Company law and securities

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FACTORS TO BE CONSIDERED BY AUSTRALIAN COMPANIES STRUCTURING US OPERATIONS THROUGH US PARTNERSHIPS

Australian companies often form partnerships to conduct their business operations in the United States in order to take advantage of certain benefits under Australian and US tax laws. Before forming a US partnership, an Australian company should take care to ensure that the nature and characteristics of the US partnership it intends to form, which may differ drastically from those of an Australian partnership, will not thwart the Australian company's ability to realise Australian tax benefits or expose its treasury to "upstream" liability for obligations of its US subsidiaries.

A particular issue that could impact Australian tax treatment in respect of the US partnership is the "entity" treatment of most US partnerships. Unlike most Australian partnerships, which are considered "aggregate" sums of their partners, most US partnerships are legal entities that are separate and distinct from their owners. Another related source of confusion arises with regard to the nature and characteristics of the "alphabet soup" of US partnership types (eg, LPs, LLPs, LLLPs). In addition, given the litigious environment in the US, the Australian company should take steps to protect the Australian company's treasury from "upstream" liability.

FORMATION AND "ENTITY" TREATMENT OF GENERAL PARTNERSHIPS

Because US partnerships formed by Australian companies are usually general partnerships, the authors have focused the discussion on general partnerships. Unlike Australian general partnerships, US general partnerships are typically considered entities separate and distinct from their owners.

Characteristics and formation of general partnerships

As used in this section note, a "general partnership" is a "traditional" partnership in which two or more persons (including individuals and entities) operate a business for profit, and does not include "statutory" partnerships such as limited partnerships and limited liability partnerships. General partnerships are characterised by the flexibility of their terms, unlimited joint and several liability of their owners, decentralised management, flexibility with respect to distributions of profits, non-transferability of ownership interests and a finite term of existence.

Similar to Australia, the formation of US general partnerships and the relationships of partners and the partnership to each other and to third parties are governed by the partnership Act of the State in which the partnership was formed. A US general partnership is deemed to exist if two or more persons operate a business for profit.[1] While partners often enter into a written partnership agreement, a written partnership agreement is not required; that is, a partnership may be formed merely through verbal agreement or conduct.[2] In the event partners have not entered into a partnership agreement, or a partnership agreement fails to address particular issues, a State's partnership Act provides a set of "default" rules.

Unlike a corporation, which must register a charter with its State of incorporation in order to exist, a general partnership is typically not required to register with the State in which it is formed.[3] However, a general partnership may elect to lodge a registration with its State of formation confirming its existence.[4] Indeed, many general partnerships do so in order to provide evidence of formation and to avail themselves of the protections of the State's partnership laws.

[1] See *Uniform Partnership Act*, § 61(1); *Revised Uniform Partnership Act*, §§ 101(6), 202.

[2] See *Revised Uniform Partnership Act*, § 103(a).

[3] See *Revised Uniform Partnership Act*, § 1095.

[4] *Revised Uniform Partnership Act*, § 105.

Entity treatment under Revised Uniform Partnership Act

Unlike general partnerships formed under Australian partnership Acts, which are typically considered "aggregate" sums of their partners, most US general partnerships are considered legal entities that are separate and distinct from their partners. A brief overview of the development of partnership law is helpful in understanding the differences in the nature and characteristics of Australian and US partnerships.

Australian partnership law developed along the lines of an "aggregate" theory of obligations and liabilities. Under English common law, general partnerships were recognised as the aggregate sum of their partners.[5] General partnerships were not distinct from their partners, partners were co-owners of partnership property, and partners were jointly and severally liable for partnership obligations.[6] The United Kingdom Parliament passed the *Partnership Act 1890*, which largely codified the English common law.[7] Using the *Partnership Act of 1890* (UK) as a model, Australian States subsequently passed partnership Acts.[8] Australian States' partnership Acts generally follow the "aggregate" theory of partnerships, and general partnerships are not considered legal entities that are separate and distinct from their partners.[9] With some exceptions, American partnership law initially followed the English common law of partnerships, and US general partnerships were generally considered aggregate sums of their partners.[10] In 1914, the National Conference of Commissioners on Uniform State Law (NCC), a commission that drafts uniform legislation to be adopted by participating States' legislatures, promulgated the *Uniform Partnership Act* (UPA), which was adopted by virtually every State in the US.[11] While the UPA ostensibly embraced the "aggregate" theory of partnerships, it was not definitive on the issue, and many States' interpretations of the UPA resulted in subtle variations, which in general tilted toward an "entity" theory.[12]

Eighty years later, widespread adoption of limited liability company legislation in the US (providing for partnership-like entities with limited liability for their owners) threatened to make the general partnership a much less relevant form of business organisation unless measures were taken to fundamentally change its nature.[13] In response, the NCC promulgated the *Revised Uniform Partnership Act* (RUPA) in 1994, which embraced the "entity" theory of partnerships. Since 1994, RUPA has been updated by the NCC, and has been adopted by most US States.[14]

Nature and characteristics of "entity" partnerships

General partnerships formed under RUPA are legal entities that are separate and distinct from their partners, rather than aggregate sums of their partners.[15] Partnership property is owned by the partnership, rather than co-owned by its partners, and a partnership may sue[16] and be sued in the name

[5] Maurice JM, "A New Person Limited Liability Shield for General Partners: But Not All Partners Are Treated the Same" (2007/2008) 43 Gonz L Rev 369 at 374.

