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The Corporation as Managing Partner in a Limited Partnership

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THE CORPORATION AS MANAGING PARTNER IN A LIMITED PARTNERSHIP

I. INTRODUCTION

The dilemma of the traditional business organizations is the double taxation that burdens corporations and the unlimited liability that threatens sole proprietors and general partners in either a general or limited partnership. The use of a limited partnership with a corporation as the sole general partner with limited partners acting as corporate directors, officers, and stockholders is a unique means of solving the dilemma of the traditional business organization. A limited partnership with a corporation as the sole general partner and with limited partners active in the corporation avoids both the burden of double taxation and the threat of unlimited personal liability. This hybrid business organization is a means by which an investor can have an active role in managing his investment without subjecting himself to personal liability and double taxation. Significant legal barriers stand in the way of general acceptance of this hybrid organization however. This paper will attempt to analyze these legal barriers while detailing the significant business advantages that accrue from the use of the hybrid organization.

II. THE ADVANTAGES OF THE HYBRID ORGANIZATION

The limited partnership managed by a corporate general partner, with limited partners acting as corporate directors, officers, and stockholders offers to the investor the advantages of a greater chance at obtaining needed financing, conduit tax treatment, and limited liability while retaining an active role in the limited partnership.

A. Finance

The corporate general partner may be able to more easily obtain financing than a non-corporate general partner, because laws regulating corporate borrowing sometimes impose a higher ceiling rate than laws regulating lending to individuals. The difference between the corporate borrowing rate and the individual borrowing rate may be significant. In Florida, for example, the ceiling on interest rates for individual borowing is ten percent while the ceiling for corporations is fifteen percent.[1] In Georgia there is no ceiling on interest rates for loans in excess of $2,500 obtained by corporations,[2] but individuals cannot borrow at a rate greater than nine percent.[3] Given this difference, a bank may legally be able to charge a corporation a higher rate of interest and a corporation may then be able to acquire needed financing. In a similar situation, a bank may hesitate to lend to an individual at the legally dictated lower rate of interest but may be willing to lend to the corporation because of the greater interest return.

B. Tax

The hybrid organization also offers a significant tax advantage.[4] The hybrid structure with the corporation as general partner and the investors as limited partners avoids the double taxation of the corporate structure.[5] In a limited partnership there

1. FLA. STAT. ANN. § 687.02 (West Supp. 1978).
2. GA. CODE ANN. § 57-118 (1977).
3. *Id.* § 57-101 (1977).
4. Sonfield, *The Texas Limited Partnership as a Vehicle for Real Estate Investment,* 3 ST. MARY'S L. J. 13, 17 (1971).
5. Whether a limited partnership with a corporation as the sole general partner will be determined to be a partnership or an association will be determined by a totality of the circumstances test. Rev. Proc. 72-13, 1972-1 C.B. 735. "[A] limited partnership will be treated as an association if . . . the organization more nearly resembles a corporation than an ordinary partnership or other business organization." Treas. Reg. § 301.7701-3 (1979). The major factors that are used to determine if a limited partnership resembles a corporation are continuity of life, centralization of management, limited liability, and free transferability of interests. Treas. Reg. § 301.7701-2 (1979); Sonfield, *supra* note 4, at 18-22. The Internal Revenue Service will issue a ruling letter determining whether the hybrid organization formed will be classified as a partnership rather than a corporation if the following conditions are met:

> [1] if [t]he limited partners [do] . . . not own . . . more than 20 percent of the stock of the corporate general partner or any affiliate, . . . [2] if the corporate general partner has an interest in only one limited partnership and the total contribution to that partnership is less than $2,500,000, the net worth of the corporate general partner at all times will be at least 15 percent of such total contribution or $250,000, whichever is the lesser; if the total contributions to that partnership are $2,500,000 or more, the net worth of the corporate general partner at all times will be 10 percent of such total contributions. . . . [3] If the corporate general partner has interests in more than one limited partnership the net worth requirements explained in [2] will be applied separately for each limited partnership, and the corporate general partner will have at all times, . . . a net worth at least as great as the sum of the total amounts required under [2] above for each separate limited partnership.

[4] For purposes of computing the net worth of the corporate general partner in [2] and [3] above, the

is no taxation at the organizational level. Rather the gain or loss of the enterprise is passed directly to the investor,[6] and the conduit tax treatment affords the investor tax leverage not available to the usual corporate investor. This tax leverage often allows the limited partner to offset substantial gains earned from other income sources with the substantial depreciation or depletion that is often incurred by limited partnerships active in such investments as real estate, oil, and gas.[7] Because of this substantial depreciation and depletion that flows through directly to the limited partner, it is in these types of business activities that the tax advantages of the hybrid organization are most apparent and pronounced.

