Forms of Ownership

Presented by:

Jeffrey C. O’Brien
Mansfield, Tanick & Cohen, PA

I. INTRODUCTION

Real estate can be acquired and owned through many different types of entities or other ownership structures. This section discusses the following forms of ownership: (i) partnerships; (ii) limited liability companies (LLCs); (iii) corporations; and (iv) tenancies in common.

II. PARTNERSHIPS

Partnerships can be classified under 1 of 4 categories: (i) general partnerships; (ii) limited liability partnerships; (iii) limited partnerships; and (iv) limited liability partnerships. Each type of partnership has different characteristics and consequences, as discussed herein.

A. General Partnerships

A general partnership is an association of two or more persons to carry on as co-owners of a business for profit. Minn. Stat. §323A.0101(8). It is the oldest type of business entity, and the easiest to form.

B. Limited Liability Partnerships

A Limited Liability Partnership has most of the same characteristics of a General Partnership. However, an obligation of a partnership incurred while the partnership is a *limited liability partnership* under Minn. Stat. § 323A.1001, whether arising in contract, tort, or otherwise, is solely the obligation of the partnership, and not the individual partners. Minn. Stat. § 323A.0306(c). In other words, all partners are shielded from personal liability in a limited liability partnership.

C. Limited Partnerships

A Limited Partnership is an entity having one or more general partners and one or more limited partners and is formed by two or more persons. Minn. Stat. § 321.0102(11). It is an entity distinct from it partners, and it has a perpetual duration. Minn. Stat. § 321.0104. It can sue and be sued, and it has the power to do all things necessary and convenient to carry on its activities. Minn. Stat. § 321.0105.

D. Limited Liability Limited Partnership

A limited liability limited partnership follows the same statutory structure as a limited partnership with one key difference: limited liability for all partners. An obligation of a limited partnership incurred while the limited partnership is a limited liability limited partnership, whether arising in contract, tort, or otherwise, is solely the obligation of that limited partnership. Minn. Stat. § 321.0404(c). A general partner is not personally liable, directly or indirectly, by way of contribution or otherwise, for such an obligation solely by reason of being or acting as a general partner. *Id*.

III. LIMITED LIABILITY COMPANIES

A limited liability company ("LLC") is a form of business organization that combines the tax advantages of a partnership with the limited liability characteristics of a corporation. In essence, an LLC offers an option in selecting a business entity without having to choose between the tax benefits of a partnership and the liability shield of a corporation.

The Minnesota Limited Liability Company Act was codified in 1992 at Minnesota Statutes Chapter 322B, and became effective on January 1, 1993. The Minnesota LLC Act created a hybrid entity by incorporating the management and control

provisions of the Minnesota Business Corporation Act (Minnesota Statutes Chapter 302A) and the financial, transfer and dissolution provisions of the Uniform Limited Partnership Act. Accordingly, the Minnesota LLC Act allows income and losses to flow through to its members, just as it would in a partnership. Unlike a general partnership, members of an LLC are (for the most part) not personally liable for the debts and obligations of the company.

IV. CORPORATIONS

The Minnesota Business Corporation Act was codified in 1981. Under the Act, a properly created business corporation is a separate legal entity. As such, the general rule is that corporate officers are not liable for the debts and obligations of the corporation, so long as they abide by the standards of conduct established in the statutes; namely that the officer act in good faith and in a manner that he reasonably believes to be in the best interest of the corporation. Minn. Stat. § 302A.251 and 302A.361. A corporation is also a separate legal entity for both state and federal tax purposes. Also for tax purposes, there are two kinds of business corporations, a C corporation and an S corporation.

Aside from the liability and tax benefits of forming a corporation, another benefit of forming a corporation is that it defines and formalizes the business relationship. In addition, the articles of incorporation will establish certain procedures for management and control of the entity.

V. Tenancies-in-Common

Technically speaking, a tenancy-in-common is not a form of an estate, but rather a relationship between cotenants. Generally, a tenancy-in-common occurs when an estate in land is held by several cotenants with distinct titles, but under unity of possession.

Thus, the cotenants own separate, yet undivided interests, in the property. What this means is that each cotenant has a right to possess the whole, and none has the right to exclude the other. Under a tenancy-in-common, cotenants may receive their titles from different sources, under different modes of acquisition, and at different times. In addition, the quality, share, and duration of each cotenants estate may be different. Likewise, each cotenant's interest is devisable, descendable, and alienable, and thus there is no right of survivorship as between cotenants. As to the outside world, the entire tenancy-in-common constitutes a joint estate.

VI. Statutory Scheme and Choice of Governing Law

A. Statutory Scheme

The statutory provisions discussed below for LLCs and partnerships are default provisions.[1] This means that they can be altered in partnership agreements, articles of organization, by-laws etc. Certain rights and duties cannot be contractually altered. For example, if there is a partnership agreement, Minn. Stat. § 323A.0103 outlines non-waivable provisions including the Duty of Care, Duty of Loyalty, Duty of Good faith and Fair Dealing, and certain expulsion and dissociation procedures.

There must also be considerations about choice of law between states. For example, Minnesota's law governs a limited partnership created in Minnesota regarding relations between partners and relations between partners and the partnership. Minn. Stat. § 321.0106. Tax structures can also change in different states when forming an LLC in different states or engaging in activity in different states. It is necessary to look at the

[1] General Partnerships and Limited Liability Partnerships often follow the similar statutory provisions, and may be analyzed together. This also applies to Limited Partnerships and Limited Liability Limited Partnerships.

relevant state and local tax structure to determine whether or not LLCs are taxable entities in that state. Minnesota's LLC Act indicates that the laws of the jurisdiction under which a foreign limited liability company is organized govern its organization, its internal affairs, and the liability of its members. Minn. Stat. § 322B.90. However, a foreign limited liability company holding a valid certificate of authority in this state has no greater rights and privileges than a domestic limited liability company. *Id*. A certificate of authority to transact business in Minnesota does not authorize the foreign limited liability company to exercise any of its powers or purposes that a domestic limited liability company is forbidden by law to exercise in Minnesota. *Id*.

