Howdy (limited) partner: Six key features of Ontario limited partnerships

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Ontario limited partnerships (LPs) are a popular structure for investment vehicles. They offer many of the same benefits of corporations but with more favourable tax treatment. Like corporate shareholders, limited partners can make a passive investment with limited liability (in most cases).

Not just "flow-through" corporations

Unlike corporate shareholders, whose corporate income is subject to taxes at the corporate level and again on distribution to shareholders, LPs are treated as flow-through entities for tax purposes, so limited partners' LP income is not taxed at the partnership level. However, as the Ontario Court of Appeal recently reiterated in *Binscarth Holdings* (*Binscarth*) from a legal perspective, **LPs are not merely corporations without the corporate tax**.

While there are many similarities between the ways in which Ontario law treats LPs and corporations, there are nonetheless certain impactful distinctions between LPs and corporations and their respective limited partners and shareholders.

We have set out six unique features of LPs that are important to keep in mind when structuring, operating and litigating with Ontario LPs so that all parties can maximize the benefits and minimize the risks associated with the structure.

Key features of LPs

1. **LPs are relationships between general and limited partners**. Unlike corporations, which are separate legal entities that can, for example, hold legal title to property, LPs are relationships between one or more general partners and one or more limited partners. Because an LP is a relationship and not a legal entity, contracts with an LP are effectively contracts with the general partner.[1]
    i. **The general partner controls the LP's business and assets and has unlimited liability for the LP's obligations.** General partners in LPs have all the rights and obligations of partners in ordinary partnerships, subject to some statutory exceptions. Investment vehicles structured as

LPs typically only have one general partner, which is often a corporation formed exclusively for the purpose of serving as general partner for that LP.

ii. **Limited partners have limited liability but cannot control the LP or its assets**.[2]Like shareholders of a corporation, limited partners typically contribute capital to the LP and their liability is limited to the amount of their capital contribution and outstanding capital commitment. Similarly, when the LP is dissolved, limited partners are only entitled to their contribution plus any profits on that contribution (after the LP's creditors' claims are satisfied).3 However, unlike a shareholder of a corporation, if a limited partner takes part in the control of the LP (i.e., if a limited partner acts like a general partner), that limited partner can be subject to the same unlimited liability for the LP's obligations as a general partner. While the exercise of rights conferred to limited partners pursuant to the *Limited Partnerships Act* (*LPA*) will not put their liability protection at risk, the boundaries of what constitutes "control" is best assessed on a case-by-case basis.[4]

2. **Legislation, the LP declaration, any LP agreement and the common law define the general and limited partners' rights and obligations.** LPs must be formed under a statutory regime, otherwise they will be treated as common law general partnerships where all partners have unlimited liability for the partnership's obligations.[5] In Ontario, an LP can be formed under the *LPA* by filing a declaration, which must generally be renewed after five years unless the LP is cancelled, dissolved, or renewed earlier. The *LPA* provides a default regime that defines the powers, rights, responsibilities and obligations of general and limited partners. However, it is standard for limited partnerships to have an LP agreement, a comprehensive document that details the specific responsibilities and obligations of the parties and any other agreed-upon terms with respect to the LP. In addition to the LP agreement, it is also common practice for general partners and limited partners to enter into a side letter, a document that contains additional obligations on the general partner vis-à-vis the LP, including but not limited to things like additional information rights, the right to appoint a member to the advisory committee, co-investment rights etc. Finally, as discussed further below in #6, the common law can be a source of additional rights and obligations.[6]
3. **The general partner has a fiduciary duty to act in the limited partners' best interest.** The general partner has a fiduciary duty to act in the limited partners' best interest, because the general partner undertakes to manage the LP's business and own and control the LP's assets for the benefit of the LP (discussed further in #4).[7] When the general partner is a corporation, given the unique structure of limited partnerships (as described in #1), the general partner's corporate directors generally have a fiduciary duty to act in the limited partners' best interest. Courts will generally look to the terms of the LP agreement to determine whether a general partner acted within its scope of authority in determining a breach of fiduciary duty.
4. **The general partner owns and controls the LP's assets.** Because an LP is a relationship, not a legal entity, an LP cannot hold legal title to assets. The general partner has sole ownership and control of the LP's assets and business, for the benefit of the limited partners, subject to its statutory, common law and contractual obligations.[8]
5. **An LP can directly sue third parties and third parties can directly sue an LP, but the general partner is effectively the party to LP litigation**. The

Ontario *Rules of Civil Procedure* provide that, for practical reasons, an LP is a proper party to litigation with a third party – i.e., a lawsuit can name the LP as the party, rather than the general partner in its capacity as general partner of the LP.[9] However, because the general partner controls the LP and has unlimited liability for the LP's obligations, even if the LP is the named party as permitted by the *Rules*, the general partner is effectively the party to a lawsuit.[10]

6. **Limited partners can directly sue the general partner, and can sue third parties on behalf of the LP in some circumstances.** The Ontario Court of Appeal confirmed in *Binscarth* that limited partners can directly sue the general partner if the general partner breaches its obligations to the limited partners.[11] Furthermore, the court confirmed that a limited partner can, with the court's permission, bring a common law "derivative action" on behalf of the LP to enforce the LP's rights against a third party in certain circumstances, where the general partner declines to do so.[12] However, the *LPA* does not contain the broad and flexible "oppression" remedy provided for in corporate statutes, so limited partners can only seek these remedies in their capacity as limited partners and not in any other capacity (for instance, like shareholders/creditors of a corporation can).

As these key features illustrate, LPs are not merely "flow-through" corporations – i.e., "corporations without the corporate tax". Ontario law treats LPs similarly to corporations in many respects. Ontario law treats general partners and directors of corporate general partners similarly to corporate directors and corporate trustees in many respects. And Ontario law treats limited partners similarly to corporate shareholders in many respects.

However, as the Ontario courts continue to affirm, there are subtle but meaningful differences between LPs and corporations, and limited partners and shareholders that are important to keep in mind when structuring, operating and litigating with LPs in Ontario.

Footnotes

[1] *Binscarth* at paras. 73, 99.

[2] *Binscarth* at para 45.

[3] *Binscarth* at para 44.

[4] This bulletin discusses the law of LPs in Ontario. It is worth noting that not all provincial statutes impose the same restrictions with respect to control on limited partners.

[5] *Binscarth* at para 42.

[6] *Binscarth* at para 43.

[7] *Binscarth*, at para 48.

[8] *Binscarth* at para 47.

[9] *Binscarth* at para 55; *Rules of Civil Procedure*, O.Reg. 194, Rule 8.01(1).

[10] *Binscarth* at paras 54-56.

[11] *Binscarth* at paras 83-90.

[12] *Binscarth* at paras 103-108.

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