C. Liability

The hybrid organization also offers to the investor the limited personal liability of the limited partner and the direct involvement in partnership affairs not found in limited partnerships with an individual as general partner. By forming a limited partnership with a corporation as the sole general partner, all persons in the limited partnership can be effectively shielded from any personal liability, but the limited partners may continue an active role in the business of the limited partnership by acting as directors, officers, and stockholders of the corporation. In the hybrid organization the limited partners trade the unlimited personal liability of individual general partnership for the personal liability shield of corporate stock ownership while continuing an active role in the limited partnership.[8]

D. Alternatives

These significant advantages are not entirely exclusive to the hybrid corporation. To a limited extent some of the advantages may be attained by the use of other business arrangements. A subchapter S corporation allows conduit taxation while providing the protection of limited liability and the avoidance of the restraints

current fair market value must be used. [5] The purchase of a limited partnership interest by a limited partner does not entail either a mandatory or discretionary purchase or option to purchase any type of security of the corporate general partner or its affiliate. [6] The organization and operation of the limited partnership must be in accordance with the applicable state statutes relating to limited partnerships. Rev. Proc. 72-13, 1972-1 C.B. 735; Rev. Proc. 74-17, 1974-1 C.B. 438. *See generally* Stein, *Partnership Taxation for the Limited Partnership with a Corporate General Partner — It Can be Done*, 25 U. OF MIAMI L. REV. 435, 436-40 (1971); Comment, *The Limited Partnership with a Corporate General Partner — Federal Taxation — Partnership or Association*, 24 SW. L. J. 285 (1970).

6. Sonfield, *supra* note 4, at 17.

7. *Id.* at 17; Comment, *supra* note 5, at 286.

8. Stein, *supra* note 5, at 435.

on individual borrowing. A subchapter S corporation is a tax election. It is limited primarily, because it is restricted to corporations owned by no more than fifteen shareholders.[9]

A second alternative to the hybrid is to place the ownership of the limited partnership in the name of the spouse. The legal effect of putting the limited partnership in the name of the spouse is to separate the limited partnership ownership from the active control of the corporation. The practical effect is to have both the ownership and control in one family unit. One limitation on this alternative is the possible consequences of divorce. Marriages like partnerships have a tendency to suffer discord and dissolution.

A final alternative is to be employed by the corporate general partner at as high a salary as is possible.[10] This alternative avoids the double taxation on the corporate investment, because salaries are a deductible business expense for the corporation. However, no advantage can be taken of depreciation incurred by the partnership entity. Depreciation deductions are not passed through to the corporate employees.

Because of the limitations on each of the possible alternatives, each is basically inadequate. The hybrid limited partnership is a less limited means by which an investor can have an active role in managing his investment without subjecting himself to personal liability or double taxation on his investment.

III. THE LEGAL BARRIERS

Corporations and limited partnerships historically developed as legally distinct and separate areas of the law. Both the Greeks and the Romans are known to have made use of the corporate association.[11] Limited partnerships existed in France and Italy in the Middle Ages.[12] Growing from these beginnings came the idea

9. I.R.C. §§ 1371-72 (1979).

10. Hamilton, *Corporations*, 30 Sw. L. J. 153, 156 (1976).

11. The ancient Greeks are known to have formed corporations as early as the time of Solon (635-558 B.C.). The only limitation on these Greek associations was that their purpose not be in conflict with general law. J. KENT, 2 COMMENTARIES ON AMERICAN LAW 269 (1896). The Romans were introduced to corporations by Numa Pompilius, the second king of Rome (715-672 B.C.). Pompilius sought to break two large factions of Rome into less politically dangerous smaller factions. Every trade and profession was broken down into smaller societies (corporations). W. BLACKSTONE, COMMENTARIES ON THE LAWS OF ENGLAND 468-69 Volume I (1897).

12. The beginnings of the limited partnership organization were described in Ames v. Downing, 1 Brad. 327 (N.Y. 1850).

> The system of limited partnerships, which was introduced by statute into this State, and subsequently very generally adopted in many other States of the Union, was borrowed from the French Code. (3 Kent, 36; *Code de Commerce*, 19, 23, 24). Under the name of *la Societe en commandite*, it has existed in France from the time of the middle ages; mention being made of it in the most ancient commercial records, and in the early mercantile regulations of Marseilles and Montpelier. In the vulgar Latinity of the middle ages it was styled *commenda*, and in Italy *accomenda*. In the statutes of Pisa

that corporations and partnerships were distinct business entities not to be entangled.

Arising out of these distinct and separate beginnings developed two basic theories which, absent statutory authority to the contrary, barred corporations from becoming partners.

A. Wrongfull Delegation

The first traditional bar to corporate partnership was the argument that by entering into a partnership a corporation wrongfully delegated the power of its directors.[13] The argument was based upon the ability of one partner in a partnership to bind the other. Thus if a corporation were allowed to be a partner, the corporation could be bound by actions of the noncorporate partner. This power of the noncorporate partner to bind the corporation was thought to be hostile to the responsibility of the board of directors. It was their exclusive duty to manage the corporation. The power of the noncorporate partner to bind the corporation was too great an abdiction of the board of directors' power. That abdiction would deprive the corporate stockholders of their corporate control.[14] Stockholders control a corporation only through their election of directors, and the elected directors remain obligated to the stockholders by their fiduciary relationship.[15] A partner's ability to bind the corporation was thus seen as a breakdown in the stockholder's ability to control his investment.

