

Limited Partnerships 101

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LPs have been well recognised internationally for a long time but only became part of New Zealand's corporate landscape relatively recently when the Limited Partnerships Act 2008 (*the Act*) was passed into law. LPs have become more popular over time as people have become more and more familiar with how they work and the benefits they afford to investors.

Key features of LPs

Like companies, LPs are separate legal entities and offer limited liability for their investors but are taxed like partnerships and are “look through” for tax purposes. As a separate legal entity with its own legal personality an LP can own assets, owe liabilities, and can sue and be sued.

The New Zealand Registrar of Companies maintains a register of all LPs established under the Act. An LP is established upon registration with the New Zealand Companies Office and ceases to exist upon deregistration.

An LP is governed by the Act and by its partnership agreement. The partnership agreement must meet certain minimum requirements under the Act, and must be entered into before the LP is registered. In practical terms, on a day to day basis administering an LP is similar to running a company.

Every LP must have at least one general partner (who is either resident in New Zealand or lives in Australia and is a director of an Australian incorporated body corporate) and at least one limited partner. A person cannot be both a general partner and a limited partner of the same LP at the same time.

General partners

The role of the general partner is to manage the business of the LP as its agent. The general partner has full control over the management of the LP, subject to any constraints imposed by the partnership agreement. There is usually only one general partner but there can be more than one general partner.

General partners are jointly and severally liable with the LP for all unpaid debts and liabilities of the LP. Because of the unlimited liability of the general partner, a limited liability company is often incorporated for the special purpose of being the general partner of the LP.

For LPs established to invite people to participate in an investment fund, the general partner is usually a professional management company owned and operated by the fund manager.

Where investors have decided to use an LP for their own closely held business activities, the general partner is often a limited liability company where the shares are held by the limited partners or their affiliates in the same proportion as their respective partnership interests. The partnership interests and shares are usually "stapled", meaning that if any part of a limited partner's partnership interests is sold, the corresponding proportion of shares must also be sold to the same person at the same time.

Limited partners

The limited partners are the investors in the LP and are broadly equivalent to shareholders of a company.

Limited partners provide capital contributions to the LP, usually in exchange for limited partnership units, which are recorded on a LP unit register, in much the same way as shares are recorded on a share register. The amount that limited partners agree to contribute is referred to as committed capital, which can be drawn down by the general partner as and when required, or as set out in the partnership agreement.

Like shareholders in companies, limited partners are only liable up to the amount of their committed capital and will not otherwise be liable for any unpaid debts or liabilities of the LP.

However, limited partners can lose the benefit of limited liability if they participate in the management of the LP. There are a number of safe harbour activities listed in the Act that can be done by limited partners and do not constitute participating in the management of the LP.

Like shares, offers of LP units to the public are within the scope of the Financial Markets Conduct Act 2013, requiring compliance with onerous disclosure requirements unless a specific exclusion applies. We recommend seeking legal advice before offering LP units to any person.

"Look through" tax treatment

The main benefit of utilising an LP as a business structure is the manner in which tax is treated.

LPs are “look through” for tax purposes, which means that profits and losses of the LP flow through to the individual limited partners proportionately to their investment in the LP, for inclusion on their own tax returns. In other words, LPs are taxed at the investor level and not in the LP itself.

This means that losses incurred by an LP can be offset by an investor against any other taxable income of that investor, even if that investor is based overseas. As a result, investors can avoid the double taxation of income that is possible under a company structure, where tax losses are “locked up” until offset by future profits.

This makes LPs very attractive for:

- projects that require investment upfront with returns further down the track, so that the early tax losses can be used by the individual investors (eg movie production or a new horticulture venture);
- overseas investors, who can attribute their share of an LP’s tax losses to themselves in their own jurisdictions; and
- projects where one investor is exempt from income tax (eg by virtue of their charitable status) and one is not.

However, LPs may be less attractive for investments intended to be more “liquid” for investors or for projects forecast to need further investment from third parties (ie new limited partners). Always seek tax advice before committing to an LP structure.

Other tax implications

However, the fact that LPs are taxed like partnerships can also give rise to more complex (and sometimes adverse) tax implications for LPs in some circumstances, particularly when LP units are being issued to new investors or transferred between existing limited partners.

This is because while LP units look like shares that should be easily traded with minimal impact on other investors, they aren’t – LP units actually represent a limited partner’s share in assets that are owned by the LP as an entity, but for tax purposes are treated as being jointly held by all limited partners. Whether or not these implications have a material impact on the LP and its investors usually depends on the nature of the assets of the LP.

