Loss Sharing, Settling Accounts in a General Partnership:

Addressing Imperfections in UPA (1997) & UPA (2013)

Unincorporated Organization Acts Committee

June 10, 2021 Informational Session

Disclaimer #1

"All I say is by way of discourse, and nothing by way of advice. I should not speak so boldly if it were my due to be believed."

Michel de Montaigne

- The Essays of Michael Seigneur de Montaigne: Translated Into English (ed. 1759)

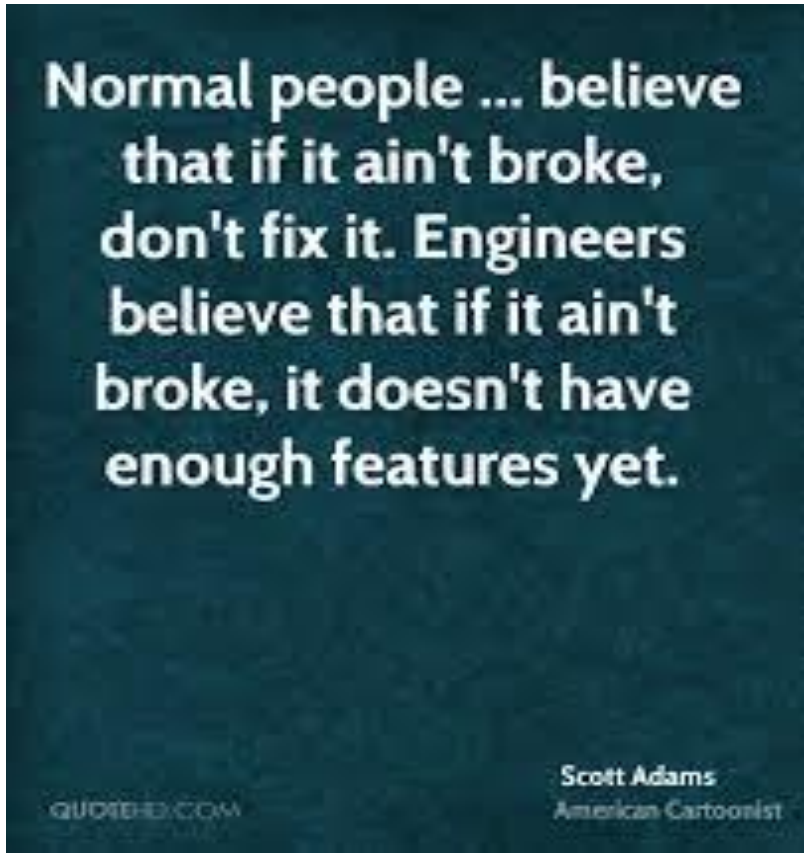
Disclaimer #2

This subject might be straightforward at 10,000 meters, but the mechanics are quite complicated.

If you are new to this material, it will/should give you a headache as you work through it.

If you are experienced with this material, getting back into it will also produce a headache.

Like an engineer's approach to simplicity



Agenda

1. the issue from 10,000 meters
2. introductory concepts
   a. we live and draft for the “default” mode
   b. loss sharing means – partners obligated to contribute funds as necessary to:
      i. fund any unpaid company debts to creditors
      ii. “true up” capital losses (contributions) to fit the loss allocation rules
   c. loss sharing is a strange concept in the world of LLCs and corporations; a full liability shield means no loss sharing
   d. profit allocation is not the same as the right to distributions (“distributive share”)
   e. tax accounting is none of our business
3. profit and loss sharing under UPA (1914)
4. profit and loss sharing under UPA (1997 and 2013) – almost but not quite
5. three questions and answers