Mallory v. Hananer Oil Works[16] was a leading case stating the wrongful delegation argument. In *Mallory* the court stated that

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and Florence, it is recognized so far back as the year 1160; also in the ordinance of Louis-le-Hutin, of 1315; the statutes of Marseilles, 1253; of Geneva, of 1588. In the middle ages it was one of the most frequent combinations of trade, and was the basis of the active and widely extended commerce of the opulent maritime activities of Italy. It contributed largely to the support of the great and prosperous trade carried on along the shores of the Mediterranean, was known in Languedoc, Provence, and Lombardy, entered into most of the industrial occupations and pursuits of the age, and even travelled under the protection of the arms of the Crusaders to the city of Jerusalem. At a period when capital was in the hands of the nobles and clergy, who from pride of caste, or canonical regulations, could not engage directly in trade, it afforded the means of secretly embarking in commercial enterprises, and reaping the profits of such lucrative pursuits, without personal risk; and thus the vast wealth, which otherwise would have lain dormant in the coffers of the rich, became the foundation, by means of this ingenious idea, of that great commerce which made princes of the merchants, elevated the trading classes, and brought the Commons into position as an influential estate in the commonwealth.

Id. at 329-30.

13. H. BALLANTINE, BALLANTINE ON CORPORATIONS § 87 (rev. ed. 1946).

14. *Id.*

15. *See id.*

16. 86 Tenn. 598, 8 S.W. 396 (1888).

> if a corporation be a member of a partnership, it may be bound by any other member of the association, and in so doing he would act, not as an officer or agent of the corporation; and by virtue of authority received from it, but as a principal in an association in which all are equal, and each capable of binding the society by his acts. The whole policy of the law creating and regulating corporations looks to the exclusive management of the affairs of each corporation by the officer provided or authorized by its charter. The management must be separate and exclusive, and any arrangement by which the control of the affairs of the corporation should be taken from its stockholders and the authorized officers and agents of the corporation, would be hostile to the policy of our general incorporation acts.[17]

B. Unforeseen Liabilities

The unforeseen liabilities that the corporation could incur because of its partnership involvement is the focus of the second traditional argument stated as preventing corporations from becoming general partners. A corporate partner, it was argued, would be liable to risks to its assets not contemplated by the stockholders at the time of investment because of the power of the non-corporate partner to bind the corporation.[18] *Whittenton Mills v. Upton*[19] is a leading case standing for the rule that the directors of the corporation must have the exclusive power to "contract the debt" of the corporation.[20]

C. Breakdown of Barriers

Despite the widespread acceptance of these arguments barring corporate partners, the rule against corporate partners was never absolute. The rule was not applied whenever the rationale behind the rule was found not to apply. Thus corporate partnerships were upheld whenever a statute or the corporate charter empowered the corporation to be a partner.[21] It was reasoned that if a statute or the corporate charter empowered the corporation to be a partner, there was notice to the stockholder at the time of his investment that the

17. Mallory v. Hananer Oil Works, 86 Tenn. 598, 604-05, 8 S.W. 396, 399 (1888).
18. Annot., 60 A.L.R.2d 917, 930 (1958).
19. 76 Mass. (10 Gray) 582 (1858).
20. H. BALLANTINE, *supra* note 13.
21. *Id.*

corporation might enter into a partnership, and the stockholder could not then argue that his investment was subject to unforeseen liabilities or that there was wrongful delegation.

The rationale behind the rule barring corporate partners also did not apply when the corporate partner reserved all management powers.[22] Where all management powers were reserved a corporation was allowed to be a partner, because the corporation, although sharing profits, had not abdicated any directorial control nor could its partner risk any corporate assets.

Similarly many courts excepted mining corporations from the rule barring corporate partnerships, because in a mining partnership there are constraints on the ability of one partner to bind the other.[23] Mining partnerships are allowed to bind the partnership only if the agreement has "a direct connection with the development of the mining venture which is the subject of the partnership."[24] This limitation on the power of one mining partner to bind the other apparently resulted from the free transferability of a mining partner's interest in the partnership. A mining partner may freely transfer his interest in the partnership without the consent of the other partners. Neither does the death of one partner dissolve the partnership. Since a mining partner could freely transfer his interest the restraint on liability was imposed. Because of this liability restraint resulting from the unique nature of mining partnerships, mining partnerships were excluded from the prohibition against corporate partners.[25]

The carving of exceptions to the traditional rules ended in many states with the enactment of statutes specifically empowering corporations to be partners.[26] The passage of these statutes was