Importantly, these complexities are usually issues for the limited partners, not the LP itself.

For these reasons, LPs are typically better suited to more stable business relationships and activities where the parties expect the LP interests to remain fairly unchanged over time or where investment offers are closed off before assets are acquired and begin to appreciate. If investors expect to be able to trade their LP units readily or if there is an expectation that investors will come and go, then depending on the nature of the assets involved, an LP may not be the best option.

Always check with your accountant to see if your plans are consistent with the features of LPs, including the tax consequences of future transactions between existing or new limited partners.

Confidentiality

Another key benefit of LPs is the confidentiality afforded to the identity of limited partners.

The register maintained by the Registrar will disclose the identity of the general partner, but the identity of the limited partners and the content of the partnership agreement are not made available to the public.

Even though the identities of limited partners are not publicly available on the register, LPs and their partners may still need to provide information about themselves to enable parties dealing with the LP to comply with their own AML/CFT requirements (eg banks, accountants, lawyers).

Use of name

All LPs must have the words “limited partnership” or its abbreviations “LP” or “L.P.” at the end of their name.

The rules around how and when an LP needs to use its full legal name are set out in the Act and are very similar to the rules that apply to the use of a company’s name. These rules need to be followed so that third parties can understand which legal entity they are dealing with.

In short, an LP must ensure its name is clearly stated on every written communication sent

by or on behalf of the LP, and on every document issued or signed by the LP that evidences or creates a legal obligation of the LP.

Resolutions of general partners and limited partners

The general partner should record its decisions relating to the management of the LP in resolutions and meeting minutes.

The partnership agreement will usually include a number of matters that require approval by either a special or unanimous resolution of the limited partners. A general partner company may also have a shareholders' agreement with its own set of reserved matters that require special approval.

If the partnership agreement or any shareholders' agreement imposes approval requirements for certain actions, those actions cannot be taken by the general partner until the relevant approval has been obtained. Any resolution by the general partner to take such an action should either record that the approval has been obtained or be subject to obtaining the relevant approval.

Who signs documents and how?

The general partner signs all contracts for and on behalf of the LP, but the entity that is a party to and bound by the terms of the contract is the LP itself.

In other words, all legal obligations of the LP should be in the name of the LP, but signed by the general partner for the LP. For example, if the LP is buying a piece of land, then the "purchaser" is the LP (and not the general partner) but the person who signs the sale and purchase agreement for the LP as purchaser is the general partner.

So the issue becomes, who has authority to bind the general partner?

- Where the general partner is a limited liability company, the usual method of contracting rules for a company apply:
- For an agreement, the person signing on behalf of the general partner has to have express or implied authority to do so.
- For a deed, it has to be signed by the general partner in the same manner as if the

general partner was entering into the deed on its own account (ie by a sole director whose signature is witnessed; if there are two or more directors, by two directors or, if the general partner's constitution allows, by one director or other person(s) authorised by the general partner board to sign the deed whose signature(s) are witnessed

Best practice when entering into a material agreement or deed is that the general partner board resolves to enter into the document for the LP, authorising specific people to sign it for the general partner (eg "any director", or "any two directors", or specifying the name of an employee of the general partner or the LP). Alternatively, the general partner board may choose to adopt a standing delegation policy for the signing of documents for the LP.

Examples of model execution blocks for contracting with an LP are appended to this memo.

Financial reporting obligations

LPs have the benefit of relatively light touch financial reporting obligations. Unless the LP is a public issuer LPs are not required to register their financial statements with the Registrar for public viewing, even if >25% of LP interests are overseas owned.

If the LP is "large" then it must prepare GAAP compliant financial statements and provide them to all partners, but the limited partners can opt out of the requirement to audit those financial statements.

If the LP is not "large" the default financial reporting obligations are minimal. An LP that is not "large" needs to prepare financial statements to a standard sufficient to meet their usual tax and accounting obligations but that are not necessarily GAAP compliant. However, limited partners holding at least 5% of the capital contributions of all partners can opt the LP into preparing GAAP compliant accounts, auditing those accounts, and/or requiring distribution of those accounts to partners.

The "large" test is set out in section 45 of the Financial Reporting Act 2013. Ask your lawyer or accountant if it applies to you.

Annual returns

Like companies, upon registration LPs are assigned a month in which they must file an annual return each year. The annual return of an LP requires confirmation of the publicly

available records of the LP, in particular the general partner's details and addresses for service.

Further information

If you have any questions or would further advice on establishing or administering a limited partnership, please do not hesitate to call your usual CLM contact or reach out to Andy Martin.

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