly like those of the general partnership. Because the formation of an LLP requires the filing of papers with a state agency, the limited liability partners will often draft some form of partnership agreement. In the absence of such an agreement than profits and losses (as well as the tax burdens and benefits associated with them) are dispersed according to the ownership percentages in the business. If the LLP has adopted a partnership agreement than the partners can agree to a special allocation for tax purposes, however such a decision should be reviewed by an attorney. If the partners wish to make a special allocation of profits and losses that is not tied directly to their ownership percentage than the IRS will closely scrutinize the transaction. The special allocation must have a “substantial economic effect” on the LLP and the tax regulations provide the details on what will satisfy this test.

Termination

The default rule for any form of partnership is that the partnership will dissolve at the loss of one partner. The default rule for dissolution can be overridden by express agreement of the partners before any partner leaves or passes away. If the partnership agreement specifically states that the business is to carry on until, for example, they meet a certain objective, until a certain amount of time has passed, or the number of partners fall below a set minimum number; or almost any other conceivable measurement as long as that is set forth in the partnership agreement.

Conclusion

A limited-liability partnership is essentially a partnership in which a partner is not responsible for acts committed by another partner or by an employee not under that partner's supervision. The LLP business structure provides several benefits over the general partnership, but there are questions about the effectiveness of some of the protections that the LLP provides. The actual application of the LLP laws within a state are typically less definitive than general partnership law because of the relative newness of this business structure. Because the business structure is new there is no body of case law in existence for attorneys to predict outcomes of certain events that occur during the LLP's operation.