22. R. STEVENS, HANDBOOK ON THE LAW OF PRIVATE CORPORATIONS § 57 (2d ed. 1949).

23. *Id.*

24. Strum v. Ulrich, 10 F.2d 9, 12 (8th Cir. 1925).

25. *See id.*

26. The following states have statutes specifically empowering a corporation to be a general partner: ALA. CODE tit. 10 § 2-163 (1975); ALASKA STAT. § 10.05.009.18 (1968); ARIZ. REV. STAT. ANN. § 10-004.A.15 (1977); ARK. STAT. ANN. § 64-104.B.6 (1966); CAL. CORP. CODE § 207.h (West Supp. 1978); COLO. REV. STAT. § 7-3-101.1.1(r) (1973); DEL. CODE ANN. tit. 8 § 122.11 (1974); FLA. STAT. ANN. § 607.011(n) (West 1977); GA. CODE ANN. § 22-202(b) (10) (1977); IDAHO CODE § 30-114.2.1 (1967); IND. CODE ANN. § 23-1-2-2.b(14) (Burns Supp. 1978); IOWA CODE ANN. § 496A.4.18 (West Supp. 1978-1979); KAN. STAT. ANN. § 17-6102.11 (1974); KY. REV. STAT. ANN. § 271A.020.16 (Supp. 1978); ME. REV. STAT. ANN. tit. 13-A § 202.1.Q (West. 1964); MD. CORP. & ASS'NS. CODE ANN. § 2-103.12 (1975); MICH. COMP. LAWS ANN. § 450.1261.n (1973); MINN. STAT. ANN. § 301.09(8) (West Supp. 1978); MO. ANN. STAT. § 351.385.5 (Vernon 1966); NEB. REV. STAT. ANN. § 21.2004.17 (1977); N.H. REV. STAT. ANN. § 305.2(3) (Supp. 1977); N.J. STAT. ANN. § 14A:3-1.1(m) (West Supp. 1978-1979); N.M. STAT. ANN. § 53-11-4.Q (1978); N.Y. BUS. CORP. LAW § 202.a(15) (McKinney 1963); OHIO REV. CODE ANN. § 1701.13(F) (4) (1978); ORE. REV. STAT. § 57.030(17) (1977); PA. STAT. ANN. tit. 15 § 1302.18 (Purdon 1967); R.I.GEN. LAWS ANN. § 7-1.1-4.q (1969); S.C. CODE ANN. 33-3-20.a(16) (1976); TENN. CODE ANN. § 48-402.1 (Supp. 1978); TEX. BUS. CORP. ACT art. 2.02.A.18 (Vernon Supp. 1978-1979); VT. STAT. ANN. tit. 11 §1852.8 (1973); VA. CODE §13.1-2.1 (1978); W. VA. CODE § 31-1-8.p (1975); WIS. STAT. ANN. § 180.04(14) (West Supp. 1978-1979); WYO. STAT. ANN. § 17-1-104.a(xix) (1977). Of the remaining states only

both a recognition that the rule forbidding corporate partners was largely being devoured by the exceptions and a reflection of the modern, legal thought that the traditional arguments justifying the prohibition of corporate partners were no longer persuasive.

Aside from the exceptions detailed above where the rationale of the rule forbidding corporate partners was found not to apply, many times the rule was avoided by a finding that a corporation had only entered into a joint venture rather than a partnership.[27] A corporation could legally enter into a joint venture for purposes otherwise empowered by the corporate charter. By entering into a joint venture, one joint adventurer does not gain control over the other. Rather, a joint venture is a combining of resources to carry out a single business enterprise for profit. A joint venture is limited in scope and duration.[28] The courts often found a joint venture rather than a partnership when it was desired to avoid the harsher effects of striking down the enterprise as a "partnership,"[29] but the result was a dilution of the strength of the rule forbidding corporate partners.

The prohibition against corporate partners can be attacked head on as well as eroded by exceptions. In response to the wrongful delegation argument, it can be argued that a corporation must delegate power to act. A corporation can act only by delegating power and responsibility to its agents. A partnership is nothing more than a mutual agency. In entering into a partnership, a corporation is really merely appointing an agent to act on its behalf just as a corporation appoints any one of its employees or officers to act on its behalf.[30] There is in effect then no "wrongful delegation."

The argument that focuses on the unforeseen liabilities that could be incurred by the corporation because of the partner is refuted by the recognition that the partner can bind the partnership only when acting to carry out the usual business of the partnership.[31] If the partner acts outside the apparent usual course of business, the partnership will not be liable for the partner's acts.[32] This restraint on the ability of one partner to bind the other

Nevada and Utah do not have statutes that are similar or comparable to Section 4(g) of the Model Business Corporation Act which has been construed to empower corporations to be general partners.

27. *See* Houston v. Dexter & Carpenter, 300 F. 354 (E. D. Va. 1924), *modified*, 20 F.2d 647 (4th Cir. 1927); Luhrig Collieries Co. v. Interstate Coal & Dock Co., 281 F. 265, 274 (S.D.N.Y. 1922).

28. H. HENN, HANDBOOK OF THE LAW OF CORPORATIONS § 49 (2d ed. 1970).

29. *See* Houston v. Dexter & Carpenter, 300 F. 354 (E.D. Va. 1924), *modified*, 20 F.2d 647 (4th Cir. 1927); Luhrig Collieries Co. v. Interstate Coal & Dock Co., 281 F. 265, 274 (S.D.N.Y. 1922).

30. *See* UNIFORM PARTNERSHIP ACT (U.L.A.) § 9(1) (1969).

