Queen's Law Clinics
Business Law Clinic

Business Law Playbooks

Part 3 – Partnerships: General, Limited, and Limited Liability Partnerships

Prepared by the Queen's Business Law Clinic in collaboration with Queen's Partnerships and Innovation

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About Queen's Partnerships and Innovation

Queen's Partnerships and Innovation ("QPI") aims to advance research, innovation, and knowledge mobilization to strengthen Queen's local, national, and global impact. QPI provides faculty, students, post-doctoral fellows, and other members of the Queen's community with a variety of services and resources to facilitate strategic initiatives and research partnerships. QPI is also proud to work with external organizations (both industry and not-for-profits) to connect them with expertise, resources, and incubation support.

About Queen's Business Law Clinic

The Queen's Business Law Clinic ("QBLC") is a free legal clinic which was established in 2009 to provide year-round legal services to a wide variety of individuals, businesses and non-for-profit organizations in southeastern Ontario. The QBLC aims to help individuals and businesses who would otherwise have difficulty affording legal counsel, while providing Queen's Law students with practical legal experience working with clients, while instilling in them the values of community service and the pro bono tradition. The QBLC is proud to have contributed to the economic growth and social well-being of Kingston and its surrounding communities by helping entrepreneurs, small businesses, charities and not-for-profit organizations with their legal needs.

Why do you need a Playbook?

For many people with little or no previous business or entrepreneurial experience, understanding the relationship between law and business – and how it may affect the success or failure of their business idea – is a very important step. In this series of Playbooks, we seek to provide general information on the legal concepts that should be considered by the entrepreneur starting out their business venture.

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3 Partnerships: General, Limited, and Limited Liability Partnerships

3.1. How is a Partnership Formed?

Partnerships are a relationship between two or more persons carrying on a business with a view to profit. Partnerships can arise explicitly (with a partnership agreement) or implicitly (by fulfilling the definition of a partnership above). In Ontario, partnerships are governed by the *Partnerships Act* ("*PA*"). In general, receiving a share of the profits in the business, without evidence to the contrary, will serve as proof that the person is a partner on the business. Partners need not exert any control over the business to be considered a partner. Partners exerting control over a partnership's operations are known as general partners, while partners who are not interested in the control or management of the partnership are known as silent partners. A general discussion of these two categories of partners is set out below.

Lastly, partners need only be legal persons, not natural persons. Thus, a partnership may be created by two unrelated corporations, natural persons, or a combination of natural persons and corporations.

3.2. Features of a Partnership

There are some distinctive features of a Partnership:

3.2.1. Agency

The most important feature is the creation of an agency relationship between partners. Partners are agents of each other partner in all matters relating to the business. Each partner can bind their partners without their knowledge or consent to contracts, imposing obligations on them unilaterally.

3.2.2. No Separate Legal Personality

Like a sole proprietorship, partnerships have no separate legal personality. This means the partnership cannot hold its own property, enter into any contracts, sue, or be sued. Actions that require legal personality must be done by a partner personally on behalf of the partnership.

3.2.3. Profit Sharing and Income Tax Benefits

Partners can only be paid by the distribution of the business' profits. This means a partner cannot be an employee of the business and partners are unable to seek any statutory protections that an employee may have. Also, like sole proprietorships, all profits and losses that occur in a partnership will "flow through" the partnership and are reported on the partner's personal income taxes, allowing partners to use business losses to offset income from other sources.

3.2.4. Liability of a Partner

Partners are personally liable for the debts of the partnership, so a creditor can pursue a claim against any partner personally if a loan defaults. Partners are also "jointly liable", which means that any obligation assumed by one partner can be enforced against all other partners. Partners are "severally liable", as partners are equally individually responsible for the partnership's losses, unless otherwise agreed to in the partnership agreement.

3.2.5. Governing Law

Without a partnership agreement, the relationship between all the partners is governed by the *PA*. The *PA's* default provisions put forth a few factors: equality, consensualism, and fiduciary duties. Thus, without an agreement modifying the default provisions, all partners share equally in the profits and losses, can all take part in managing the business, and make decisions based on a consensus. Additionally, partners cannot enter and exit the partnership freely. A partner entering or exiting the partnership will be deemed a new partnership, with the old one dissolved.