B. Formation - Introduction

1. General Partnerships

There is no written partnership agreement or other documentation required for general partnerships. However, an agreement may be required under the Statute of Frauds if the partnership involves real estate or partnerships that will exist for more than one year**.** If there is no written agreement a court may infer Inadvertent Partnerships. These can be either:

- Implied in fact, meaning that there is still an actual partnership. This depends on whether the partners intend to form a partnership relationship, even if they do not know what a partnership is, and may be implied by conduct. *See* Minn. Stat. §323A.0202.
- Implied in law; depending on reliance by a third party on the existence of a partnership. *See* Minn Stat. §323A.0308. The person alleging that a partnership exists has the burden of proof.

2. Limited Liability Partnerships

A Limited Liability Partnership must file a Statement of Qualification with the Secretary of State. Minn. Stat. § 323A.1001; *see also* Minn. Stat. § 323A.0101(7). The statement must contain: (1) the name of the partnership, (2) the street address, including the zip code, of the partnership's chief executive office and, if different, the street address, including the zip code, of an office in Minnesota. Minn. Stat. § 323A.1001. The terms and conditions on which a partnership becomes a limited liability partnership must be approved by the vote necessary to amend a partnership agreement. *Id.*

The name of a limited liability partnership must meet the standards for corporation names found in Minn. Stat. § 302A.115, the name must also include "Registered Limited Liability Partnership," "Limited Liability Partnership," "R.L.L.P.," "L.L.P.," "RLLP," or "LLP". Minn. Stat. § 323A.1002. If the partnership does not have an office in this state, the statement of qualification must also include the name and street address, including the zip code, of the partnership's agent for service of process. Minn. Stat. § 323A.1001(c)(3). The agent of a limited liability partnership for service of process must be an individual who is a resident of Minnesota, or some other person authorized to do business in this state.[2] Minn. Stat. § 323A.1001(d). The Statement of Qualification must also include a statement that the partnership elects to be a limited liability partnership, and any deferred effective date. Minn. Stat. § 323A.1001(c)(4)-(5).

The status of a partnership as a limited liability partnership is effective on the later of the filing of the statement or a date specified in the statement. Minn. Stat. § 323A.1001(e). The status remains effective, regardless of changes in the partnership,

until it is canceled by the partnership or revoked by the Secretary of State. Minn. Stat. § 323A.1001(f). The status of a partnership as a limited liability partnership and the liability of its partners is not affected by errors or later changes in the information required to be contained in the statement of qualification. *Id.* The filing of a statement of qualification establishes that a partnership has satisfied all conditions precedent to the qualification of the partnership as a limited liability partnership. Minn. Stat. § 323A.1001(g). An amendment or cancellation of a statement of qualification is effective when it is filed or on a deferred effective date specified in the amendment or cancellation. Minn. Stat. § 323A.1001(h).

3. Limited Partnerships and Limited Liability Limited Partnerships

A limited partnership or Limited Liability limited partnership has two different types of partners: general partners and limited partners. A General Partner has many the same characteristics as a partner in a general partnership. Limited partners take on more of a silent role. This difference should be considered when forming a limited partnership or a limited liability limited partnership.

Prior to January 1, 2005, businesses could choose whether they wanted to be governed by the Minnesota Uniform Limited Partnership Act of 1976 or the Minnesota Uniform Limited Partnership Act of 2001 ("The 2001 Act"). However, as of January 1, 2005, the 2001 Act must be followed when forming Limited Partnerships. Under the 2001 Act, a person is defined as "an individual, corporation, business trust, estate, trust, partnership, limited liability company, association, joint venture, government;

[2] A person is any individual, corporation, business trust, estate, trust, partnership, association, joint venture, government, governmental subdivision, agency, or instrumentality, or any other legal or commercial entity. Minn. Stat. § 323A.0101.

governmental subdivision, agency, or instrumentality; public corporation, or any other legal or commercial entity. Minn. Stat. § 321.0102(14). Any of these "persons" can become limited or general partners under a partnership agreement. They can also become general partners following the dissociation of a limited partnership's last general partner, as the result of a conversion or merger, or with the consent of all the partners.

A limited partnership must file a certificate of limited partnership with the Secretary of State. Minn. Stat. § 321.0201. The certificate must include: (1) the name of the limited partnership (which must comply with section 321.0108 for naming corporations), (2) the street and mailing address of the initial designated office and the name and street and mailing address of the initial agent for service of process, (3) the name and the street and mailing address of each general partner, (4) whether the limited partnership is a limited liability limited partnership; and (5) any additional information relating to conversion or merger. *Id.*

4. Limited Liability Companies

The Minnesota LLC Act is quite similar to Minnesota Statutes Chapter 302A, which governs Minnesota business corporations. However, the original Act differed in some important respects.[3] Historically, in order to obtain partnership tax treatment for an LLC, the entity was required to lack at least two of the four elements recognized in federal tax law as characteristics of a corporation. The four elements that were commonly thought of as characteristic of a corporation are: (1) limited liability, (2) centralized management, (3) continuity of life, and (4) free transferability of ownership interests. *See* Former Treas. Reg. § 301.7701-2(a)(1).

[3] The Minnesota LLC Act was amended in 1992 to accommodate to the IRS "Check-the-Box" regulation, which automatically classified LLC's as partnerships for income tax purposes.

A Minnesota LLC is created as a distinct legal entity upon filing Articles of Incorporation with the Secretary of State and paying a $135 filing fee. Minn. Stat. §322B.175. The Articles are effective as of the date of filing. *Id.* Upon filing, the Secretary of State will issue a Certificate of Organization.

After filing the articles, the board of governors (or the organizers if a board has not yet been elected) shall hold an organizational meeting or take written action for the purposes of conducting business and to complete the organization of the LLC. Notice of the meeting shall be made to each organizer or governor in writing and at least three days in advance of the meeting. Minn. Stat. § 322B.60(2). The notice shall contain the date, time and place of the meeting. *Id.*

5. Corporations

An entity may incorporate "for any business purpose or purposes, unless some other statute of this state requires incorporation for any of those purposes under a different law." Minn. Stat. § 302A.101. Any person of at least 18 years of age can incorporate by a corporation "by filing with the secretary of state articles of incorporation for the corporation." § 302A.105. The articles of incorporation must include the following: "(a) The name of the corporation;[4] (b) The address of the registered office[5] of the corporation and the name of its registered agent, if any, at that address; (c) the aggregate number of shares that the corporation has authority to issue;[6] and (d) the name and address of each incorporator." § 302A.111.