31. *Id.*

32. *Id.*

refutes the unforeseen liability argument, because the usual business of the partnership is consistent with the interest of the corporation.[33] The corporation will not prosper unless the partnership does, and thus the interests of the corporation and partnership are the same. Both have an interest in making a profit.

IV. THE DEVELOPMENT OF THE HYBRID

Many of the statutes that were enacted to empower the corporation to be a partner were modeled after or are comparable to Section 4(p) of the Model Business Corporations Act[34] and specifically state that corporations may be partners.[35] Other states[36] have passed only the more nebulous Section 4(g).[37] A sizeable minority of states specifically empower corporations to be members of limited partnerships however.[38] Where a state statute specifically empowers corporations to be members of limited partnerships there is no question that a corporation can be a limited partner or a general partner in a limited partnership. However, where corporations are only empowered to be partners under section 4(p) or 4(g) of the M. B. C. A., a question of legislative intent arises.

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33. 6 TEX. TECH. L. REV. 1171, 1172 (1975).

34. The following states have statutes identical or similar to the Model Business Corporation Act § 4(p): ARIZ. REV. STAT. ANN. § 10-004.A.15 (1977); FLA. STAT. ANN. § 607.011(n) (West 1977); IDAHO CODE § 30-114.2.1 (1967); IND. CODE ANN. § 23-1-2-2.b(14) (Burns Supp. 1978); KY. REV. STAT. ANN. § 271A.020.16 (Supp. 1978); MD. CORP. & ASS'NS. CODE ANN. § 2-10.12 (1975); N.M. STAT. ANN. § 53-11-4.Q (1978); N.Y. BUS. CORP. LAW § 202.a(15) (McKinney 1963); OHIO REV. CODE ANN. § 1701.13(F) (4) (1978); ORE. REV. STAT. § 57.030(17) (1977); PA. STAT. ANN. tit. 15, § 1302.18 (Purdon 1967); R.I.GEN. LAWS ANN. § 7-1.1-4.Q (1969); TEX. BUS. CORP. ACT art. 2.02. A.18 (Vernon Supp. 1978-1979); W. VA. CODE § 31-1-8.p (1975); WIS. STAT. ANN. § 180.04(14) (West Supp. 1978-1979).

35. "Each corporation shall have power: . . . .

(p) To be a promoter, partner, member, associate, or manager of any partnership, joint venture, trust or other enterprise."

MODEL BUS. CORP. ACT ANN. 2d § 4 (p). North Dakota has not adopted this paragraph into its code.

36. The following states have statutes identical or similar to Section 4(g) of the Model Business Corporation Act but have not enacted a statute identical or similar to Section 4(p) nor do they specifically authorize a corporation to be a limited partner: Hawaii, Louisiana, Mississippi, Missouri, Montana, North Dakota, Utah, Washington.

37. Each corporation shall have power:. . . .

(g) To purchase, take, receive, subscribe for, or otherwise acquire, own, hold, vote, use, employ, sell, mortgage, lend, pledge, or otherwise dispose of, and otherwise use and deal in and with, shares or other interests in, or obligations of, other domestic or foreign corporations, associations, *partnerships* or individuals, or direct or indirect obligations of the United States or of any other government, state, territory, governmental district or municipality or of any instrumentality thereof.

MODEL BUS. CORP. ACT § 4(g) (emphasis added). North Dakota has adopted a paragraph identical in substance. N.D. CENT. CODE § 10-19-04 (1976).

38. ALA. CODE tit. 10 § 2-163 (1975); ALASKA STAT. § 10.05.009.18 (1968); ARK. STAT. ANN. § 64-104.B.6 (1966); COLO. REV. STAT. § 7-3-101.1.1(r) (1973); DEL. CODE ANN. tit. 8 § 122.11 (1974); FLA. STAT. ANN. § 607.011(n) (West 1977); IOWA CODE ANN. § 496A.4.18 (West Supp. 1978); KAN. STAT. ANN. § 17-6102.11 (1974); MICH. COMP. LAWS ANN. § 450.1261.n (1973); MINN. STAT. ANN. § 301.09(18) (Supp. West 1978); MO. ANN. STAT. § 351.385.5 (Vernon 1966); NEB. REV. STAT. ANN. § 21.2004.17 (1977); N.H. REV. STAT. ANN. § 305.2(3) (Supp. 1977); N.J. STAT. ANN. § 14A:3-1.1(m) (West Supp. 1978-1979); WYO. STAT. ANN. § 17-1-104.a(xix) (1977).

Did the legislature intend to empower corporations to be members of limited as well as general partnerships? An indication of that intent can be determined by assessing the validity of the traditional arguments barring corporations from becoming members of general partnerships as they apply to limited partnerships with a corporate limited or general partner.