[6] Maurice, n 5 at 374-376.

[7] See *Partnership Act 1890* (UK), § 4; see also Maurice, n 5 at 375, 379.

[8] See *Partnership Acts*: *1891* (Qld); *1891* (SA); *1891* (Tas); *1892* (NSW); *1895* (WA); *1958* (Vic); *1997* (NT); see also Fletcher K, "Incorporated Limited Partnerships: Venture Capital's Contribution to Legal Development" (2004) 17(2) *Australian Journal of Corporate Law* 168 at 168-169.

[9] See *Rose v FC of T* (1951) 84 CLR 118; see also Australian Taxation Office, TR 2004 1D4 *Draft Tax Ruling: Income Tax: The Taxation Implication of Partnership Salary Agreements* (citing Rose).

[10] Maurice, n 5 at 379-380.

[11] Maurice, n 5 at 379-380.

[12] Maurice, n 5 at 379-380.

[13] Maurice, n 5 at 383.

[14] National Conference of Commissioners on Uniform State Law (NCC), *Uniform Partnership Act (1997) Legislative Fact Sheet*, http://www.nccusl.org/Update/uniformact_factsheets/uniformacts-fs-upa9497.asp viewed 10 March 2009.

[15] *Revised Uniform Partnership Act*, § 201(a).

[16] *Revised Uniform Partnership Act*, § 203.

of the partnership.[17] Similar to "aggregate" partnerships, partners are jointly and severally liable for partnership obligations; however, unlike "aggregate" partnerships, judgment creditors must exhaust the assets of the partnership before they may seek recovery from partners' personal assets.[18]

Addressing "entity" treatment of US general partnerships

Some Australian tax and legal professionals have expressed concern that benefits available under Australian tax laws might not be available where an Australian company's US operations are conducted through an "entity" general partnership because its nature is fundamentally dissimilar to that of an Australian "aggregate" partnership.[19] However, in working with Australian legal and tax professionals, the authors have identified approaches that might be helpful in helping Australian companies support the position that the benefits sought under Australian tax laws should be available.

One approach is to form the general partnership in the State of Delaware and elect to be treated as an "aggregate" partnership. Unlike most US States, Delaware has modified its RUPA to provide that partners may elect that a partnership have the nature and characteristics of an "aggregate" partnership, such as treatment of the partnership as an aggregate sum of its partners and co-ownership of partnership property by its partners. (Indeed, the ostensible rationale for permitting these elections is to permit partners resident in Australia and other countries with similar partnership Acts (eg, the UK and Canada) to elect "aggregate" partnerships for home-country tax advantages.)[20]

To make these elections, the partnership's registration with Delaware must indicate that the partnership will be treated as an aggregate of the partners and/or that partnership property will be co-owned by the partners.[21] The partnership agreement should also contain provisions to similar effect.[22]

Another approach is for the general partnership to be formed as an "entity" partnership, but to contractually agree to guarantee or to be primarily liable with respect to partnership obligations that are pertinent to the Australian tax benefits sought. This can be done in the partnership agreement.

THE "ALPHABET SOUP" OF US PARTNERSHIPS

Non-US investors looking to form a partnership in the US are sometimes bewildered to find many types of non-traditional partnerships available. These types of partnerships are sometimes called "statutory" partnerships because their existence is enabled by statute, rather than by operation of law (eg, the formation of a partnership through mere agreement or conduct). Provided below are descriptions from this "alphabet soup" of organisations.

LP

A "LP" is a limited partnership. Similar to Australian limited partnerships, a limited partnership consists of at least one general partner and at least one limited partner. General partners have unlimited joint and several liability with respect to partnership obligations, while the liability of limited partners is limited to the extent of their capital contributions to the partnership. In most States, a limited partnership is an entity, rather than an aggregate sum of its partners.[23]

[17] *Revised Uniform Partnership Act*, § 307(a).

[18] *Revised Uniform Partnership Act*, § 307.

[19] *Delaware Revised Uniform Partnership Act*, §§ 15-202(a), 15-203.

[20] Telephone interview with Walter C Tuthill, Esq of Morris Nichols Arsht & Tunnell LLP (30 May 2008). Mr Tuthill was a member of the Delaware Bar Association Committee that recommended to the Delaware General Assembly that the *Revised Uniform Partnership Act* be adopted, with certain revisions.

[21] *Delaware Revised Uniform Partnership Act*, §§ 15-202(a), 15-203.

[22] *Delaware Revised Uniform Partnership Act*, §§ 15-202(a), 15-203.

[23] See *Revised Uniform Limited Partnership Act*, § 104(a), NCC, *Revised Uniform Partnership Act (2001) Legislative Fact Sheet*, http://www.nccvsl.org/Update/uniformact_factsheets/uniformacts.fs.ulpa.asp viewed 28 July 2009; telephone interview with Katie Robinson of the NCC (4 August 2009) (Ms Robinson confirmed that almost all States have adopted the 1976 or 2001 version of the *Uniform Limited Partnership Act*.)

