

Business Law

Text & Exercises *6th Ed.*

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Chapter 29: Sole Proprietorships, Partnerships, and Limited Liability Companies

Learning Outcomes

LO1

- **Describe doing business as a sole proprietorship.**

LO2

- **Identify the features of a general partnership.**

Learning Outcomes

LO3

- Outline the elements of a limited partnership.

LO4

- List the advantages of limited liability companies.

Sole Proprietorship

- **The simplest form of business in which the owner is the business. A sole proprietor reports business income on his or her personal income tax return and is legally responsible for all debts of the business.**

Sole Proprietorships

- **Advantages:**
 - Proprietor receives all profits.
 - Less costly to startup.
 - Taxed once.
- **Disadvantages:**
 - Proprietor bears all liability.
 - Limited opportunity for raising capital.
 - Business is dissolved upon death.

Partnership

- **Definition:** association of two or more persons to carry on, as co-owners, a business for profit.
- **Elements:**
 - Sharing of profits and losses.
 - Joint ownership of the business.
 - Equal rights in the management of the business.

Partnership

- **Characteristics:**
 - Independent entity.
 - Aggregate of the individual partners.
 - Pass-through income and loss.
- **Formation. →**

- **Formation: partnership is formed by agreement of the parties.**
 - Can be formed by estoppel (persons who are not partners, represent they are to third parties). →
- **Partnership by Agreement:** can be oral, but some agreements must be written under Statute of Frauds. Called articles of partnership.

Partnership Formation

- **Partnership by Estoppel:** occurs when a party who is not a partner represents himself as such to third persons, who rely on the representations.
 - Or, when a partner represents that a nonpartner is a partner. The nonpartner is regarded as an agent whose acts are binding on the partnership.



Partnership Formation

- **Partnership by Estoppel:**
 - Third person relies on representation that the nonpartner was part of the partnership.
 - Partners (and the nonpartner) are liable to third party and estopped (prevented or barred) from denying that the nonpartner is a partner.

Partnership Formation: Rights

Basic Structure	<ol style="list-style-type: none"> 1. Name of the partnership. 2. Names of the partners. 3. Location of the business and the state law under which the partnership is organized. 4. Purpose of the partnership. 5. Duration of the partnership.
Capital Contributions	<ol style="list-style-type: none"> 1. Amount of capital that each partner is contributing. 2. The agreed-on value of any real or personal property that is contributed instead of cash. 3. How losses and gains on contributed capital will be allocated, and whether contributions will earn interest.
Sharing of Profits and Losses	<ol style="list-style-type: none"> 1. Percentage of the profits and losses of the business that each partner will receive. 2. When distributions of profit will be made and how net profit will be calculated.
Management and Control	<ol style="list-style-type: none"> 1. How management responsibilities will be divided among the partners. 2. Name of the managing partner or partners, and whether other partners have voting rights.
Accounting and Partnership Records	<ol style="list-style-type: none"> 1. Name of the bank in which the partnership will maintain its business and checking accounts. 2. Statement that an accounting of partnership records will be maintained and that any partner or her or his agent can review these records at any time. 3. The dates of the partnership's fiscal year and when the annual audit of the books will take place.
Dissolution	<ol style="list-style-type: none"> 1. Events that will dissolve the partnership, such as the retirement, death, or incapacity of any partner. 2. How partnership property will be valued and apportioned on dissolution. 3. Whether an arbitrator will determine the value of partnership property on dissolution and whether that determination will be binding.
Arbitration	Whether arbitration is required for any dispute relating to the partnership agreement.



Partnership Formation: Rights

- **Management in the Partnership.**
- **Compensation.**
- **Inspection of the Books.**
- **Partner's Interest:** personal asset consisting of proportional share of profits and return of capital. Partner's personal creditors can sue for that interest.



Partnership Formation: Rights

- **Partnership Property:** partner may use or possess partnership property only on behalf of the partnership.
 - A partner is not a co-owner of partnership property and has no interest in the property that can be transferred. Partnership property is owned by the partnership as an entity and not by the individual partners.



Duties and Powers of Partners

- **Fiduciary Duties:** partners are fiduciaries of each other, based on extraordinary trust and loyalty.
 - Good Faith, Duty of Care to partners and partnership.
 - May pursue personal rights as long as fiduciary duties are not violated.
- **Agency Powers:** partners are general agents of the partnership.

Duties and Powers of Partners

- **Joint and Several Liability:** third party may sue one or more of the partners separately or all of them together, at his option.
 - If third party is successful, he may collect judgment only against assets of those partners sued.
 - Partner who commits tort resulting in judgment against partnership is required to repay damages to the firm.

Partner's Dissociation

- **Dissociation:** severance of the relationship between a partner and a partnership when the partner ceases to be associated with the carrying on of the partnership business.
- **Events Causing Dissociation.**



Partner's Dissociation

- **Effects of Dissociation:**
 - Right to have interest purchased by the partnership.
 - Right to participate in the management and conduct of the partnership business ends, along with the duty of loyalty.
 - For up to two years, dissociated partner (and firm) may be liable to third party for obligations.
 - Partnership should notify its creditors of the dissociation, and file a statement of dissociation in the appropriate state office.

Partnership Termination

- **Acts of Partners.**
- **Operation of Law.**
- **Judicial Decree.**

Winding Up

- **Once a partnership is dissolved, it continues to exist legally until the process of winding up all business affairs (collecting and distributing the firm's assets) is complete.**

Limited Partnership

- **Elements:** one or more general partners (who manage the business and are liable to the full extent of their personal assets for debts of the partnership) and one or more limited partners (who contribute only assets and are liable only up to the amount contributed by them).
- **Benefit:** limited liability to limited partners up to investment.



Limited Partnership

- **General Partner:**
 - In a limited partnership, a partner who assumes responsibility for the management of the partnership and liability for all partnership debts.



Limited Partnership

- **Limited Partner:**
 - In a limited partnership, a partner who contributes capital to the partnership but has no right to participate in the management and operation of the business. The limited partner assumes no liability for partnership debts beyond the capital contributed.



Limited Liability Partnership

- **Limited Liability Partnership (LLP):**
 - A form of partnership that allows professionals to enjoy the tax benefits of a partnership while limiting their personal liability for the malpractice of other partners.

Family Limited Liability Partnership

- **Business organization in which the majority of the partners are persons related to each other, essentially as spouses, parents, grandparents, siblings, cousins, nephews, or nieces.**
 - A person acting in a fiduciary capacity for persons so related could also be a partner.

Limited Liability Limited Partnership

- **A type of limited partnership. The difference between a limited partnership and an LLP is that the liability of the general partner in an LLP is the same as the liability of a limited partner in a limited liability partnership.**



Limited Liability Company

- **LLC:** hybrid form of business enterprise that offers the limited liability of the corporation but the tax advantages of a partnership.
- **Advantages:**
 - Profits pass through and taxes are paid individually.
 - Liability is limited to a member's investment.



LLC Advantages

- **Advantages:**
 - Managers need not be members.
 - Corporations, partnerships, and foreign investors can be members.
 - No limit on members.
 - Flexibility of a simple operating agreement.