A. Corporate Limited Partners

A strong argument supports corporate limited partners. A limited partner is liable only to the extent of his contribution to the limited partnership.[39] The limited partner is not personally liable beyond the extent of that contribution, but in exchange for that limited liability the limited partner is precluded from taking part in the control of the business of the limited partnership.[40] Thus if a corporation is a limited partner the only control on its assets relinquished by the corporation is the investment in the limited partnership. The remainder of the corporate assets would remain under the direction and control of the corporate officers and directors. There has been then no significant delegation of the powers of the directors and officers of the corporation. The directors or officers in choosing to invest in the limited partnership have exercised their function to guide corporate development. The powers of the board of directors have not been wrongfully-delegated. Rather the corporate directors have made a very ordinary business decision to invest a certain amount of corporate assets subject to some possible risk. In no event will the risk to the corporation exceed the total value of the assets invested in the limited partnership.

The court in *Port Arthur Trust Co. v. Muldrow*[41] argued that the rule barring corporate general partners was inapplicable to the situation where the corporation was a limited partner. The wrongful delegation argument was held not to apply, because none of the assets of the corporation had been invested in the limited partnership. Rather only the trusts which the corporation was charged with were invested in the limited partnership. The unforeseen liabilities argument was inapplicable, because none of the corporate assets were subject to partnership risk. Neither were they subject to any direction other than from corporate officers and directors.[42]

39. *See* UNIFORM LIMITED PARTNERSHIP ACT (U.L.A.) §§ 7, 17 (1969).
40. *Id.* § 7.
41. __ Tex. __, 291 S.W.2d 312 (1956).
42. Port Arthur Trust Co. v. Muldrow, __ Tex. __, __, 291 S.W.2d 312, 314 (1956).

The court in *Muldrow* made a statutory argument to justify allowing a corporation to be a limited partner. The court asserted that generally the use of the term "person" in a statute was construed as including corporations, absent a contrary indication. In trying to determine whether a corporation was a "person" empowered to be a limited partner, no contrary indication was found. A limited partnership is defined simply as a "partnership formed by two or more persons,"[43] and no provision in the U. L. P. A. excludes a corporation as a person.[44]

B. Corporate General Partners in a Limited Partnership

Many of the same arguments that justify a corporate limited partner also apply to the sole corporate, general partner in a limited partnership. A corporation acting as sole general partner does not delegate any directorial powers nor are any corporate assets subject to any unforeseen risks. The limited partners cannot incur liabilities against the corporate assets, because they have relinquished all control in the limited partnership.[45] Clearly the sole, general, corporate partner in a limited partnership is but a variation on the long accepted exception to the traditional rule against corporate general partnership where the corporation, although a general partner, reserved all management powers of the partnership.

This argument for corporations as sole general partners is buttressed by the reasoning that the dangers in terms of the traditional rules barring corporate partnerships are, as has been shown, substantially less in a limited partnership with a corporate, general partner than in a general partnership. Logically then, if the legislature has empowered corporations to be partners in general partnerships, then sole, corporate, general partners in a limited partnership should be permissible.[46]

A statutory argument for corporate, general partners in a limited partnership relies on the interrelationship of the Uniform Partnership Act and the Uniform Limited Partnership Act. Section 2 of the U. P. A. defines "persons" as including corporations. A limited partnership is defined as being "formed by two or more p-

43. UNIFORM LIMITED PARTNERSHIP ACT (U.L.A.) § 1 (1969).
44. __ Tex. at __, 291 S.W.2d at 315.
45. *See* UNIFORM LIMITED PARTNERSHIP ACT (U.L.A.) § 22 (1969).
46. Kitchell Corp. v. Hermansen, 8 Ariz. 424, __, 446 P.2d 934, 936 (1968).
47. UNIFORM LIMITED PARTNERSHIP ACT (U.L.A.) § 1 (1969).

ersons,"[47] but "persons" is never defined in the U. L. P. A. Lacking a U. L. P. A. definition of person, the U. P. A. definition is applied as provided by U. P. A. §6(a): "This act shall apply to limited partnerships except insofar as the statutes relating to such partnerships are inconsistent therewith." Absent any inconsistent statute the U. P. A. and U. L. P. A. clearly do not bar and may be construed as empowering corporate, limited partnership involvement.[48]

One section of the U. L. P. A. can be construed to be inconsistent with the U. P. A. Section 21 of the U. L. P. A. refers to the effect of the "retirement, death, or insanity" of a general partner. This section can by implication preclude a corporate general partner. A corporation is by definition eternal and sane. This section gives some indication that corporations were not intended to be general partners.[49] It is quite likely though that corporations were never meant to be barred from limited partnerships, but rather the advantages resulting from the use of corporate general partners were probably just not foreseen when the U. L. P. A. was drafted.[50]

The policy argument that stresses a need for someone to be personally liable in limited partnerships is also expressed as a bar to corporate general partners in limited partnerships. The policy argument stresses that a nominally capitalized corporation could evade the liability imposed upon general partners by the U. L. P. A.[51] However, the power to pierce the corporate veil may be exercised by the courts where there is inadequate initial financing or where the financial resources of the corporation are drained off to the detriment of the creditors.[52] If the corporate veil is pierced and the corporate entity disregarded, the individual stockholders become personally liable.[53] By disregarding the corporate entity only when there has been inadequate capitalization, the tax, financial, and limited liability advantages of the hybrid organization would be available to those willing to adequately finance their corporations.

