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WHAT NEW HAMPSHIRE CPAs AND EAs SHOULD KNOW ABOUT LIMITED LIABILITY

EXECUTIVE SUMMARY

Whether they know it or not, most of our clients need statutory liability shields. In theory, the liability shields provided by all of the various types of New Hampshire limited liability entities are essentially the same. However, for important practical reasons, the LLC shield is the best.

DISCUSSION

1) Types of New Hampshire business entities that confer limited liability on their owners. New Hampshire law confers statutory limited liability on the owners of four main types of business entities (referred to collectively in this newsletter as "limited liability entities"). The types of entity owners who are entitled to limited liability under New Hampshire are:

   a) The partners of limited liability partnerships ("LLPs);

   b) The limited partners of limited partnerships;

   c) The shareholders of corporations; and

   d) The members of LLCs.

2) Types of New Hampshire business entities that do not confer limited liability. Two main types of New Hampshire entities do not confer limited liability on their owners—namely, sole proprietorships and general partnerships. And under New Hampshire law, liability shields are not provided to the general partners of limited partnerships.

3) What is a liability shield? What do we mean when we say that persons who are owners of limited liability entities have statutory liability shields? We mean that if the entities owned by these persons are sued, the owners' personal assets—e.g., their homes and any stocks and other personal property they may own—will not be at risk in the suit unless, in general, these owners have been personally responsible for the actions or omissions resulting in the suit.

4) Who needs a liability shield? The theory relevant to answering this question is complex, but the answer is simple: Every business owner who has co-owners or who uses employees or independent contractors in his or her business needs a liability shield.

5) Are all New Hampshire liability shields equal? In theory, the answer to this question is yes. However, there are two main exceptions to this general statement:

   a) Full vs. partial liability shields. First, while the liability shields afforded by LLCs, corporations and limited partnerships are "full" shields, the shields afforded by LLPs are only "partial" shields. In other words, LLC shields, corporate shields and limited partnership shields protect the owners of these three types of entities from claims based on negligence, contract breaches, statutory breaches and every other possible ground. By contrast, LLPs protect their owners only from claims based on negligence and other personal misconduct and not from contract claims, statutory suits or other common types of claims. This means, in general, that in New Hampshire, it is not smart to use an LLP to conduct a business.

   b) The superiority of the LLC shield over the corporate shield. Second, although in theory the liability shield afforded by corporations is as strong as the LLC liability shield, in practice the LLC shield is stronger. This is because in veil-piercing claims against corporations—that is, claims that seek to hold shareholders liable for the actions of their corporations—plaintiffs' lawyers often argue that these shareholders should not benefit from their corporate liability shields because their corporation does not comply with corporate statutory formalities (e.g., the adoption of bylaws, the issuance of share certificates, and the holding of annual shareholder and director meetings). These arguments can be harmful to the many small corporations that do not have good minute books. However, the New Hampshire LLC Act *does not impose* statutory formalities on LLCs. Thus, plaintiffs' lawyers cannot use a "statutory noncompliance" argument in veil-piercing cases against LLC members.

6) Practical consequences. The above theoretical considerations lead to some very practical conclusions:

   a) New businesses should be formed as LLCs. Business people who are forming new businesses and who want the strongest liability shield available under New Hampshire law should form their businesses as LLCs.

   b) Existing sole proprietorships and general partnerships should convert to LLCs. Business people who conduct existing businesses as sole proprietorships or general partnerships—neither of which provides either a full or a partial liability shield—should convert their businesses to LLCs as soon as possible.

   c) Existing LLPs, limited partnerships and corporations should consider converting to LLCs. Business people who conduct their businesses as LLPs, limited partnerships or corporations should seriously consider converting these businesses to LLCs. It is a matter of cost-effectiveness. Under New Hampshire law, entity conversions are generally simple, quick and relatively cheap, and they will generally have no adverse tax consequences. If a particular conversion is not unduly costly in professional fees, filing fees or internal administrative inconvenience, why not do it?

d) General partners of limited partnerships should transfer their general partnership interests to single-member LLCs. As mentioned above, under New Hampshire law the general partners of limited partnerships lack liability shields. To obtain such a shield, most or all of these general partners, whether they are individuals or entities, should transfer their general partnership interests to single-member LLCs.

7) Limited liability vs. liability insurance. Which is more important to business people—good business liability insurance or a strong liability shield? This can be a hard question to answer. I sometimes advise certain of my clients that if they have to choose between buying liability insurance and paying me to form a limited liability entity for them, they should choose the insurance. But liability insurance policies often have loopholes in them, and sometimes the judgments that plaintiffs win against businesses exceed the business owners' liability policy limits. So for most clients, the best answer to the question is this: Get both.