

Limited Partnerships – Dangers for Unwary Limited Partners

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Limited Partnerships are unique investment vehicles that provide investors with certain benefits attributable to partnerships and corporate entities. Limited Partnerships have the flow through attributes of partnerships (the ability to “flow” net profits and net losses to the partners) while affording limited partners limited liability similar to that of shareholders (exposure is limited to limited partners contribution to the Limited Partnership).

The following are three of the more common traps we see in our practice.

1. Inclusion of a Surname or Distinctive Part of Corporate Name

We sometimes see a distinctive part of the corporate name of one or more of the limited partners incorporated into the name of the proposed limited partnership, contrary to the Act.¹ The inclusion of a surname or distinctive part of a limited partner’s corporate name in the name of the limited partnership will cause that limited partner to lose its limited partner status. This means that the limited partner will be liable as a general partner to any creditor that does not have actual knowledge that the limited partner is not a general partner.² If including a limited partner’s name is vital to the project’s success, there are ways to reduce the risk of losing limited partner status.

2. Taking Part in the Control of the Business

One of the underlying features of limited partnerships is that a limited partner has limited liability. This limited liability status is based on the limited partner being a passive investor. If the limited partner is considered to take part in the control of the business of the limited partnership, it will lose its limited partner status.³

Most limited partnership agreements contain provisions specifically prohibiting limited partners from taking part in the management or control of the business of the limited partnership. Despite this, the agreement may also contain conflicting provisions. For example, there may be a provision that requires the general partner to obtain the consent of the limited partners for

¹ Section 6(1) — The surname or a distinctive part of the corporate name of a limited partner shall not appear in the firm name of the limited partnership unless it is also the surname or a distinctive part of the corporate name of one of the general partners.

² Section 6(2) — Where the surname or a distinctive part of the corporate name of a limited partner appears in the firm name contrary to subsection (1), the limited partner is liable as a general partner to any creditor of the limited partnership who has extended credit without actual knowledge that the limited partner is not a general partner.

³ Section 13(1) — A limited partner is not liable as a general partner unless, in addition to exercising rights and powers as a limited partner, the limited partner takes part in the control of the business.

fundamental business decisions. Another example is a provision that enables limited partners to provide input into annual business plans. Limited partners must understand that increased input equals increased exposure. Limited partners must balance these competing interests.

Many First Nation communities value limited partnerships primarily because of their positive tax attributes (preservation of tax status for off reserve income). For others, tax attributes are of less importance than having active input into business decisions.

3. Common Directors, Officers and Employees

Limited partners sometimes appoint one or more directors (or senior officers or employees) of the limited partner to act as directors (or senior officers or employees) of the general partner. The strategy here is often to obtain a level of control over the general partner.

Limited partners should be extremely careful in using this kind of strategy. If its determined that directors (or senior officers or employees) are not acting in their capacity as directors (or senior officers or employees) of the general partner, but are acting on behalf of a limited partner, the limited partner could be found to be indirectly taking part in the management or control of the business of the limited partnership.

While limited partnerships provide certain industries with an attractive vehicle for their projects, limited partners must take care not to lose the beneficial attributes of limited partnerships due to a lack of understanding of the Act.

If you are looking to structure, or invest in, a limited partnership we would be happy to provide you with advice to ensure positive results.

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