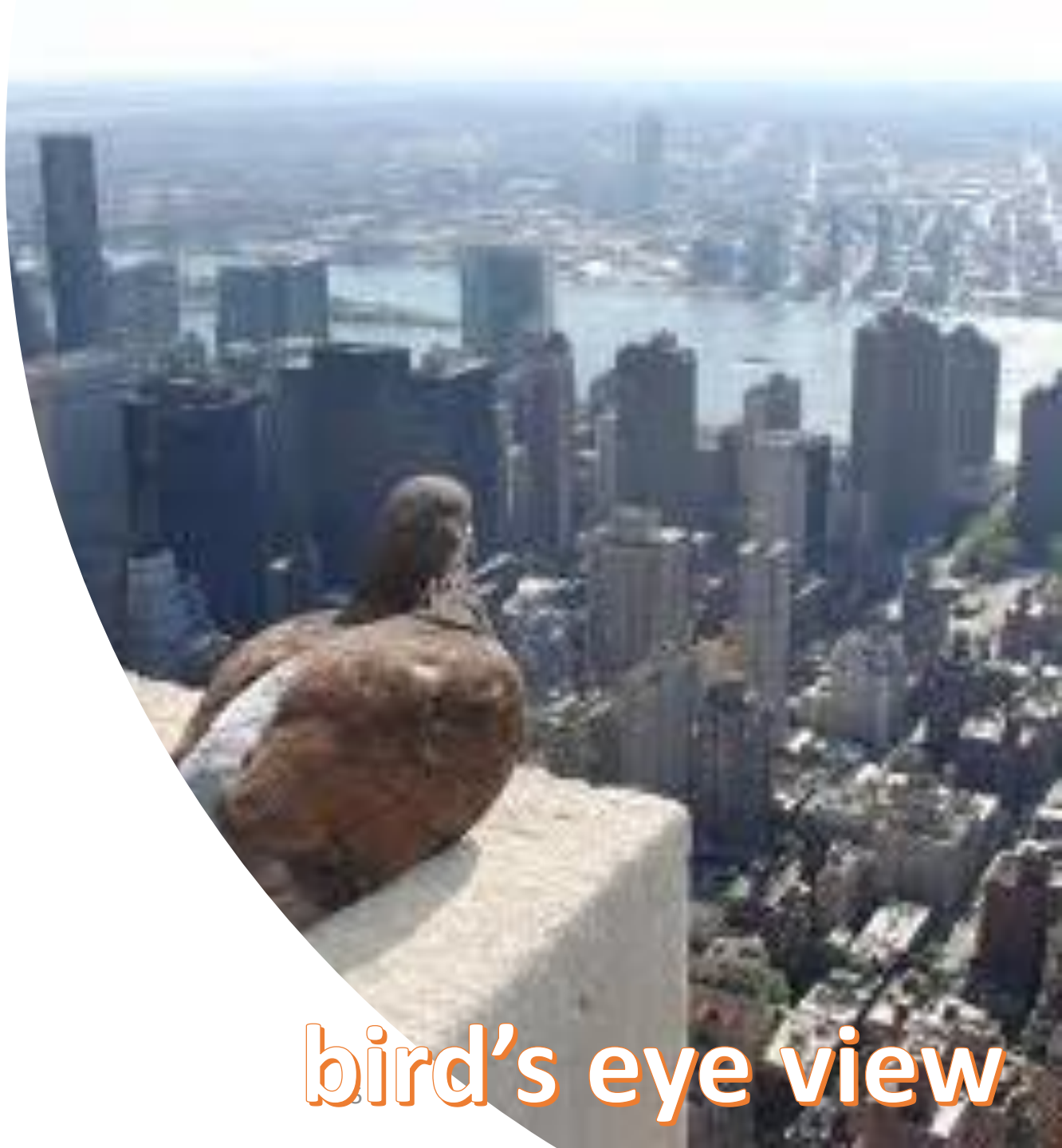
from 10,000 meters

Back in the day

before limited liability partnerships

partnership law and practice had a straightforward set of rules to determine:

- in the event the partnership lost money
  whether insolvent or not
  - as among the partners (*inter se*)
  - how those losses affected each partner



from 10,000 meters

- The advent of the limited liability partnership

partners no longer liable *by status, automatically* for partnership obligations

- loss sharing goes
- **semi-out the window**

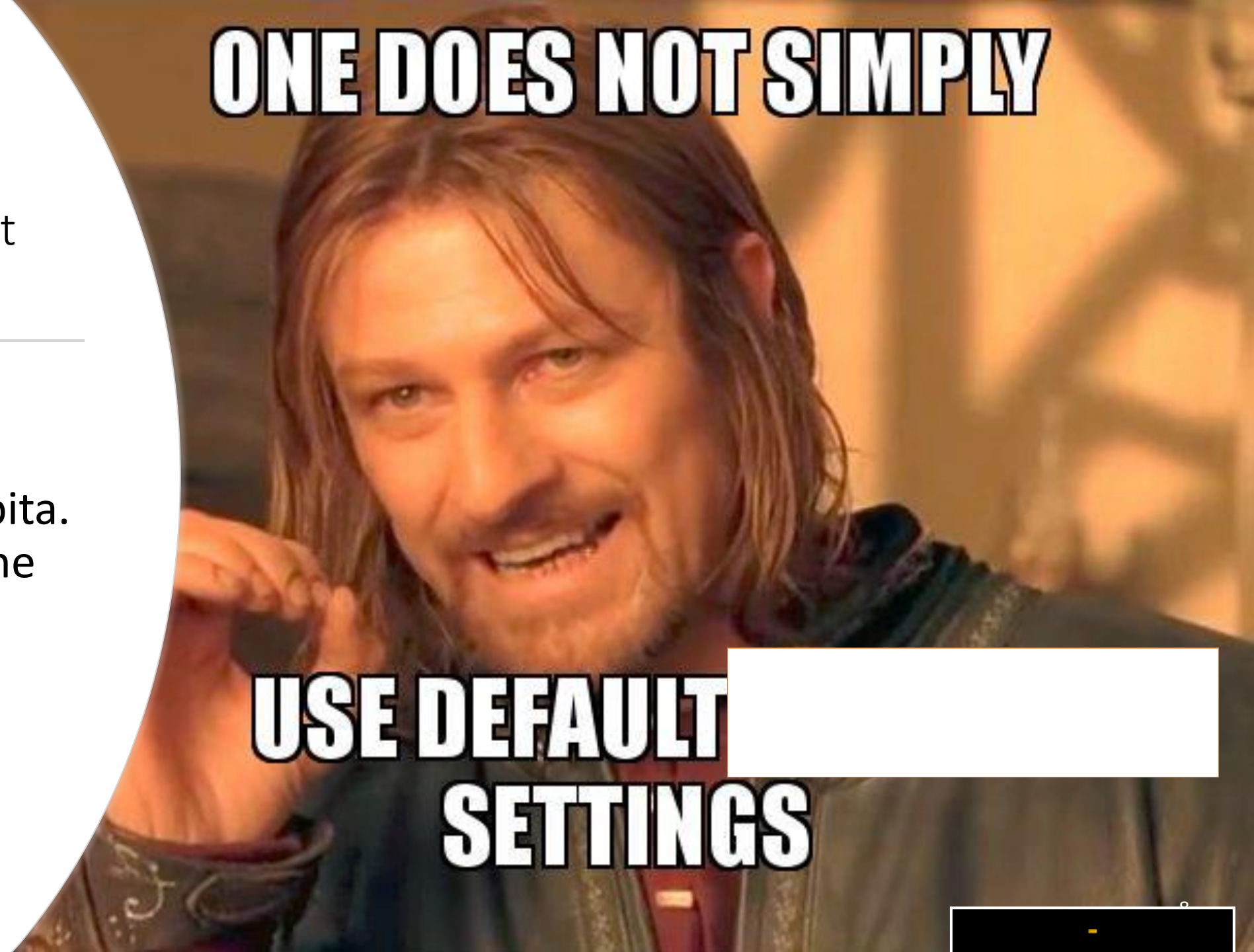
- In effect, the statute needed two different templates:
- the old-fashioned rules for a non-LLP partnership
- entirely different rules for an LLP

we live and draft for the “default” mode

- uniform entity acts
  - must be “self-actuating”
  - must work “off the shelf”
  - thus, a comprehensive set of “unless otherwise agreed” rules is necessary
- if the drafter of a partnership agreement varies a default rule but does not address all the ripples – the uniform act does not help
  - we do not provide additional rules to handle possibly inadequate variations from one default rule or another
- we strive for default rules that approximate would-have-made choices, but in all events:
  - we must choose a rule that is clear, not excessively complex, and workable; and
  - we can only have one default rule for each situation

for example – profit sharing per capita

“I never do per capita. It’s more likely some variation on per capital.”