LLP

A "LLP" is a limited liability partnership. LLPs have many of the same characteristics of a general partnership (eg, equal participation in management, agreed-upon distribution of profits, and restricted transferability of partnership interests).

However, unlike general partnerships, all partners of LLPs enjoy limited liability with respect to partnership obligations.[24] In addition, also unlike general partnerships, which may be formed merely through partners' verbal agreement or conduct, partners must approve the decision to become an LLP according to certain voting requirements and lodge a registration with the State of formation in order to receive LLP status.[25] (A general partnership that does not obtain LLP status at the time of its formation may become an LLP at a later time by lodging a registration with its State of formation.)[26] In most States, an LLP is an entity, rather than an aggregate sum of its partners.[27] Due to professional licensing requirements, many LLPs are formed in professional fields, such as law firms and accounting firms.

LLLP

A "LLLP" is a limited liability limited partnership. Similar to limited partnerships, a LLLP consists of at least one general partner and at least one limited partner.[28] However, unlike typical limited partnerships, but similar to LLPs, general partners (ie, in addition to limited partners) enjoy limited liability with respect to partnership obligations.[29] Also similar to LLPs, partners must approve the decision to become a LLLP according to certain voting requirements and lodge a registration with the State of formation in order to receive LLLP status, and a limited partnership that does not obtain LLLP status at the time of its formation may become an LLLP at a later time by lodging a registration with its State of formation.[30] In most States, a LLLP is an entity, rather than the aggregate sum of its partners.[31]

LLC

A "LLC" is a limited liability company. LLCs are not partnerships; rather, they are "hybrids" between a partnership and a corporation. Similar to partnerships, management is decentralised, there is flexibility with respect to distribution of profits, and ownership interests are generally not transferable. Unlike partnerships, but similar to corporations, owners of LLCs enjoy limited liability with respect to LLC obligations. LLCs are usually treated as partnerships for US tax purposes, meaning that LLC income and losses are usually recognised by their owners for tax purposes (eg, rather than first being recognised by the entity and then recognised by the owners when dividends are paid, as in the case of a corporation). However, a LLC can elect to be treated as a corporation for tax purposes. A registration must be lodged with the LLC's State of organisation in order for the LLC to exist. A LLC is always an entity.

REDUCING THE EXPOSURE TO "UPSTREAM" LIABILITY

Given the litigious environment of the US and the potential unlimited liability for partners of US general partnerships, Australian companies have expressed concerns that being an owner of a US general partnership could expose the Australian company to substantial upstream liability with respect to its US business operations. However, structures and policies can be put in place as part of

[24] *Revised Uniform Partnership Act*, § 306(c).

[25] See *Revised Uniform Partnership Act*, § 1001(b), (c), (e).

[26] See *Revised Uniform Partnership Act*, § 1001(c).

[27] See *Revised Uniform Partnership Act*, § 201(a).

[28] See *Revised Uniform Limited Partnership Act*, § 102(11).

[29] See *Revised Uniform Limited Partnership Act*, § 404(c).

[30] See *Revised Uniform Limited Partnership Act*, § 102(11); see also § 201(a)(4).

[31] See *Revised Uniform Limited Partnership Act*, § 104(a).

multi-faceted approach to greatly reduce the Australian company's exposure to such "upstream" liability. The three basic objectives of such an approach are to ensure that:

(i) the corporate structure in the US utilises limited liability entities to take advantage of liability shields;
(ii) the Australian company's US operating subsidiaries (ie, and not the US general partnership or Australian company) are primarily liable for obligations of the US businesses; and
(iii) the Australian company's US business operations are indeed conducted by the US operating subsidiaries (ie, and not by and through the Australian company).

A corporate structure whereby the partnership operates its businesses through subsidiaries of the general partnership that are limited liability entities (eg, corporations or limited liability companies) can help to quarantine liabilities to the operating company level and segregate liabilities among separate lines of business. In addition, the US operations themselves can be structured to help ensure that the US operating subsidiaries are primarily liable for business obligations and that business operations are indeed being conducted through the US operating subsidiaries (ie, and not by or through the US general partnership or Australian company). For example, the US operating subsidiaries – and not the US general partnership or the Australian company – should enter into agreements with third parties, and operations conducted outside the US by the Australian company's non-US affiliates should be performed pursuant to subcontracts with the US operating subsidiaries. Further, management should be structured and governance policies should be put in place to ensure that the decision-making process with respect to the US subsidiaries' activities are appropriate and centered in the US and that both US and Australian managers and personnel adhere to corporate procedures and formalities.

Gaining an understanding of these considerations prior to forming a general partnership in the US will help the Australian parent company take steps to ensure that operating its US business as a general partnership will achieve its business, tax, and risk management objectives.

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(This section note is not intended, nor should it be construed, to constitute US or Australian legal or tax advice. US and Australian legal counsel and tax professionals should be consulted before organising any business in the US or determining tax consequences under US and Australian tax laws.)