Partnerships can conduct business under the names of the partners. If the partners decide they would like to use a different name, the name must be registered in compliance with the *Business Names* Act ("*BNA*").

3.3. The Partnership Agreement

As noted above, partnerships can exist with or without a partnership agreement. The partnership agreement has several main functions: it provides certainty that a partnership exists, and it allows partners to modify many of the default obligations from the *PA*.

With a partnership agreement, many of the obligations between the partners can be renegotiated by the partners to suit their preferences with the main exception of the fiduciary duty owed to each other. For example, partnership agreements can allow for decisions to be made by a simple or super majority instead of by consensus, alter the contributions each partner makes to the partnership and how profit and losses are split between partners, or allow for the addition and expulsion of partners. The last is an example of a power that can only be granted with a partnership agreement.

A partnership agreement strictly governs the relationship between partners and not the partnership's relationship with third parties. While a partnership agreement may split the losses of the partnership in the manner agreed upon by the partners, a third party seeking to recover its debt from the partnership or from one of the partners enjoys the benefit of the principle of joint liability. This means that if a partnership owes money to a third party, that third party can choose to go after one or all the partners personally to recover his money.

The QBLC can assist you in drafting a partnership agreement and help you tailor the rules of partnership to your specific circumstances.

3.4. Partnerships vs Sole Proprietorships

Sole proprietorships and partnerships are very similar in nature, as neither business structure has a separate legal personality. The differences between a sole proprietorship and a partnership are minimal, besides the differences arising from having multiple parties. The decision of partnership or a sole proprietorship is made automatically by the amount of people managing the business.

Characteristics	Partnerships	Sole Proprietorships
Formation	• Partnerships are formed when persons carry on a business in common with a view to profit, or if they sign a partnership agreement	• Sole proprietorships are formed when an individual carries on business
Lifetime	• Unless provided otherwise in the partnership agreement, a partnership is dissolved when the business in common in concluded, a partner dies or is disabled, or by agreement of the partners	• Sole proprietorships end when the sole proprietor dies or is disabled
Ownership Structure	• Two or more legal persons – partners can be individuals or corporations	• Operated by a single individual
Business Name Registration Requirements	• If operating under the partners' full names, no business name registration is necessary • If operating under any other business name, the name must be registered in compliance with the *BNA*	• If operating under the sole proprietor's full name, no business name registration is necessary • If operating under any other business name, the name must be registered in compliance with the *BNA*
Separate Legal Personhood	• The business is not legally distinct from the partners – contracts must be signed in the partners' names	• The business is not legally distinct from the business owner – contracts must be signed in the sole proprietor's name
Liability	• Partners have unlimited joint and several liability for the debts of the partnership – each partner is personally	• A sole proprietor has unlimited personal liability for the debts of the business

	liable for the obligations of the other partners within the partnership	
Employees	• The partnership can hire employees, but the partners cannot be employees themselves	• The sole proprietorship can hire employees, but the owner cannot be an employee themselves
Taxes	• Income from the partnership "flows through" to the partners as business income • Profit is shared either equally between partners, or in accordance with the partnership agreement	• Income from the sole proprietorship "flows through" to the sole proprietor as business income
Governing Law	• Partnerships are governed by the *PA* and must comply with the *BNA*	• Sole Proprietorships must comply with the *BNA*

3.5. Partnerships vs Incorporation

Unlike a partnership, a corporation is a highly formal business structure. It is impossible for a corporation to be created inadvertently. The process of incorporation (literally meaning "to give a body") creates a new legal person. The existence of legal personality for a corporation brings with it a higher sense of responsibility as there are regulatory requirements that the corporation must comply with. As a legal person, a corporation can own its own property and can enter into contracts in its own name. Most importantly, legal personality creates a separation between the business and its shareholders. Shareholders have no direct claim to any of the business' property or earnings, but are also not liable for any of the business' liabilities. For example, if a corporation takes on a loan but goes bankrupt, the shareholders cannot be compelled to pay the outstanding balance on the loan, provided there was no fraudulent behaviour involved.