losing sharing: fbo of whom?

creditors

partners obligated to contribute funds as necessary to:

- fund any unpaid company debts to creditors

truing up occurs in theory (i.e., in the default mode):

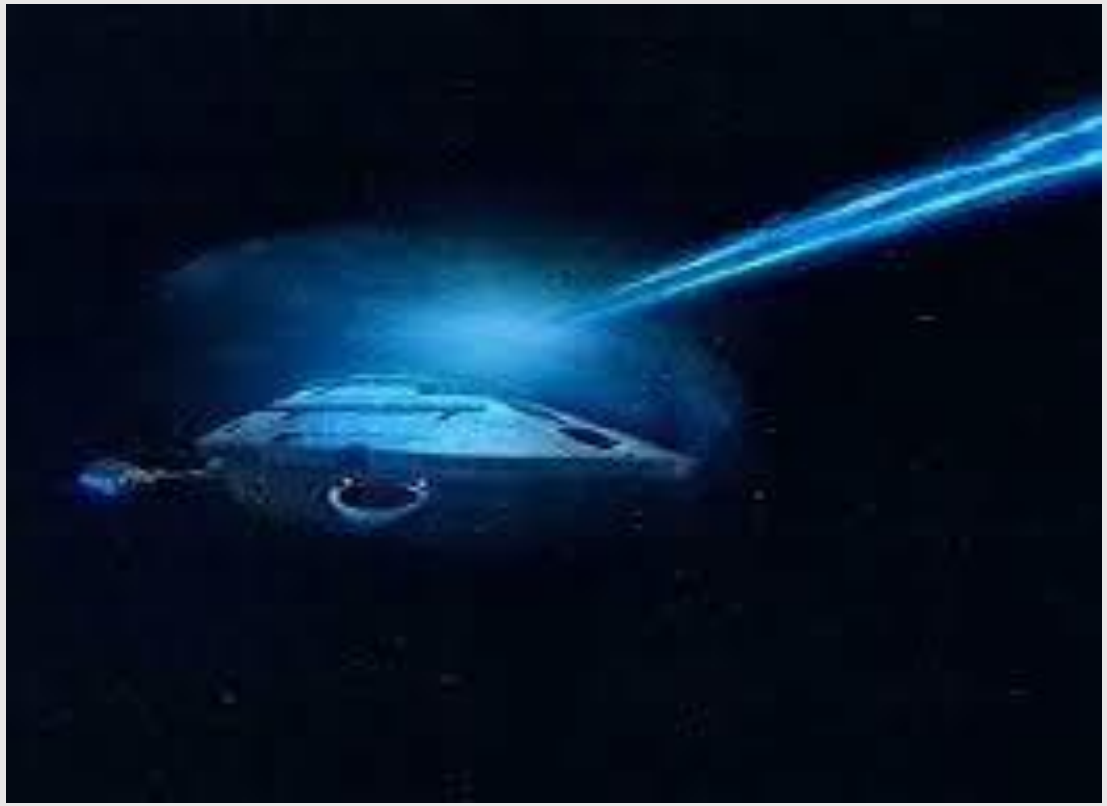
- only upon dissolution and winding up: and
- without any prior distributions

fellow partners

partners obligated to contribute funds as necessary to:

- "true up" capital losses (contributions) to fit the loss allocation rules (default or by agreement)

the impact of the shield on loss sharing



absent piercing

impact (con’t)

directly – the essence

- no contribution to pay the company’s debts

indirectly necessary

- no contributions to true up capital losses
  - necessary to protect against a hole in the shield
    - creditor goes after partner’s obligation to contribute to the partnership as an asset of the partnership
  - LLC influence – following the corporation

profit sharing

profits

distribution share

distributive share

AND NOW ….

profit and loss default rules

- THROUGH THE AGES

UPA (1914) §18

(a) Each partner shall be repaid his contributions, whether by way of capital or advances to the partnership property and share equally in the profits and surplus remaining after all liabilities, including those to partners, are satisfied; and must contribute towards the losses, whether of capital or otherwise, sustained by the partnership according to his share in the profits.