[4] The name of the corporation must include the word or any abbreviation of the word "corporation," "incorporated," "limited," or "company." The name cannot be a name that would imply that the corporation was formed for any reason other than a business reason. Also, the name cannot be indistinguishable from some other corporation already registered with the state of Minnesota.
[5] The corporation must continuously maintain a registered office, which does not necessarily have to be the corporation's principle place of business, in the state at any address other than a post-office box.
[6] Any number of shares may be issued and more than one class or series of shares may be issued.

Section 302A.111, subd. 2 describes how certain other subsections of Chapter 302A will operate as "default provisions" that will govern the corporation, unless the articles, themselves, modify these provisions. Subdivision 3 specifies other subsections of Chapter 302A that govern the corporation that may be modified in either the articles or the bylaws. Finally, subdivision 4 lists optional provisions that may be included in the articles of incorporation or the bylaws.[7] A corporation is not required to have bylaws, however, bylaws can often be helpful in further establishing the way in which the corporation will operate and be governed.

Once the articles are signed by each incorporator, filed with and accepted by the Minnesota Secretary of State, and the corporation or incorporators pay the necessary fees, the entity is then incorporated.

6. Tenancies-in-Common

A tenancy-in-common is a default form of ownership. Whenever two or more parties acquire a piece of real estate in a manner that does not expressly or by implication call for some other form of concurrent ownership, the law will presume that a tenancy-in-common has been formed. For example, members of an unincorporated entity usually hold their interests as tenants-in-common.

The parties can, of course, affirmatively decide to enter into a tenancy-in-common form of ownership. If it is the intention of the parties to create a tenancy-in-common, it is critical that each cotenant has a right to possess the whole, and that none has a right to exclude others, as such an arrangement would not permit a tenancy-in-common.

[7] As a practical matter, clients are usually advised to place any modifications of subdivision 3 provisions and any subdivision 4 optional provision in the bylaws only. The reasons for this preference are twofold: First, articles of incorporation are public documents, and second, articles of incorporation are much more difficult to amend then bylaws are.

Although a tenancy-in-common is often distinguishable from a joint tenancy in that there are no survivorship rights under a tenancy-in-common, the parties can agree to survivorship rights under a tenancy-in-common form of ownership.

C. Profits and Losses

1. General Partnerships and Limited Liability Partnerships

A person who receives a share of the profits of a business is presumed to be a partner. Minn. Stat. § 323A.0202(3). This presumption holds unless the share is received (1) as payment of debt by installment; (2) for services of an independent contract or wages of an employee; (3) as rent; (4) as an annuity or other benefit; (5) as interest on a loan, even if the amount varies with the profit of the business; or (6) for the sale of goodwill of a business.

By default, partners share equally in the profits and surplus remaining after all liabilities. Partners share in the losses according to their shares in the profits. However, partners can agree on how to share profits and losses. For example, assume partner A and B agree that A will receive 60% of the profits, and B will receive 40% of the profits. If there is no agreement as to losses, A will receive a 60% share of the losses, and B will receive a 40% share of the losses. Loss sharing arrangements amongst partners do not affect the personal liability of partners in relation to third party claims against the partnership.

Partners may contribute money or goods to the partnership; they will be repaid or credited the original value of these contributions when the partnership is terminated. Minn. Stat. § 323A.0401(a)(1). Partners who contribute real property to a partnership are not entitled to the appreciation in the value of the property during the life of the

partnership. *See* Minn. Stat. § 323A.203. Partners who contribute services are not entitled to remuneration (salary) unless the partnership agreement permits such payment and value is assigned. Minn. Stat. § 323A.401(h). Upon winding up of the partnership, secured creditors are paid first, followed by general creditors. Next, partners are repaid contributions. Only after all of that is the share of any profits paid out pursuant to the appropriate shares of each partner.

2. Limited Partnerships and Limited Liability Limited Partnerships

Distribution of profits and losses by a limited partnership must be shared among the partners on the basis of the value of the contributions the limited partnership has received from each partner. Minn. Stat. § 321.0503. When a partner or transferee becomes entitled to receive a distribution, the partner or transferee has the status of, and is entitled to all remedies available to, a creditor of the limited partnership with respect to the distribution. Minn. Stat. § 321.0507.

3. Limited Liability Companies

Profits and losses of a limited liability company are to be allocated among the members, and among the classes and series of members in proportion to the value of the contributions of the members reflected in the required records. Minn. Stat. § 322B.326.

4. Corporations

As to profits, so long as the corporation will still be able to pay its debts, the board of directors of the corporation may authorize and cause a distribution to the shareholders. § 302A.551. Such distributions are made to the shareholders according to the number of shares each shareholder owns. In a C corporation, the corporation is taxed on its annual net income. If the corporation then disburses dividends to its owners, they

will be taxed on those dividends as well. C corporations can avoid double taxation, to a certain extent, by keeping net income in the form of retained earnings, rather than disbursing dividends. An S corporation is much more like a partnership. Thus, regardless of whether net income is disbursed in the form of dividends or is kept in the form of retained earnings, the net income will be taxed only once. Likewise, loss

5. Tenancies-in-Common

Under a sale of the entire property being held under a tenancy-in-common, each cotenant is entitled to a share in the profits, or responsible for a share in the losses, in proportion to the share in interest each held in the property. As already mentioned, each cotenant in a tenancy-in-common, may sell his interest in the real estate as he sees fit, and without prior approval of the other cotenants. Accordingly any profits or losses he realizes in selling his own interest will be his own. To the extent that a cotenant uses common property to make a profit, for example by renting the common property out to a third party, he will liable to the other cotenants in proportion to their respective shares for the profits he received. A cotenant is not, however, accountable to the other cotenants for profits produced by his own use of property, so long as such use does not exclude the others to their right to possess the whole, and so long as such use does not create waste.