While partnerships have minimal maintenance requirements (an accounting of the business and allocating its profits and losses), corporations have a variety of requirements they need to fulfil. There is a fee to incorporate, and annual returns are required by the government. There is also management overhead, like holding annual shareholder meetings and having to maintain a corporate minute book.

As a separate legal entity, corporations also have perpetual existence. Because a partnership is made up of individual partners with no legal personality, a partnership ceases to exist upon the death of a partner (unless partners agree otherwise in a partnership agreement). The founders of a corporation can pass away, and the corporation itself remains fully functional and continues to conduct its business. Transferring an interest in a corporation is also different, as shares can be exchanged while a partner can only transfer his/her partnership interest in the business. This partnership interest represents their share of profits and losses, voting rights and managerial responsibilities (if any). A partner cannot delegate or assign any portion of their other rights, including the right to take part in the management of the business.

While the business' profits or losses are claimed on the partner's personal taxes, corporations file taxes on their own behalf. Corporations instead distribute their profits as dividends, which are then taxed as the recipients of the income.

Lastly, corporations can utilize "equity financing" instead of borrowing money from a lender (debt financing). Equity financing is the issuance of shares in the corporation for money. Unlike debt financing, equity financing need not be repaid, but instead grants shareholders a degree of control over the corporation. Conversely, any debt borrowed by a partnership will be considered a personal loan of the partners individually and collectively.

Characteristics	Partnerships	Corporations
Formation	• Partnerships are formed when persons carry on a business in common with a view to profit, or if they sign a partnership agreement	• Corporations are formed by filing articles of incorporation with the appropriate governing body
Lifetime	• Unless provided otherwise in the partnership agreement, a partnership is dissolved when the business in common in concluded, a partner dies or is disabled, or by agreement of the partners	• Corporations have an unlimited lifetime
Ownership Structure	• Two or more legal persons – partners can be individuals or corporations	• Subject to any limitations in the articles of incorporation, corporations can have unlimited owners/shareholders – shareholders can be individuals or corporations
Business Name Registration Requirements	• If operating under the partners' full names, no business name registration is necessary	• A NUANS search report is required during the incorporation process and ensures the business name

	• If operating under any other business name, the name must be registered in compliance with the *BNA*	• The corporation's name must indicate its status as a separate legal person and comply with the requirements in the Act under which it incorporated
Separate Legal Personhood	• The business is not legally distinct from the partners – contracts must be signed in the partners' names	• A corporation is legally distinct from its shareholders and directors – a corporation can sign contracts and own property
Liability	• Partners have unlimited joint and several liability for the debts of the partnership – each partner is personally liable for the obligations of the other partners within the partnership	• Absent some circumstances involving fraudulent, illegal or improper purpose, shareholder and directors are not liable
Employees	• The partnership can hire employees, but the partners cannot be employees themselves	• An individual can be a shareholder, a director, and an employee simultaneously
Taxes	• Income from the partnership "flows through" to the partners as business income • Profit is shared either equally between partners, or in accordance with the partnership agreement	• Corporations are taxed separately from shareholders on any income they earn • Income can be distributed to shareholders through dividends, and shareholders will be taxes on the receipt of those dividends
Governing Law	• Partnerships are governed by the *PA* and must comply with the *BNA*	• Corporations are governed by the Act under which they were created. For example, federally incorporated businesses are governed by the *Canada Business Corporations Act*

3.6. Limited Partnerships

Limited partnerships are related to partnerships but allow for passive investment. Limited partnerships consist of one or more "general partner(s)" and one or more "limited partner(s)". In Ontario, Limited Partnerships are governed by a different legislative act, the *Limited Partnerships Act* ("*LPA*"). Unlike a partnership, limited partnerships must be registered in accordance with the *LPA* and will never arise inadvertently.

