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A PRIMER ON MANITOBA LIMITED PARTNERSHIPS

By Michael A. Choiselat, with assistance from Laura C. Workman (Articling Student-at-law)

The purpose of this article is to briefly describe:

- the benefits of the limited partnership as a form of business organization; and
- the benefits of choosing Manitoba as the jurisdiction of formation for a limited partnership.

Benefits as a Business Organization

The most widely used forms of formal business organization in Manitoba are general partnerships, limited partnerships and corporations.

A general partnership is formed by two or more persons carrying on a business in common with a view to profit. It has the following basic characteristics:

- A partner in a general partnership has unlimited liability for the debts of the partnership. In other words, the assets of the partners are exposed to seizure;
- Profits and losses of the partnership are allocated directly to all of the partners for taxation purposes;
- Any partner may participate in the management and control of the partnership business.

A corporation is a legal entity created by statute, which exists separate from its shareholders. It has the following basic characteristics:

- A shareholder's exposure to the liabilities of the corporation is limited to its capital contribution (i.e. the amount which it paid for its shares);
- Profits and losses of the corporation do not flow directly to the shareholders, but rather are first taxed within the corporation;
- Shareholders do not participate in the management and control of the business of the corporation, except to the extent a unanimous shareholder agreement requires the approval of the shareholders for certain material matters.

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A limited partnership is also a creature of statute; however, it does not exist separately from its partners. A limited partnership consists of one or more general partners and one or more limited partners. It has the following basic characteristics:

- A general partner is analogous to a partner in a general partnership, except that it typically does not share in the profits of the partnership. This partner manages the business of the limited partnership and has unlimited liability for its debts and obligations;
- A limited partner's exposure to the liabilities of the partnership is limited to its capital contribution, much like a shareholder in a corporation. Limited partners may not participate in the management or control of the partnership business without losing their limited liability protection;
- Profits and losses of the partnership flow directly to the limited partners. As a result, partnership losses can be used by limited partners to off-set their other income. The *Income Tax Act* (Canada) provides that limited partners can deduct their share of investment tax credits, business losses and property losses to the extent of their "at-risk amount". This amount is defined in the *Income Tax Act*. Losses that a partner is unable to use to offset other income in the year that such losses were accrued may be carried forward indefinitely and applied to off-set future limited partnership income;
- A limited partner also has the right to more extensive information regarding the partnership than a minority shareholder typically would have with a corporation. Further, pursuant to the governing legislation, a limited partner may demand the return of all or part of its capital contribution by giving six months' notice to its partners (although the limited partnership agreement could provide otherwise). Not all minority shareholders have a right to redeem their shares.

As a result, to the extent an investor in a business desires the tax benefits of a partnership structure, but requires the liability protection afforded by a corporate structure, a limited partnership structure may be appropriate.

However, as illustrated above, an investor in a business carried out through a corporate or limited partnership structure sacrifices control over the management of the business, and therefore loses some control over its investment, in exchange for limited liability protection. This is typically addressed by requiring that the investor approve certain material acts of the corporation or limited partnership, pursuant to the terms of a unanimous shareholder agreement or limited partnership agreement, as the case may be. However, in the case of a limited partnership, this may result in the loss of limited liability protection.

Benefits of Manitoba as the Jurisdiction of Formation

Provincial legislation governing limited partnerships is relatively uniform among all of the Provinces and Territories of Canada, except Manitoba and Quebec. Pursuant to the legislation of all of the other Provinces and Territories, a limited partner loses its limited liability status, and becomes liable as a general partner, when it takes part in the management or control of the business of a limited partnership. In other words, to the extent a creditor of a limited partnership can demonstrate that a limited partner was involved in the management or control of the limited partnership's business, that limited partner has unlimited liability for the debts and obligations of the limited partnership.

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In Manitoba, if a limited partner takes an active part in the business of a limited partnership, the limited partner will be liable for the debts of the limited partnership as a general partner only to a person whom it deals with on behalf of the partnership and who does not know that it is a limited partner.

Therefore, three criteria must be satisfied for a limited partner in a Manitoba limited partnership to be generally liable for the debts of the partnership:

1. The limited partner must take an active part in the business of the partnership (this is all that must be established under the legislation of the other Provinces and Territories, in order for a limited partner to lose its limited liability status);
2. The limited partner must deal with a third party on behalf of the partnership; and
3. The third party must not know that the partner with whom it is dealing is a limited partner.

These latter two conditions are unique to Manitoba and greatly limit the circumstances in which a limited partner can lose its limited liability protection.

Further, under Manitoba law, liability extends only between the time the limited partner first dealt with the third party and the time when the third party acquired actual knowledge that it was dealing with a limited partner.

As mentioned above, most limited partnership agreements require the approval of the limited partners before the limited partnership, or the general partner on behalf of the limited partnership, can perform certain material acts. This type of provision is designed to protect the limited partner's investment in the limited partnership. For this reason, it is highly desirable to a limited partner.

Pursuant to the limited partnership legislation of the Provinces and Territories other than Manitoba, the exercise of a limited partner's rights under this type of provision potentially amounts to the limited partner taking part in the management or control of the business of the partnership, which results in the loss of its limited liability protection.

Consider the example of a general partner, for and on behalf of its limited partnership, borrowing money from a lender, with the approval of the limited partners pursuant to the provisions of their limited partnership agreement. Assume that the limited partnership is formed outside of Manitoba. If the limited partnership defaults on the loan, the lender may have recourse to the assets of the limited partners because, by approving the loan, they took part in the control or management of the business of the partnership.

If the partnership in the above example was a Manitoba limited partnership, the lender would have no claim against the assets of the limited partners as they had no direct dealings with the lender on behalf of the limited partnership. Further, even if a limited partner had negotiated the loan on behalf of the limited partnership, if it advised the lender of its limited partner status, it would maintain its limited liability protection.

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Canadian jurisprudence on the issue of what constitutes “control” or “taking part in management” is largely unhelpful in clarifying the threshold over which a limited partner would lose its limited liability status. There are relatively few cases which have considered the issue and no clear rules have been established. Rather, courts have treated the issue as a question of fact to be decided on a case by case basis.

Although the Manitoba legislation is more forgiving than the relatively uniform legislation of each of the other Provinces and Territories in respect of the role a limited partner can take in the control or management of the partnership’s business, it can be less forgiving in other circumstances. Persons who wish to form a limited partnership, or who currently operate a business through a limited partnership, should be sure to retain experienced counsel to advise them in respect of all limited partnership matters.

If you would like more information on this topic or wish to discuss issues of a legal nature, [Michael](#) can be contacted by phone at 204.934.2557 or by e-mail at mac@tdslaw.com.

For assistance with this or any other business matter, please contact any member of the TDS [Business](#) Practice Group.

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