D. Duration

1. General Partnerships

By default, a general partnership is a partnership at will. In a partnership at will partners have both power and right to withdraw at any time. Partners can also create a partnership for term or specific undertaking pursuant to a partnership agreement. However, a partnership for a term or undertaking gives partners the power, but not the

right to withdraw. In that type of partnership, other partners may have a claim against a withdrawing partner for breach of contract. Minn. Stat. § 323A.0602.

2. Limited Liability Partnerships

A limited liability partnership must file an annual registration once each calendar year with the Secretary of State. Minn. Stat. § 323A.1003. The secretary of state must revoke the statement of qualification of a partnership that fails to file an annual registration when due or pay the required filing fee. *Id*. at subd. (b). A revocation under only affects a partnership's status as a limited liability partnership and is not an event of dissolution of the partnership. A partnership whose statement of qualification has been revoked may apply to the secretary of state for reinstatement within one year after the effective date of the revocation.

3. Limited Partnerships and Limited Liability Limited Partnerships

Limited Partnerships and Limited Liability Limited Partnerships are both presumed to have perpetual duration.

4. Limited Liability Companies

Pursuant to Sections 322B.115 and 322B.20 of the Minnesota LLC Act, a Minnesota LLC can now have perpetual duration. Previously, an LLC had a limited duration of thirty (30) years.

5. Corporations

So long as the corporation continues to file its annual registration form with the secretary of state, in compliance with § 302A.821, the corporation can exist, perpetually, or until the corporation dissolves pursuant to § 802A.701, et. seq.

6. Tenancies-in-Common

A tenancy-in-common can exist as long as the cotenants wish. Generally, there are several ways in which a tenancy-in-common can be extinguished, and include the following: 1) one of the cotenants acquires (whether it be by purchase or adverse possession) all outstanding interests from the other cotenants; 2) all of the cotenants abandon or repudiate their interest in the property; 3) destruction of the property; 4) foreclosure; 5) a sale or conveyance of all the common property or all of the interests to a third person; 6) the common property is divided or partinioned (either by agreement or judicial decree) among the cotenants.

E. Management and Duties

1. General Partnerships and Limited Liability Partnerships

In a general partnership, each partner has equal rights in the management and conduct of the partnership business. Minn. Stat. § 323A.401(f). However, partners owe each other a Duty of Care under Minn. Stat. § 323A.0404(c). The Duty of Care essentially states that partners have to make management decisions in the best interests of the partnership. Partners also owe each other a fiduciary Duty of Loyalty under Minn. Stat. § 323A.0404(b). This means that any benefit personally incurred as a result of partnership business is the property of the partnership. Partners have a duty to inform other partners about personal business dealings. This duty cannot be contracted around.

The partnership or partners may take actions against individual partners for breach of the duties listed above pursuant to Minn. Stat. § 323A.0405. In general, the Business Judgment Rule provides a broad defense for management decisions under circumstances where there is a reasonable basis to indicate that the decision was made

with due care and in good faith. This is a procedural rule, not a results rule. So, the partner is protected if he or she used reasonable care in making the decision, even if the outcome of the decision is bad.

Partners also have accounting rights and duties. A partnership must provide partners and their agents and attorneys access to its books and records. In addition, each partner and the partnership must furnish to a partner, and to the legal representative of a deceased partner or partner under legal disability, without demand, any information concerning the partnership's business and affairs reasonably required for the proper exercise of the partner's rights and duties under the partnership agreement or this chapter. Minn. Stat. § 323A.0403. On demand, each partner and the partnership must furnish to a partner any other information concerning the partnership's business and affairs, except to the extent the demand or the information demanded is unreasonable or otherwise improper under the circumstances. *Id*. This information may include financial statements, income statements, and balance sheets showing assets, liability, and equity.

A partner must discharge his or her duties to the partnership and the other partners under this chapter consistently with the obligation of good faith and fair dealing. Minn. Stat. § 323A.0404(d). This applies whether the partnership is guided by the default rules or a partnership agreement.

2. Limited Partnerships and Limited Liability Limited Partnerships

A General Partner has generally the same characteristics as a partner in a general partnership. Under the 2001 Act, a person is defined as “an individual, corporation, business trust, estate, trust, partnership, limited liability company, association, joint venture, government; governmental subdivision, agency, or instrumentality; public

corporation, or any other legal or commercial entity. Any of these "persons" can become general partners under a partnership agreement. Minn. Stat. § 321.0401. They can also become general partners following the dissociation of a limited partnership's last general partner, as the result of a conversion or merger, or with the consent of all the partners. *Id*.

Each general partner has equal rights in the management and conduct of the limited partnership's activities. Minn. Stat. § 321.0406. Each General Partner is an agent of the limited partnership for carrying on in the ordinary course of business or in activities of the kind carried on by the limited partnership. Minn. Stat. § 321.0402.

Any matter relating to the activities of the limited partnership may be exclusively decided by the general partner or, if there is more than one general partner, by a majority of the general partners. *Id*. However, The consent of each partner is necessary to: (1) amend the partnership agreement, (2) amend the certificate of limited partnership to add or delete a statement that the limited partnership is a limited liability limited partnership; and (3) sell, lease, exchange, or otherwise dispose of all, or substantially all, of the limited partnership's property, with or without the good will, other than in the usual and regular course of the limited partnership's activities. *Id*. at subd. (b). In addition, a general partner has fiduciary duties of Loyalty and Care to both the Limited Partners and the partnership itself. Minn. Stat. § 321.0408.

Any "person" can become a limited partner as provided for in the partnership agreement, as the result of a conversion or merger, or with the consent of all the partners. Minn. Stat. §321.0301. A limited partner does not have the right or the power as a limited partner to act for or bind the limited partnership. Minn. Stat. §321.0302.

