

# CaseStudy

## USING A LIMITED LIABILITY PARTNERSHIP AS THE ENTITY OF CHOICE

A NEW TYPE OF ENTITY THAT HAS APPEARED in the United States in recent years is the limited liability partnership (LLP) or registered limited liability partnership (RLLP). This entity is similar in many respects to the limited liability company (LLC). All states now have LLP statutes.

### Differences Between LLCs and LLPs

LLPs are special general partnerships (or limited partnerships in some instances) that exist under state law. LLPs arose in response to the personal liability problems faced by partners in law and accounting partnerships as a result of the many malpractice claims related to thrift and financial institution failures in the early 1990s.

In some states, partners in an LLP are personally liable for the commercial and other general obligations of the partnership and for their own errors and omissions and the errors and omissions of persons under their supervision, but they are not liable for errors and omissions by their partners or by employees under another partner's supervision.

However, in most states, LLP partners have the same blanket liability protection as LLC members. LLP partners in these states are not liable for the commercial or other obligations of the partnership but remain liable for their own errors and omissions or those of employees under their supervision. (See the exhibit for a summary of the LLP liability protection available in each state.)

Because partners in an LLP generally enjoy a higher degree of limited liability than that enjoyed by partners in a general or limited partnership, many state statutes require LLPs to carry a specific amount of liability insurance. This amount can be as much as several million dollars.

The administrative burdens of converting an existing partnership to an LLP or adopting LLP status for a professional practice (for example, meeting the state board of accountancy rules) are minimal in comparison to converting to or forming an LLC.

### Key Tax and Nontax Considerations

LLPs are general partnerships under state law with modifications regarding personal liability. (Limited partnerships can also be LLPs in some states.) Consequently, LLPs have the benefits as partnerships.

**Formation:** Unlike the formation of an LLC, which generally requires filing articles of organization and drafting an operating agreement, an existing partnership usually can become an LLP by filing a registration statement. No amendment

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of the agreement is otherwise required. While the fee for filing an LLC's articles of organization is usually minimal, the fee for registering an LLP can be significant, particularly when the fee is a function of the number of partners.

**Insurance requirements:** As previously mentioned, some states require LLPs to maintain a specific amount of liability insurance. The cost of maintaining such coverage may be substantial. However, partnerships formed to conduct a professional services business, such as an accounting firm, will generally carry significant amounts of malpractice insurance anyway.

**Liability for debts:** In many states, partners in an LLP and members in an LLC enjoy the same type of liability protection—i.e., they have no liability for debts of the entity or for the wrongful conduct of another partner or member. In other states, however, an LLP member is protected from liability only for the wrongful conduct of another partner. In such states, an LLP partner remains jointly and severally liable for the LLP's debts and other contractual obligations. Most states provide that the liability protection afforded to a partner in a foreign LLP (i.e., an LLP formed in another state) is governed by the law in the state of formation.

Like other business entities, partners in an LLP may be liable for certain debts of the partnership. For example, the partners may be liable for environmental torts or ERISA claims due to breaches of fiduciary relationship with respect to a qualified plan.

**Provisions of governing laws:** LLPs generally are formed and governed under the provisions of the version of the uniform partnership act adopted by the state of formation. LLCs, on the other hand, are formed and governed under the specific provisions of the state of formation's LLC act. Because different laws govern LLCs and LLPs, there may be significant differences in the rules pertaining to distributions, withdrawals, management, and many other matters. Practitioners should review state law provisions to determine the differences.

**Single-member entities:** An LLP must have more than one member, while an

LLC can have a single member. Under the default rule in the regulations, a single-member LLC is not treated as an entity separate from its owner (Regs. Sec. 301.7701-3(b)(1)(ii)). Alternatively, a single-member LLC can elect to be taxed as a corporation.

### Compliance with State Requirements

It is unclear whether the limited liability available to partners in an LLP disappears if the LLP fails to comply with state requirements. Delaware has recently indicated that an LLP that fails to comply with the state LLP act or the state filing requirements returns to general partnership status (i.e., the partners lose their limited liability protection) (DE Code Ann. §15-1003).

In any event, practitioners should make sure clients forming an LLP know the importance of continued compliance with state requirements.

### LLP Liability Protection by State

The exhibit indicates whether the liability protection available to LLP partners in each state is protection only from vicarious liability (indicated by "Vicarious") or is protection similar to the protection afforded LLC members (indicated by "Comparable").

For example, in many states with comparable coverage for LLP partners, the LLC statute provides that obligations incurred while the partnership is an LLP (whether arising in contract, tort, or otherwise) are solely the obligation of the partnership—i.e., partners are not personally liable, directly or indirectly, by way of contribution or otherwise, for the obligations of the partnership solely by reason of being or acting as a partner.

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### Exhibit: LLP liability protection by state

State	LLP Liability Protection
Alabama	Comparable
Alaska	Comparable
Arizona	Comparable
Arkansas	Comparable
California	Comparable
Colorado	Comparable
Connecticut	Comparable
Delaware	Comparable
District of Columbia	Comparable
Florida	Comparable
Georgia	Comparable
Hawaii	Comparable
Idaho	Comparable
Illinois	Comparable
Indiana	Comparable
Iowa	Comparable
Kansas	Comparable
Kentucky	Comparable
Louisiana	Vicarious
Maine	Comparable
Maryland	Comparable
Massachusetts	Comparable
Michigan	Vicarious
Minnesota	Comparable
Mississippi	Comparable
Missouri	Comparable
Montana	Comparable
Nebraska	Comparable
Nevada	Comparable
New Hampshire	Vicarious
New Jersey	Comparable
New Mexico	Comparable
New York	Comparable
North Carolina	Comparable
North Dakota	Comparable
Ohio	Comparable
Oklahoma	Comparable
Oregon	Comparable
Pennsylvania	Vicarious
Rhode Island	Comparable
South Carolina	Vicarious
South Dakota	Comparable
Tennessee	Vicarious
Texas	Comparable
Utah	Vicarious
Vermont	Comparable
Virginia	Comparable
Washington	Comparable
West Virginia	Vicarious
Wisconsin	Comparable
Wyoming	Comparable

### EditorNotes

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