

**JOHN CUNNINGHAM'S LLC NEWSLETTER
FOR TAX AND LEGAL PROFESSIONALS**

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**NOW THAT LLCs ARE AVAILABLE, SHOULD
NEW HAMPSHIRE BUSINESS PEOPLE EVER USE
LIMITED PARTNERSHIPS?**

EXECUTIVE SUMMARY

The enactment of the New Hampshire Limited Liability Company Act has made limited partnerships all but obsolete in New Hampshire. However, there are a few practical, legal and tax reasons why at least a small number of New Hampshire business people may find limited partnerships preferable to LLCs.

DISCUSSION

- 1) Limited partnerships—introduction. A limited partnership is a partnership that has at least one general partner and one limited partner. To form one, you have to file a “certificate of limited partnership” with the New Hampshire Secretary of State. In general, only the general partner of a limited partnership may sign contracts for the limited partnership and deal on its behalf with third parties. Every general partner of a limited partnership has unlimited personal liability for limited partnership debt.

New Hampshire law has provided for limited partnerships since 1916, and its current limited partnership act was enacted in 1988. By contrast, the New Hampshire Limited Liability Company Act (the “LLC Act”) was not enacted until 1993, and LLCs only became widely useful for New Hampshire businesses in 1997, when the Check-the-Box Regulations became effective and the LLC Act was amended to take advantage of those regulations.

- 2) Principal similarities between limited partnerships and LLCs. There are many significant similarities between limited partnerships and LLCs under New Hampshire law and from a federal tax viewpoint. For example, both limited partnerships and LLCs provide “charging order protections”—powerful statutory asset protections that corporations do not provide. And the default federal income tax classification of both limited partnerships and LLCs under the Check-the-Box Regulations is that of partnerships taxable under Internal Revenue Code Subchapter K.
- 3) Principal difference between limited partnership and LLCs. However, LLCs have so many important legal advantages over limited partnerships that, for almost all New Hampshire business people, the limited partnership form has become obsolete. For example:

- a) Liability shield. All of the members of an LLC have a strong liability shield. Only the limited partners of a limited partnership have a liability shield, and these limited partners can easily lose the protections provided by this shield if they misstep—for example, by participating too much in the conduct of the limited partnership’s business.
 - b) Single member vs. multiple members. As noted, limited partnerships must have at least two partners—namely, at least one general partner and at least one limited partner. LLCs need have only a single member. This means, among other things, that if either a general partner or a limited partner in a two-partner limited partnership ceases being a partner—e.g., because of death—the limited partnership will automatically be dissolved and must be wound up unless it quickly obtains a replacement partner. By contrast, if a two-member LLC loses a member, this will have no effect whatsoever on the LLC’s continuity of life.
 - c) The limited partnership/general partnership link. Limited partnership law is a combination of general partnership statutory law and limited partnership statutory law, and sometimes it can be difficult to determine which statute governs—the general partnership statute or the limited partnership statute. This potential source of statutory confusion does not exist for LLCs.
- 4) Does it ever make sense to use a limited partnership instead of an LLC for a New Hampshire business start-up? Given the above strong legal advantages of LLCs over limited partnerships, are there any situations in which it may still make sense for New Hampshire business people to use limited partnerships in start-up businesses? I can think of only the following situations:
- a) Limited partnerships as investment vehicles. Limited partnerships have traditionally been used as investment vehicles, and many investors are more comfortable with limited partnerships than with LLCs for this purpose. Thus, from a purely marketing viewpoint, it may sometimes make more sense to use a limited partnership than an LLC in an investment venture.
 - b) The “statutory passivity” of limited partners. The default statutory rules of the Limited Partnership Act are generally more pro-manager than the default rules of the LLC Act. Business promoters who want their investors to have as little power in their investment entities as possible may thus prefer the limited partnership form to the LLC form. (However, failure to disclose the relative lack of management power of limited partners can, in some situations, give rise to significant federal or state securities law hazards.)
 - c) State and Canadian tax considerations. The tax laws of a few states and, apparently, Canada, may in some circumstances be more favorable to limited partnerships than to LLCs.
 - d) Estate planning discounts. A few estate planning professionals believe that limited partnerships can provide better discounts than LLCs (though many other estate planning professional disagree with this belief).
 - e) Charging order protections—the *Catamount Construction* case. There is a New Hampshire Supreme Court case (called “*BayBank v. Catamount Construction*”)

that provides strong judicial support for the validity of limited partnership charging order protections. There is no such New Hampshire case with regard to LLC charging order protections. (However, because the charging order provisions of the Limited Partnership Act and the LLC Act are essentially identical, I have little doubt that a New Hampshire court would view the *Catamount Construction* case as conclusive in interpreting the LLC Act.)

- f) Self-Employment Tax considerations. Internal Revenue Code Section 1402(a)(13) can be read as providing that all limited partnership income allocated to a limited partner is automatically exempt from Self-Employment Taxation. One could argue that the complicated IRS rules under Prop. Reg. § 1.1402(a)-2 (the “Prop. Reg.”) that determine the Self-Employment Tax liability of LLC members don’t apply to limited partners; and I somewhat doubt that the IRS would seek to apply the Prop. Reg. to limited partners. (However, I believe if a limited partner does not meet the Prop. Reg. SET tests, he or she faces at least a modest SET audit risk. Why run that risk if you don’t have to?)
- 5) Should existing New Hampshire limited partnerships convert to LLCs? There are presently at least a couple of thousand active New Hampshire limited partnerships. In light of the above discussion, should some or all of them convert to LLCs? (Under New Hampshire law, such a conversion is relatively easy and inexpensive to accomplish.) Here are my thoughts in regard to this question:
 - a) Protecting the general partner. If the general partner of a New Hampshire limited partnership is an individual, he or she will automatically obtain a strong liability shield if the limited partnership converts to an LLC. However, it will normally be much easier and cheaper to provide the general partner with this shield if the general partner simply forms a single-member LLC and contributes his or her general partnership interest to it.
 - b) The greater administrative simplicity of LLCs. On the other hand, it is cumbersome to manage a limited partnership through a single-member LLC general partner, and this can create liability risks. Thus, assuming that the legal and tax professionals who assist a limited partnership are willing to accomplish the limited partnership’s conversion to an LLC for professional fees that are reasonably affordable, the fact that LLCs are easier to administer than limited partnerships may justify a limited partnership’s conversion costs.