A limited partner does not have any fiduciary duty to the limited partnership or to any other partner solely by reason of being a limited partner. Minn. Stat. § 321.0305 (a). However, a limited partner must perform duties to the partnership and the other partners and exercise any rights consistently with the obligation of good faith and fair dealing. *Id*. at subd. (b). A limited partner does not violate a duty or obligation merely because the limited partner's conduct furthers the limited partner's own interest. *Id*. at subd.(c).

3. Limited Liability Companies

An LLC is governed by a board of governors, analogous to a board of directors in a corporate context.[8] The board of governors appoints the LLC's managers. If the board is not named in the articles of organization, the organizers may elect the first board of governors, or may act as governors themselves, with all of the powers, rights, duties, and liabilities of governors. *See* Minn. Stat. § 322B.60(1). The organizers will assume the role as board of governors until governors are elected or until a contribution is accepted, whichever occurs first. *Id*.

After filing the articles, the board of governors (or the organizers if a board has not yet been elected) shall hold an organizational meeting or take written action for the purposes of conducting business and to complete the organization of the LLC. Notice of the meeting shall be made to each organizer or governor in writing and at least three days in advance of the meeting. The notice shall contain the date, time and place of the meeting. *See* M.S.A. § 322B.60, Subd. 2.

The business activities of an LLC are generally managed by or under the direction of a board of governors. The number of governors must be fixed by or in the manner

[8] The board must consist of one or more governors, Minn. Stat. § 322B.61, each of whom being a natural person. Minn. Stat. § 322B.613.

provided in the articles, a member control agreement, or the bylaws. *See* Minn. Stat. § 322B.61. Unless fixed terms are provided for in the articles, member control agreement, or bylaws, a governor serves for an indefinite term that expires at the next regular meeting of the members. Fixed terms for governors may not exceed five years. *See* Minn. Stat. § 322B.616.

The board is allowed to act pursuant to an affirmative vote by a majority of governors present at a meeting. Minn. Stat. § 322B.653. In some instances, the Minnesota LLC Act, the articles, or the member control agreement may allow the board to act without an affirmative majority vote. *Id*. In such instances, any action other than action requiring member approval may be taken by written action signed by the number of governors that would be required to take the same action at a meeting of the board of governors at which all governors were present. *See* Minn. Stat. § 322B.656(1).

"Member controlled" or "member managed" LLC's offer owners a direct voice by requiring a vote on decisions related to the management of the company. Under this management structure, members govern the LLC, and are usually able to enter into contracts on behalf of the company, just as partners do in a general partnership. The owners of membership interests entitled to vote for governors of the LLC may, by unanimous affirmative vote, take any action that the Act requires or permits the board to take, whereupon:

a. The governors have no duties, liabilities, or responsibilities as governors under the Act with respect to or arising from the action;

b. The members collectively and individually have all of the duties, liabilities, and responsibilities of governors under this chapter with respect to an arising from the action;

c. The action is considered to have been approved or adopted by the board of governors if the action relates to a matter required or permitted by the Act or by any other law to be approved or adopted by the board of governors, either with or without approval or adoption by the members; and

d. A requirement that an instrument filed with a governmental agency contain a statement that the action ahs been approved and adopted by the board of governors is satisfied by a statement that the members have taken the action under this subdivision.

Minn. Stat. § 322B.606(2).

4. Corporations

The provisions of Chapter 302A, together with the articles of incorporation, and bylaws (if any exist) govern the management and control of the corporation. Normally a board of directors will have authority over most business decisions. More major decisions, such as the sale of the business, require approval by the shareholders. Generally speaking, in carrying out the business of the corporation, officers must discharge their duties "in good faith," and "in a manner the officer reasonably believes to be in the best interest of the corporation, and with the care an ordinarily prudent person in a like position would exercise under similar circumstances." § 302A.361.

5. Tenancies-in-Common

Although not arising to the level of fiduciary duties, a tenancy-in-common is a relationship of trust and confidence that carries with it a duty that each cotenant has to sustain, or at least not to assail, the common interest or title. Thus, each cotenant has an equal right to the use and enjoyment of the common property, and a duty not to exclude the other cotenants or to use the common property in a way that would be detrimental to the other cotenants interests, such as by creating waste. PRACTICE TIP: cotenants can agree among themselves as to management issues through negotiation and execution of a "co-tenancy" or "tenants-in-common" agreement.

F. Liability

1. General Partnerships

In a general partnership, all partners are liable jointly and severally for all obligations of the partnership unless otherwise agreed by the claimant or provided by law. Minn. Stat. § 323A.0306. This includes tort and contract actions. However, a partner admitted into an existing partnership is not personally liable for any partnership obligation incurred before the person's admission as a partner. *Id*. at subd. (b).

Each partner is an agent of the partnership for the purpose of its business. Minn. Stat. § 323A.0301. An act of a partner for apparently carrying on in the ordinary course the partnership business or business of the kind carried on by the partnership binds the partnership. *Id*. An act of a partner which is not apparently for carrying on in the ordinary course the partnership business or business of the kind carried on by the partnership binds the partnership only if the act was authorized by the other partners. There is also an exception if the partner had no authority to act for the partnership in the

particular matter and the person with whom the partner was dealing knew or had received a notification that the partner lacked authority.

Minn. Stat. § 323A.0303 also provides a shield to the agency provisions of Minn. Stat. § 323A.0301. Minn. Stat. § 323A.0303 allows partnerships to file notice of what authority each partner might have. This puts third parties on notice and avoids problems with apparent authority.

2. Limited Liability Partnerships

A Limited Liability Partnership has most of the same characteristics of a General Partnership. However, an obligation of a partnership incurred while the partnership is a limited liability partnership under Minn. Stat. § 323A.1001, whether arising in contract, tort, or otherwise, is solely the obligation of the partnership, and not the individual partners. Minn. Stat. § 323A.0306. In other words, all partners are shielded from personal liability in a limited liability partnership.