48. 8 Ariz. 424, 446 P.2d 934 (1968); __ Tex. __, 291 S.W.2d 312 (1956); Frigidaire Sales Corp. v. Union Properties, Inc., 88 Wash. 2d 400, 562 P.2d 244 (1977).

49. Delaney v. Fidelity Lease, Ltd., 517 S.W.2d 420, 426 (Tex. Ct. App. 1974) (Presler, C.J., dissenting) *rev'd in part,* 526 S.W.2d 543 (Tex. 1975).

50. Hamilton, *supra* note 10, 157-8.

51. Delaney v. Fidelity Lease, Ltd., 526 S.W.2d 543, 546 (Tex. 1975).

52. Frigidaire Sales Corp. v. Union Properties, Inc., 88 Wash. 2d 400, __, 562 P.2d 244, 247 (1977).

53. Mayo v. Pioneer Bank & Trust Co., 270 F.2d 823, 830 (5th Cir. 1959), *rehearing denied,* 274 F.2d 320 (5th Cir. 1960), *cert. denied,* 362 U.S. 962 (1960); Majestic Co. v. Orpheum Circuit, 21 F.2d 720, 724 (8th Cir. 1927).

C. The Hybrid and the Control Test

All of the advantages of the hybrid organization accrue only when the limited partners are also officers, directors, and shareholders of the corporate general partner. Whether those limited partners active in the corporation are protected by the corporate fiction from personal liability imposed by the "control" test of section 7 of the U. L. P. A. is in question however. The control test provides that any limited partner who acts to control the business of the limited partnership is liable as a general partner. The courts must accept that a limited partner while acting in a corporate capacity is not also a limited partner controlling the partnership if the limited partner is not to be held generally liable. The acts for the corporation must be distinguished from the acts in the capacity of limited partner. The Texas court in *Delaney v. Fidelity Lease Limited* would not accept the corporate fiction.[54] The court adopted a part of the dissent of the lower court which found

> it difficult to separate the [defendants'] acts for they were at all times in the dual capacity of limited partners and officers of the corporation. Apparently the corporation had no function except to operate the limited partnership and [the defendants] were obligated to their other partners to so operate the corporation as to the benefit of the partnerships. Each act was done then, not for the corporation, but for the partnership. Indirectly, if not directly, they were exercising control over the partnership. Truly the corporate fiction was in this instance a fiction.[55]

There is reason to respect the corporate fiction as applied to limited partners however. There is arguably no conflict of interest between the corporation and the limited partnership. Both have an interest in a profitable limited partnership. The Washington Court of Appeals has recognized that there is "no inherent wrong"[56] in that dual relationship and that "dual capacities are not inimical."[57] Indeed, courts should have no less trouble accepting the corporate fiction when limited partners are active in the corporation then

54. 526 S.W.2d at 546.
55. *Id.* at 545.
56. Frigidaire Sales Corp. v. Union Properties, Inc., Wash. App. ___, 544 P.2d 781, 784 (1976), *aff'd.* 88 Wash. 2d 400, 562 P.2d 244 (1977).
57. *Id.*

when two persons operate a business by way of a close corporation.

It is argued, however, that the corporate fiction in this case acts to circumvent the control test, and a court should disregard the corporate fiction when the corporate form is used to circumvent a statute.[58] The hybrid with the limited partners active in the corporation does circumvent the control test statute as it reads on its face but the corporation is a statutory creature. It is designed to avoid personal liability.[59] The statutory control test then is in seeming conflict with the statutory corporate scheme designed by legislatures to avoid the personal liability that the control test would impose. When two statutes are in conflict they are to be construed as being consistent with each other if possible.[60] The statutory control test and the statutory scheme creating corporations can be construed as being consistent with each other if the corporate entity is respected when a limited partner is active in the corporate general partner. The control test should not be applied blindly with no regard to its purpose. When the limited partner conscientiously keeps his actions in his corporate capacity separate and distinct from his actions within his capacity as limited partner and where the corporation is known to be the general partner, no injustice is committed by respecting and not piercing the corporate veil.

The purpose of the control test is to "prevent third parties from mistakenly assuming that the limited partner is a general partner and to rely on his general liability."[61] The control test thus may be construed as implicitly containing a reliance requirement. The Washington court in *Frigidaire Sales Corp. v. Union Properties, Inc.*[62] recognized such a reliance component in the control test. The limited partners active in the corporate, general partner had "conscientiously kept the affairs of the corporation separate from their personal affairs, and no fraud or manifest injustice [was] perpetrated upon third parties who [dealt] with the corporation. The corporation's separate entity should be respected."[63] The court found that no reliance had been placed upon the personal liability of the limited partners.

