Unincorporated Organization Acts Committee
Fourth Meeting: March 29, 2021
Fifth Issue

Traditional Loss Sharing Rules Falter

Issue: traditional profit and loss sharing rules, which work fine for a non-LLP general partnership, falter when a non-LLP general partnership with unperformed obligations becomes a limited liability partnership

Assumptions: relevant UPA (2013)[1] provisions are erroneous; for non-LLP status, we should return to the UPA (1997)[2] provisions on partnership accounts

The Problem Exemplified – L & S General Partnership

- duration – three years[3]
- UPA (1997) Section 401 applies throughout
- partnership comes into existence as an ordinary general partnership (non-LLP)
- initial contributions L: 100 S: 50
- no interim distributions[4]
- distributions (and therefore losses) shared equally[5]
- year 1 – non-LLP; loss
- year 2 – LLP; profit
- year 3 – LLP; loss
- partnership becomes an LLP as Year 3 begins

Beginning of Year 1 – Upon Formation

L & S – partners' equity = 150
cash on hand = 150

Partners' Respective Accounts under UPA (1997) Section 401(a)

L	S
100	50
(75)	(75)
25	(25)

[1] UPA (2013), Section 401(a) and (b).
[2] Printed at the end of this document.
[3] For the purposes of this example, it does not matter whether the L & S General Partnership has a three-year term or is an at-will partnership which happens to dissolve at the end of three years.
[4] Default rule from UPA (1997) and (2013).
[5] Default rule from UPA (1997) and (2013).

<u>During Year 1 – Partnership Has Loss of 150</u>

L & S – partners' equity = 0
cash on hand = 0

Partners' Respective Accounts under Section 401(a)

L		S
100	initial amounts, per above	50
(75)	losses shared equally	(75)
25	account balance end of year 1	(25)

(25)

<u>During Year 2 – Partnership Has Profit of 200</u>

L & S – partners' equity = 200
cash on hand = 200

Partners' Respective Accounts under Section 401(a)

L		S
25	account balance end of year 1	(25)
100	profits shared equally	100
125	account balance end of year 2	75

partnership becomes an LLP as Year 3 begins; Section 401(a) continues to apply

<u>During Year 3 – Partnership Has Loss of 200</u>
<u>and Dissolves at End of Year</u>

L & S – partners' equity at dissolution = 0
cash on hand = 0

Partners' Respective Accounts under Section 401(a)

L		S
125	account balance end of year 2	75
(100)	losses shared equally	(100)
25	account balance end of year 1	(25)

Analysis

If the partnership had dissolved at the end of year 1, S would have had a contribution obligation of 25, and L would had received 25 (via the partnership). There would be no reason to "exclud[e] from the calculation charges attributable to an obligation for which the partner is not personally liable under Section 306." Section 807(b).[6]

The situation is different by the end of year 3. Is S's negative balance attributable to year 1 obligations, even though:

- S had a positive balance at the end of year 2; and
- S's negative balances in year 3 results from obligations for which S was not personally liable?

UPA (1997) – Section 401(a) and (b)

SECTION 401. PARTNER'S RIGHTS AND DUTIES.

(a) Each partner is deemed to have an account that is:

(1) credited with an amount equal to the money plus the value of any other property, net of the amount of any liabilities, the partner contributes to the partnership and the partner's share of the partnership profits; and

(2) charged with an amount equal to the money plus the value of any other property, net of the amount of any liabilities, distributed by the partnership to the partner and the partner's share of the partnership losses.

(b) Each partner is entitled to an equal share of the partnership profits and is chargeable with a share of the partnership losses in proportion to the partner's share of the profits.

---

[6] Printed at the end of this document after Section 401(a) and (b)

UPA (1997) – Section 807(a) and (b)

SECTION 807. SETTLEMENT OF ACCOUNTS AND CONTRIBUTIONS AMONG PARTNERS.

(a) In winding up a partnership's business, the assets of the partnership, including the contributions of the partners required by this section, must be applied to discharge its obligations to creditors, including, to the extent permitted by law, partners who are creditors. Any surplus must be applied to pay in cash the net amount distributable to partners in accordance with their right to distributions under subsection (b).

(b) Each partner is entitled to a settlement of all partnership accounts upon winding up the partnership business. In settling accounts among the partners, profits and losses that result from the liquidation of the partnership assets must be credited and charged to the partners' accounts. The partnership shall make a distribution to a partner in an amount equal to any excess of the credits over the charges in the partner's account. A partner shall contribute to the partnership an amount equal to any excess of the charges over the credits in the partner's account but excluding from the calculation charges attributable to an obligation for which the partner is not personally liable under Section 306.