3. Limited Partnerships and Limited Liability Limited Partnerships

The limited partnership is liable for the tortious acts of the general partner (Minn. Stat. §321.0403(a)) or for other acts in the course of the partnership's activities or with the authority of the partnership (Minn. Stat. §321.0403(b)). All general partners are liable jointly and severally for all obligations of the limited partnership unless otherwise agreed by the claimant or provided by law. Minn. Stat. § 321.0404. However, a person that becomes a general partner of an existing limited partnership is not personally liable for an obligation of a limited partnership incurred before the person became a general partner. An obligation of a limited partnership incurred while the limited partnership is a limited liability limited partnership, whether arising in contract, tort, or otherwise, is

solely the obligation of the limited partnership. So, a general partner is not personally liable, directly or indirectly, by way of contribution or otherwise, for such an obligation solely by reason of being or acting as a general partner.

A limited partnership must reimburse a general partner for payments made and indemnify a general partner for liabilities incurred by the general partner in the ordinary course of the activities of the partnership or for the preservation of its activities or property. *Id*. at subd. (c). A limited partnership must also reimburse a general partner for an advance to the limited partnership beyond the amount of capital the general partner agreed to contribute. *Id*. at subd. (d). A general partner is not entitled to remuneration for services performed for the partnership. *Id*. at subd. (f).

In general, there is no personal liability for a limited partner. An obligation of a limited partnership, whether arising in contract, tort, or otherwise, is not the obligation of a limited partner. Minn. Stat. § 321.0303. A limited partner is not personally liable, directly or indirectly, by way of contribution or otherwise, for an obligation of the limited partnership solely by reason of being a limited partner. Traditionally, participation and control in the business removed the shield of limited liability for limited partners. However, under Minnesota's current law, limited partners are shielded from personal responsibility even if the limited partner participates in the management and control of the limited partnership. *Id*.

In a limited partnership, any partner may maintain a direct action against the limited partnership or another partner for legal or equitable relief, with or without an accounting as to the partnership's activities, to enforce the rights and otherwise protect the personal interests of the partner. Minn. Stat. § 321.1001(a). A partner may also

maintain a derivative action to enforce a right of a limited partnership if: (1) the partner first makes a demand on the general partners, requesting that they cause the limited partnership to bring an action to enforce the right, and the general partners do not bring the action within a reasonable time; or (2) a demand would be futile. Minn. Stat. § 321.1002.

4. Limited Liability Companies and Corporations

In Minnesota, LLCs and corporations are treated similarly with regard to liability issues.

A member, governor, manager, or other agent of a limited liability company is not, merely on account of this status, personally liable for the acts, debts, liabilities, or obligations of the limited liability company. Minn. Stat. § 322B.303. However, case law states that the conditions and circumstances under which the corporate veil of a corporation may be pierced also apply to limited liability companies. *Id*.

Minnesota Statutes § 322B.88 provides the general rule as to when an LLC member is properly joined as a party to a case. A member is not a proper party to a proceeding by or against an LLC with certain exceptions. A member is a proper party if the object of the proceeding is to determine or enforce a member's right against, or liability to, the LLC; or if the proceeding involves a claim of personal liability or responsibility of that member and that claim has some basis other than the member's status as a member. Minn. Stat. § 322B.88(2)

LLC members may be held liable for/when:

1. The member's own tortious conduct, even though the conduct may have been the result of activities on behalf of the LLC.

2. Liability for the member's agreed upon contributions and for the return of contributions while the LLC is insolvent.

3. Members may be liable where they serve as an LLC agent and purport to bind the LLC even when they have no authority to do so under which circumstances they may be liable to the LLC and to other third parties for obligations or purported obligations.

4. Members may be responsible for the collection and payment of employment related taxes and may be liable for those taxes where they are not paid to either state or federal government.

5. Members are liable for LLC obligations they personally guarantee.

While there is no direct statutory provision, case law provides the conditions and circumstances under which the veil of an LLC may be pierced. Corporate veils in Minnesota are pieced when: An entity ignores corporate formalities; and the liability limitations result in an injustice or it may be fundamentally unfair. *See Tom Thumb Food Markets, Inc. v. T.L.H. Properties*, No. C9-98-1277, 1999 WL 31168 (Minn. Ct. App. Jan. 26, 1999) (unpublished).

As to corporations, the general rule is that corporate officers do not have personal liability with respect to contract actions, and tort actions founded on contract, unless they act outside the scope of their employment. *See Piper Jaffray Cos., Inc. v. National Union Fire Ins. Co.*, 967 F. Supp. 1148 (D. Minn. 1997). Likewise, corporate officers can only be held personally liable for corporate torts, such as conversion, when "the officer actually participated or acquiesced in [the conversion]." *State by Humphrey v. Alpine Air Prods., Inc.,* 490 N.W.2d 888, 897-98 (Minn. Ct. App.1992). *See, e.g., Morgan v.*

Eaton's Dude Ranch, 239 N.W.2d 761, 762 (Minn. 1976) (stating that a corporate officer is not liable for the torts of the company's employees *unless he participated in, directed, or was negligent in failing to learn of and prevent the tort*) (emphasis added).

Thus, the critical factor in deciding whether an officer can be held liable for the acts of a corporation is the extent or level of the officer's involvement/participation in the alleged wrongful conduct. *See, e.g., Federal Trade Comm'n v. Kitco*, 612 F. Supp. 1280, 1281 (D. Minn.1985) (holding that a corporate officer who "misrepresented material facts to induce purchasers to invest in the corporation . . . was liable based on his direct participation in the deceptive sale"); *Alpine Air Prods.*, 490 N.W.2d at 890 (holding that "[a] corporate officer may be held personally liable in a consumer fraud and antitrust case where the officer *directly participated in the violations*") (emphasis added).

Case Law:

In *Tom Thumb*, a developer sought to develop a piece of land with Tom Thumb, an operator of convenience stores. Although the developer had not yet purchased the land to develop, he signed a lease on behalf of T.L.H. Properties with Tom Thumb. Financing for the developer fell through and a competitor of Tom Thumb bought the property.

Tom Thumb sued for breach of lease. The trial court found the developer personally liable under a theory of piercing the corporate veil, even though the contract was with T.L.H. Properties, an LLC. *Id.* at *1. The Court of Appeals reversed the lower court's determination of personal liability. Although recognizing that the conditions and circumstances under which a corporate veil may be pierced also applied to an LLC, the court held that the record failed to show fundamental unfairness and the corporate veil

prevailed. *Id*. at *3. The court recognized that corporate veils in Minnesota are pieced when:

(a) An entity ignores corporate formalities; and;

(b) The liability limitations result in an injustice or it may be fundamentally unfair.