The general partner in a limited partnership is very similar to the general partner of a partnership. They remain liable for all the debts and obligations of the partnership, without limit. However, limited partnerships are "limited" in the sense that their liability for any debts of the partnership is capped at their investment in the corporation. For example, if you invest $1,000 in a partnership, you will only have to pay $1,000 if creditors demand payments from the partnership. In exchange for this limitation of liability, limited partners cannot take part in the management of the business. A limited partner may contribute money and other assets to the limited partnership, but cannot offer services. Where the limited partner actively manages the affairs of the business, the limited partner will lose the benefit of limited liability. One other difference between the two types of partners is that a limited partner can be an employee of the business (and enjoy the benefits of employee protections), while general partners cannot.

As limited partnerships must be registered before coming into existence, part of the registration includes a partnership name. Therefore, limited partnerships are exempt from the business name registration requirements of the *BNA*. Lastly, limited partnerships lapse every five years, and must be renewed. This form of business vehicle can be attractive when you are looking to have partners who are not interested in the management of the business, or when employees wish to invest into a partnership.

3.7. Limited Liability Partnerships

Limited liability partnerships ("LLPs") are a special subset of partnerships, which have features of a corporation and a partnership. Despite the name, limited liability partnerships are not a subset of limited partnerships. In Ontario, limited liability partnerships are governed by the *PA*. Limited liability partnerships are intended to be a way for professionals to pool their resources, while not being liable for another partners' professional negligence. Corporations are not normally available to the professions to prevent a professional from limiting their liability, hence the creation of limited liability partnerships. Partners in a limited liability partnership are still generally liable for all business obligations of the partnership but would not be liable for one partner's tortious acts in carrying out their practice.

Limited liability partnerships offer many benefits over general partnerships. However, the ability to create a limited liability partnership is heavily restricted in Ontario. The *PA* limits this type of business vehicle to professions where the act governing the profession explicitly allows the formation of a limited liability partnership. Thus, limited liability partnerships are mostly limited to lawyers, accountants and medical professionals.

Characteristics	Partnerships	Limited Partnerships	Limited Liability Partnerships
Formation	• Partnerships are formed when persons carry on a business in common with a view to profit, or if they sign a partnership agreement	• Limited Partnerships cannot be formed inadvertently and are formed by registering in accordance with the *LPA*	• Limited Liability Partnerships are a type of partnership that is formed by registering under the *Partnership Act* • Limited Liability Partnerships can only be formed by professionals such as lawyers, accountants and medical professionals
Lifetime	• Unless provided otherwise in the partnership agreement, a partnership is dissolved when the business in common in concluded, a partner dies or is disabled, or by agreement of the partners	• Registration of a limited partnership lapses every five years and must be renewed	• Registration of a limited liability partnership lapses every five years and must be renewed
Ownership Structure	• Two or more legal persons – partners can be individuals or corporations	• Two or more legal persons – partners can be individuals or corporations • General partners manage the business, while limited partners contribute	• Two or more legal persons – partners must be individuals

		financially but do not take part in the management of the partnership	
Business Name Registration Requirements	• If operating under the partners' full names, no business name registration is necessary • If operating under any other business name, the name must be registered in compliance with the *BNA*	• A limited partnership's business name is registered during the registration under the *LPA*	• The partnership's name must be registered in compliance with the *BNA*
Separate Legal Personhood	• The business is not legally distinct from the partners – contracts must be signed in the partners' names	• The business is not legally distinct from the partners – contracts must be signed in the partners' names	• The business is not legally distinct from the partners – contracts must be signed in the partners' names
Liability	• Partners have unlimited joint and several liability for the debts of the partnership – each partner is personally liable for the obligations of the other partners within the partnership	• General partners have unlimited joint and several liability for the debts of the partnership, while limited partners have limited liability up to the amount they invested into the partnership • If a limited partner takes part in the management of the partnership, they will lose their limited liability	• In Ontario, partners are not liable for claims made against other partners in the partnerships, whether those are contractual claims or negligence claims • Partners still have unlimited personal liability for their own wrongful acts