UPA (1997) aka RUPA § 401

(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.

UPA (2013) version

(a) Each partner is entitled to an equal share of the partnership distributions and, except in the case of a limited liability partnership, is chargeable with a share of the partnership losses in proportion to the partner's share of the distributions.

LLC influence

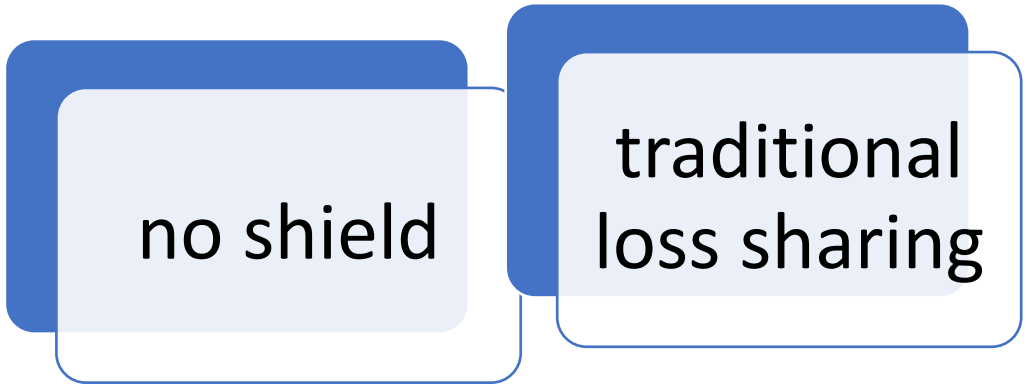
transition not addressed

against what?

our conundrum

pure, traditional non-LLP

pure LLP



- total shield
- no loss sharing*

NO LOSS SHARING?
WHAT ABOUT THE IRS?

TAX ACCOUNTING?

not our concern

WHAT ABOUT ACCOUNTANTS AND THEIR CAPITAL ACCOUNTS?

the mutt problem

bringing us finally to:

- the three questions

Assuming	a general partnership (GP) has never been an LLP, should UPA (2013) produce the same loss-sharing results as RUPA (1997) and UPA (1914)?
Assuming	a GP has been an LLP throughout its existence, should UPA (2013) produce the same results as ULLCA (2013)?
Assuming	a GP has been a non-LLP for some time and then an LLP until dissolution, what should the results be?

and, as night follows day, the …

two

and

a half

answers

2.5 – not yet vetted

1. Yes	a general partnership (GP) has never been an LLP, should UPA (2013) produce the same loss-sharing results as RUPA (1996) and UPA (1914)?
2. Yes	a GP has been an LLP throughout its existence, should UPA (2013) produce the same results as ULLCA (2013)?
2.5	a GP has been a non-LLP for some time and then an LLP until dissolution, what should the results be?

1. Perform a simple (simplistic?) calculation as to whether – as of just before the transition from non-LLP to LLP – the partnership has made a profit, broken even, or sustained a loss:
    a. measuring from:
        i. inception of the general partnership (if solely a non-LLP to date); or
        ii. inception of the current phase of the general partnership as a non-LLP; and
    b. considering only expenses actually paid and revenue actually received.
2. If the result is break-even or a profit, no truing up is done – moot w/r/t loss sharing.

Answer 2.5 – not yet vetted

Answer 2.5 – con't – not yet vetted

3. If the result is a loss, calculate each partner's share of the loss according to the then applicable loss-sharing percentages.
4. Preserve that amount for each partner as a debt to the partnership:
    a. due from a partner that dissociates before dissociation and without the dissociation resulting in a dissolution – when the partner dissociates; or
    b. due from a partner that has not dissociated when dissolution occurs – as part of the marshalling of partnership assets during winding up.

technical points:

- no interest accrues on the debt; and
- analysis is the same regardless of whether the partnership is or is not an LLP when a partner’s debt is due

end