The court in *Tom Thumb* did not even address the first element – probably due to the fact that LLCs may often go through fewer formalities than corporations. This case and others bode well for limited member liability in Minnesota. *See also Piercing the Veil of the Limited Liability Company*, 22 Iowa J. Corp. L. 131, 140 (1996).

In a case arising outside of the District of Minnesota, the Eighth Circuit also had a chance to pierce the corporate veil of an LLC in *Gallinger v. North Star Hospital Mutual Assurance, Ltd.*, 64 F.3d 422 (8th Cir. 1996). In *Gallinger*, 13 hospitals formed an LLC (NSHMA) to ensure against malpractice under various Bermuda statutes. Membership later grew to almost 250 hospitals. NSHMA's by-laws originally provided members would pay premiums annually, later to be increased or modified on a member's loss for a given year. *Id*. at 424. The modifying provision was later deleted by a member resolution.

Great Global Assurance (GGA) began providing worker's compensation insurance for NSHMA members and, in return, NSHMA became re-insured for claims under GGA policies. GGA became insolvent. The receiver then sued the LLC and some individual members of the LLC because NSHMA was re-insured for GGA's policies and therefore the LLC and its members were liable for amounts sought from the receiver by state insurance guarantee funds. The receiver sued members individually based on the

theory that NSHMA was a mere instrumentality of the defendants and the defendants controlled the affairs of NSHMA as their own. *Id*. at 425.

The District Court granted summary judgment to the members. The Eighth Circuit affirmed by applying the Minnesota LLC Act. It held that the LLC did not violate the second prong of fundamental unfairness usually needed to pierce the corporate veil. The court did so even though there were questions of capitalization, corporate formalities, and siphoning funds. *Id*. at 428. The case seems to be beneficial for members of LLCs and may come into an Eighth Circuit jurisdiction, including Minnesota.

There may also be liability for acts committed by a member serving in a role other than as member, such as a governor, manager or agent; acts committed by a member in a defective LLC; or for a member's failure to comply with his or her contribution agreement. Minn. Stat. § 322B.42. A member may be liable for damages when receiving a distribution which violates M.S. § 322B.54 because the distribution renders the LLC unable to pay its debts in the ordinary course of business. A member's receipt of a distribution in dissolution of the LLC also makes the member liable for claims arising after the LLC is dissolved. Minn. Stat. § 322B.55.

5. Tenancies-in-Common

Tenants-in-Common are not liable for the acts of the other cotenants, unless they have chosen to bind themselves jointly by contract or through obtaining a mortgage. Tenants-in-Common who delegate control and management of their property to a separate legal entity generally are not immunized from liability to third parties.

G. Property

1. Partnerships

Partnership property was traditionally treated as tenancy in partnership meaning that every partner was a co-owner of partnership property. Partnership property interests could not be transferred without the consent of all partners. Minnesota now follows an entity theory similar to that of corporations. A partnership is the owner of partnership property, and partners are no longer co-owners of partnership property. Partners own the partnership, but not its assets. The only transferable interest of a partner is their financial share of profits and losses.

Creditors of an *individual* general partner have no right to seize *partnership* property. Minn. Stat. § 323A.501; *see also* Minn. Stat. § 323A.504. Creditors can request a charging order to garnish profits paid to individual partners, but creditors cannot try to take over partnership property, or other partnership assets. *Id*. Charging orders are basically liens on the transferable interests of partners, i.e. individual financial interests. Practically, a partner may try to ask the partnership to sell a piece of the partnership property. The partner can also dissociate from the partnership and wind up the business in order to have his share of the profits erase the charging order (assuming there will be profits left after the partnership's creditors and partners are repaid).

2. Limited Liability Companies

Real estate is typically owned by pass-through entities. Society's litigious tendencies make ownership of real estate a somewhat risky endeavor. The limited liability aspect of an LLC makes real estate ownership through such an entity particularly

beneficial because it provides some shelter for the members of an LLC should a suit involving the property arise.

Of course, the closely held corporation can own real estate, but it is also desirable to protect the business from as many of the inherent risks in property ownership as possible. Such risks include operating risk, financing risk, or environmental liability risks. Therefore, LLC ownership and a lease to a corporation is a particularly appropriate option.

The single-member LLC is the most appropriate entity to own real estate. The business owner's family does not have to be made partial owners of the real estate to satisfy the two-member requirement (which is now gone for LLC's, but remains for general and limited partnerships, including LLP's and LLLP's.) If taxation on a pass-through basis is not beneficial, the closely held corporation itself can form a single-member LLC and thereby cause the LLC's income to be taxed at corporate rates. This use of LLC's was necessary for S-corporations which could not have controlled corporate subsidiaries until 1997.

Even real estate which is presently owned individually or by a limited or general partnership may create benefits if transferred to an LLC. However, the income tax consequences of such a shift must be considered. Transfers to an LLC may shift the allocation of indebtedness related to the real estate among members. Therefore, a newly organized LLC that acquires title to already owned real estate has primary liability for any losses associated with the real estate. Many liabilities do not follow prior owners up the chain of real estate title. Thus, an LLC may prove useful as an ownership vehicle for existing real estate holdings.

The limited liability aspect of an LLC may also make ownership of tangible and intangible personal property by the LLC a wise strategy. The liability risk varies depending on the type of property. An airplane is an inherently risky piece of property to own, whereas a sofa is not as likely to cause much harm. Although one could imagine a scenario in which an owner might incur liability for an injury taking place on a sofa, it has far less potential to create the type of financial burden arising from an airplane crash.

With personal property, the nature of the property and the goals of the owners must be specifically considered before an appropriate entity can be selected. All else being equal, a limited liability entity, like an LLC, is the only legitimate option for a new entity.

Limited liability: Limited liability is always preferable to unlimited liability. Again, society's litigious nature creates potentially unacceptable and unforeseen liability risks. For this reason, a limited liability entity such as an LLC is the obvious choice for a newly created entity.