Employees	• The partnership can hire employees, but the partners cannot be employees themselves	• The partnership can hire employees, but the partners cannot be employees themselves	• The partnership can hire employees, but the partners cannot be employees themselves
Taxes	• Income from the partnership "flows through" to the partners as business income • Profit is shared either equally between partners, or in accordance with the partnership agreement	• Income from the partnership "flows through" to the partners as business income • Profit is shared in accordance with the limited partnership agreement	• Income from the partnership "flows through" to the partners as business income • Each partner is taxed on their own income earned within the partnership
Governing Law	• Partnerships are governed by the *PA* and must comply with the *BNA*	• Limited Partnerships are governed by the *LPA*	• Partnerships are governed by the *PA* and must comply with the *BNA*

3.8. Quick Chart Summary - Advantages and Disadvantages

Type of Entity	Advantages	Disadvantages
Sole Proprietorship	• Easy and inexpensive to set up • Regulatory burden is very light • Direct control of decision making • Enjoys tax advantages in certain scenarios • No profit/loss sharing – owner bears all the benefits and risks alone	• Unlimited personal liability • Income from the business is taxed using the personal income tax rate • Lack of continuity – business dissolves upon the disability or death of the sole proprietor • Raising capital from traditional sources may be difficult
Corporation	• Limited liability for shareholders	• Initial cost of incorporation • Annual filing requirements

	• Ability to raise equity capital for the business • Continuous existence and transferability • Indemnification of directors • Tax benefits such as the Small Business Deduction, Lifetime Capital Gains Exemptions for Canadian-Controlled Private Corporations and the ease of estate planning	• Residency requirements for directors • Dissolving a corporation is more complex than other business structures • Fiduciary duties owed by directors • Disclosure requirements of directors • Duty of care owed by directors • Potential of directors' personal or statutory liability
General Partnership	• Fairly easy to set up – can be set up informally or upon entering into a partnership agreement • Start-up costs can be split between partner(s) • Some tax advantages in certain scenarios (e.g. partnerships may avoid potential tax liability by "rolling over" their assets to the partnership, which shifts the tax liability to the partnership instead of the contributing partner • A partnership agreement gives you flexibility to deviate from many default rules and create your own rules	• Potential uncertainty as it may arise inadvertently • Partners are subject to unlimited personal liability • The partnership has no legal personality, a partner is always acting on behalf of himself/herself • Partners are jointly and severally liable for the actions of each partner • A person may continue to be liable for losses and debts of the partnership after leaving the partnership or upon their death, which were acquired when the person was still a partner • Partner cannot be an employee of the partnership
Limited Partnership	• Partners can invest without exposing themselves to unlimited liability • Partnership does not need to register under the *BNA* • Clear when it exists, limited partnerships will never arise inadvertently • Limited partners can be employees of the partnership	• Must be registered as a limited partnership, and renewed every five years • Limited partners may inadvertently take control and be liable as general partners • You cannot contribute services to the business as a limited partner • Often requires a limited partnership agreement to avoid ambiguities

	• No burden of managing the business because general partners has control	
Limited Liability Partnership	• Partners are not liable for any professional wrongs of the other partners • Not liable for any other debt or obligations of the LLP	• Limited to select professions • Partners are still jointly liable for all the obligations of the partnership as a whole

3.9. Conclusion

Like a sole proprietorship, partnership is relatively easy and inexpensive to form as the start-up cost is relatively low. However, partnerships might be formed inadvertently if the relationship is one where two or more persons carrying on a business with a view to profit. Unlike a sole proprietorship, there are governing legislations for partnerships. Therefore, having a partnership agreement in place is not only beneficial for clearly outlining the partners' duties and obligations, but it also allows you to tailor the business relationship to reflect your needs.

Whether you are looking to start a partnership with others or you are looking to join a partnership, it is important that you understand the benefits and drawbacks of a general partnership, a limited partnership, and a limited liability partnership. This part of the Playbook offers an overview of the three. Should you require additional legal advice specific to your situation, the QBLC will be happy to assist you.