



LAW ADVOCATE GROUP, LLP

9701 Wilshire Blvd. Suite 1000 Beverly Hills, CA 90212

Phone: 310-651-3065 Fax: 310-601-7110

www.LawAdvocateGroup.com

Doron F. Eghbali Business Formation Law

[Nuts and Bolts of Limited Partnerships](#)

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Limited Partnerships are one of the forms of entities available to form in California. Limited Partnership offers limited partners limited liability to the extent of their investment in the business. Nonetheless, Limited Partnership has several salient drawbacks. This article explores the building blocks of Limited Partnerships, its formation, taxation and some of the drawbacks associated with such business entity.

WHAT ARE THE DISTINGUISHING CHARACTERISTICS OF LIMITED PARTNERSHIPS?

- General Partnership is formed regardless of partners intending to create one as long as there is an association of two or more co-owners to carry on a business for profit. On the other hand, LIMITED PARTNERSHIP MAY BE ORGANIZED only if, a CERTIFICATE of Limited Partnership is FILED with CA Secretary of State on a form PRESCRIBED by CA SECRETARY OF STATE.
- Both GP and Limited Partnership require at least 2 partners to be treated as partnership for tax purposes. Nonetheless, for Limited Partnership, there must be at least 1 limited partner.
- For Limited Partnership, only general partners may be held jointly and severally liable while the limited partners, as the name correctly indicates, have only limited liability with some exceptions.

SOME PREDOMINANT ADVANTAGES OF LIMITED PARTNERSHIP, GENERALLY

- Enables owners to avoid double taxation of entities taxed at both corporate and individual level
- Enables owners to divide or allocate profits or losses not directly tied to their percentage of ownership interest
- Enables owners to place management in the hands of a few, presumably expert hands
- Enables passive investors (limited partners) from general liability risk for the liabilities of the enterprise



SOME PREDOMINANT DISADVANTAGES OF LIMITED PARTNERSHIP, GENERALLY

- Limited Partner is still subject to passive loss limitations rules for federal income tax purposes. IRC §469(h)(2).
- Both Limited Partner and General Partner have relatively greater exposure to general liability by virtue of their participation in partnership affairs. Thereby, being left bereft of a wide shield that is available to shareholders of a corporation or members of Limited Liability Company irrespective of their membership or shareholder status.
- Simply put, Limited Partnerships are not the most prudent option for relatively simple, non-sophisticated enterprises.

SOME BASICS OF LIMITED PARTNERSHIP TAXES

BASICS OF FEDERAL TAXES

- For Federal Tax Purposes, a Limited Partnership is NOT a separate tax-paying entity. Accordingly, Limited Partnership is NOT subject to tax at the entity level. IRC §701.
- This means Partners, limited and general, reported their respective distributive shares of partnership income, loss, gain, deduction and credit on their individual federal income tax returns. This is the so called “Pass-Through” treatment.

HOW TO PROTECT GENERAL PARTNERS AGAINST PERSONAL LIABILITY

If practitioner still wants to form a Limited Partnership and wants to protect General Partners should seriously consider establishing a Corporation OR Limited Liability Company as General Partner.

Nonetheless, forming a Corporation and a Limited Liability Company as a General Partner of a Limited Partnership would require spending additional financial resources.

WHEN LIMITED PARTNERS COULD BE HELD PERSONALLY LIABLE?

The GENERAL rule is Limited Partners are NOT liable beyond their capital contributions in the Limited Partnership. Nonetheless, the following offer some circumstances under which a Limited Partner could be held personally liable:

- Limited Partner MAY be required to return distributions received from the Limited Partnership at a time the Limited Partnership is deemed to lack sufficient assets to satisfy its liabilities. Corp C §15905.09.
- Limited Partner MAY be held liable personally for satisfying a debt to a third party creditor or Limited Partnership.



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Limited Partner MAY be held personally liable for the debts and obligations of the Limited Partnership if the Limited Partner “actively” participates in management and control of the Limited Partnership. See Corp C §15903.03(a).

HOW TO FORM LIMITED PARTNERSHIP

Certificate of Limited Partnership MUST be filed with CA Secretary of State on the form prescribed.

The Limited Partnership is considered formed on the date the certificate is filed.

PARTNERSHIP INCOME TAX RETURN

1. SCHEDULE K-1 (1065)

- Generally, a partnership MUST file a partnership information return (IRS Form 1065) with the IRS for each year it receives income or incurs expenditures allowable as deductions.
- The partnership must file a return on or before the 15th day of the 4th month following the end of each taxable year. An automatic extension may be obtained for 5 months by filing IRS Form 7004.

2. FRANCHISE TAX BOARD

Form 565 – Schedule k-1 (565)

Every partnership doing business in CA must file a annual partnership return (Partnership Return of Income i.e. FTB Form 565) with the Franchise Tax Board.

- The partnership must file a return on or before the 15th day of the 4th month following the end of each taxable year. An automatic 6-month extension could be obtained.

DISCLAIMER

This article NEITHER supplants NOR supplements the breadth and depth of such esoteric topic. In fact, this article ONLY provides a rather RUDIMENTARY synopsis of such esoteric subject matter.

***DORON EGHBALI** is a Partner at the Beverly Hills Offices of Law Advocate Group, LLP. Doron Primarily Practices Business, Real Estate and Entertain ment Law. Doron Can Be Reached at: 310-651-3065. For More information, Please, Visit: HERE.*