Similarly in *Western Camps v. Riverway Ranch Enterprise,*[64] one of the limited partners who was also an officer, director, and shareholder of the corporate, general partner, negotiated a

58. 526 S.W.2d at 546.
59. Ramey v. Koons, 230 F.2d 802, 806 (5th Cir. 1956); Elenkrieg v. Siebrecht, 238 N.Y. 254, 144 N.E. 519 (1924); Buckner v. Dillard, 184 Okla. 586, 89 P.2d 326 (1939).
60. Thornton v. Anderson, 207 Ga. 714, 64 S.E.2d 186, 188-89 (1951).
61. 517 S.W.2d 420, 425 (Ct. App. 1974) *rev'd in part*, 526 S.W.2d 543 (Tex. 1975).
62. 88 Wash. 2d 400, 562 P.2d 244 (1977).
63. 88 Wash. 2d at ___, 562 P.2d at 247.
64. 70 Cal. App. 3d 714, 138 Cal. Rptr. 918 (Ct. App. 1977).

sublease. In considering the "control" test the court pointed out that the limited partner had intended to act only within the corporate entity and that the creditor was fully aware that the corporation was the general partner of the limited partnership. The court accepted the argument that the limited partner was at all times "acting with his capacity as agent of the corporate general partner, not in his capacity as a limited partner."[65] Since the limited partner acted only within the corporate entity and because the creditor was fully aware that the corporation was the general partner no reliance was placed on the limited partner's personal liability. Finding no reliance, there was no valid reason for imposing personal liability upon the limited partner.

There is no actual mention of a reliance requirement in the control test. If a court applies the control test strictly without examining its purpose, then any limited partner who has been active in the limited partnership will be held personally liable. The limited partner will be personally liable even though he always acted within his corporate capacity and the creditors knew that the general partner was a corporation. The limited partner will be personally liable despite the lack of any possible reliance on his personal liability, because the court finds no explicit requirement of reliance in the wording of the control test.[66]

As long as the limited partners act within their corporate capacities and the business dealings are voluntary and without deception, there seems to be little reason to apply the control test without the implied reliance requirement. A creditor dealing with a corporation knows that he cannot look to the personal liability of the corporate agents if the corporation is unable to cover its liabilities. The creditor knows that he assumes the risk of loss if the corporation is unable to meet its liabilities. However, the creditor always has the option of getting a personal guarantee from someone in the corporation before dealing with the corporation if the corporation's financial situtation is questionable. There is no logical reason for a creditor who knows he is dealing with a corporation that is the general partner of a limited partnership to be able to look to the corporate agents' personal liabilities just because those corporate agents are also limited partners.[67] There is then no valid justification to pierce the corporate veil of the corporate

65. Western Camps, Inc., v. Riverway Ranch Enterprises, 70 Cal. App. 3rd 714, __, 138 Cal. Rptr. 918, 926 (Ct. App. 1977).
66. 526 S.W.2d at 545.
67. 562 P.2d at 247.

general partner when the creditor has knowingly and voluntarily dealt with the corporate general partner, and the parties have allocated the risks by their agreement.

V. CONCLUSION

The limited partnership with a corporate, general partner owned and managed by the limited partners offers the unique advantages of limited liability, conduit taxation, and active control over the investment. The hybrid business organization has evolved out of an increasing judicial and legislative acceptance of corporate involvement in partnerships. The thrust for change came from businessmen seeking to avoid taxes and insulate themselves from personal liability. Legislative action has abolished the traditional barriers to corporate partners represented by the arguments that a corporation in a partnership wrongfully delegated to the partner powers that were the exclusive duty of the board of directors to exercise and wrongfully subjected corporate assets to risks not contemplated by the stockholders at the time of their investment.

Despite the abolition of the traditional arguments by statute, the control test of section 7 of the U. L. P. A. remains as a present threat to the limited partner active in the corporate, general partner of a limited partnership. *Delaney v. Fidelity Lease Limited*[68] and *Frigidaire Sales Corp. v. Union Properties, Inc.*[69] are the landmark cases delineating the present conflict in the courts over the acceptance of the corporate general partner as a shield from the general liability the control test would impose. These two cases take opposing approaches in reading and applying the control test. In *Delaney* a plain meaning reading was adopted. In *Frigidaire* an implied reliance requirement was read into the control test.

In the long run it will probably be the state legislature and not the courts that finally determine if the hybrid will be acceptable. A revised Uniform Limited Partnership Act was drafted in 1976, and that revision added a definitions section. That definitions section includes "corporations" within its definition of persons that can be general and limited partners.[70] The revision also itemizes a number of things that will not be considered as taking part in the control of the business. These "safeharbor" provisions include a provision for agents and employees of the limited or general partners.[71] The

68. 517 S.W.2d 420, *rev'd in part*, 526 S.W.2d 543 (Tex. 1975).
69. 88 Wash. 2d 400, 562 P.2d 244 (1977).
70. UNIFORM LIMITED PARTNERSHIP ACT (U.L.A.) § 101 (1976).
71. *Id.* § 303.

effect of this revision is to allow corporations to be general or limited partners with no danger of personal liability for the limited partners just because they are agents or employees of the corporate general partner.

The revision reflects the better view of the validity of the hybrid organization. Upholding the corporate entity of the hybrid results in no injustice as long as the corporate agents have manifested that their acts are in their capacities as agents for the corporation and there has been no justifiable reliance on their personal liability.

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