Property Transfers: LLC ownership of property also eases some of the burdens associated with the transfer of property. Transactions between a corporation and one or all of its shareholders are usually immediately taxable. This rule generally pertains whether the property is being transferred into or out of the corporation. Also, the withdrawal of property from a corporation is usually taxable both at the shareholder and corporate levels. Conversely, transfers to and from an LLC are generally tax free. If the property will ever be removed from the entity or sold and the proceeds removed, the LLC is clearly the best option.

H. Withdrawal

1. General Partnerships and Limited Liability Partnerships

In Minnesota, withdrawal of a partner is considered dissociation. Minn. Stat. § 323A.601. Dissociation does not automatically terminate the partnership and begin winding up the business. The partnership is a separate entity that can continue on after one partner leaves. Continued use of a partnership name, or a dissociated partner's name as part of the partnership name does not of itself make the dissociated partner liable for an obligation of the partners or the partnership continuing the business. Minn. Stat. § 323A.0705.

The type of partnership affects a partner's right to withdraw. *See* Minn. Stat. § 323A.0602. Partners always have the power to withdraw, but not necessarily the right to. In a partnership at will partners have both power and right to withdraw. However, a partnership for a term or undertaking gives partners the power, but not the right to withdraw. In a partnership for term, other partners may have a claim against withdrawing partner for damages for breach of contract.

The date of dissociation is the day the partner leaves the partnership. The partnership should file a Statement of Dissociation under Minn. Stat. §323.704. This creates a presumption that persons who are not partners have notice of dissociation 90 days after it is filed. Therefore, the dissociated partner cannot bind the partnership after 90 days, and the partnership and the dissociated partner are no longer liable for the actions of the other.

There are certain events that automatically cause a partner's dissociation. If a partner dies, the partnership is effectively dissociated, but can still carry on its business.

The deceased partner's heirs are entitled to accounting for that partner's interest at the time of death. Minn. Stat. § 323A.0601(7)(i). Even if a partnership is for term, the court can dissolve the partnership for equitable reasons such as insanity of a partner, a partner committing a criminal offence, or no chance of the business ever making a profit. If a court dissolves the partnership, no damages are assessed. Expulsion of a partner is permitted under Minn. Stat. § 323A.0601(3), but only if it is pursuant to the terms of the partnership agreement.

Dissociation does not equal a discharge of liabilities. Partners may discharge liabilities to third parties, creditors, and other partners by agreement. Partners may also be discharged of liability if a third party assumes liabilities and a creditor consents to such assumption. A successor partnership is liable for the debts of the first or dissolved partnership, and new partners are generally protected from prior obligations except in contract cases, e.g. the partnership contractually assumed a leases under which liability is continually arising.

Partners continue to owe each other duties as long as they remain partners, even if they are contemplating leaving the partnership or in the process of winding up. Covenants Not to Compete are generally permitted as long as they are, reasonable as to time and area, necessary to protect legitimate interests, not harmful to the public, and not unduly burdensome.

A dissociated partner's power to bind partnership also continued under Minn. Stat. §323A.0702. For two years after withdrawal, a dissociated partner has the power to bind a partnership in a transaction with a third party provided the third party: (1) reasonably believed the dissociated partner was a partner, (2) did not have notice of

dissociation, and (3) is not deemed to have knowledge of the dissociation. *Id.* The dissociated partner remains liable to the partnership for damages caused by his or her actions. A dissociated partner's liability to third parties also continues under Minn. Stat. § 323A.0703. The dissociated partner remains liable for two years after dissociation if the 3rd party is not aware of the dissociation. Again, a statement of dissociation will cut off all new liability for the partnership and the dissociated partner after 90 days by presuming that third parties are on notice of the dissociation.

2. Limited Partnerships and Limited Liability Limited Partnerships

In general, a limited partner does not have the right to dissociate before the termination of the limited partnership. Minn. Stat. § 321.0601. However, a limited partner is considered dissociated upon the limited partnership's having notice of the person's express will to withdraw as a limited partner. An event agreed to in the partnership agreement may also cause a person's dissociation as a limited partner. A limited partner may be expelled pursuant to the partnership agreement. In the absence of a partnership agreement, some limited circumstances, such as unlawful activity or dissolution of a corporate limited partner, may allow expulsion of a limited partner by unanimous consent of the other partners. *Id.*

On application by the limited partnership, the person's expulsion as a limited partner by judicial order because: (1) the person engaged in wrongful conduct that adversely and materially affected the limited partnership's activities, (2) the person willfully or persistently committed a material breach of the partnership agreement or of the obligation of good faith and fair dealing under Minn. Stat. § 321.0305(b); or (3) the person engaged in conduct relating to the limited partnership's activities which makes it

not reasonably practicable to carry on the activities with the person as limited partner. A limited partner's death also causes dissociation. *Id*.

Upon a person's dissociation as a limited partner, the person does not have further rights as a limited partner. Minn. Stat. § 321.0602. However, the limited partner's obligation of good faith and fair dealing continues for matters arising and events occurring before the dissociation. *Id*. A person's dissociation as a limited partner does not of itself discharge the person from any obligation to the limited partnership or the other partners which the person incurred while a limited partner. *Id*.

A general partner is dissociated from a limited partnership upon the occurrence of any of the following events: (1) the limited partnership's having notice of the person's express will to withdraw as a general partner or on a later date specified by the person; (2) an event agreed to in the partnership agreement as causing the person's dissociation as a general partner; (3) the person's expulsion as a general partner pursuant to the partnership agreement. The person's expulsion as a general partner by the unanimous consent of the other partners in limited circumstances similar to those for limited partners. Minn. Stat. § 321.0603.

A person has the power to dissociate as a general partner at any time, rightfully or wrongfully. Minn. Stat. § 321.0604. There is a two-prong test for wrongful dissociation. A person's dissociation as a general partner is wrongful only if it is in breach of an express provision of the partnership agreement or it occurs before the termination of the limited partnership *AND;* (1) the person withdraws as a general partner by express will; (2) the person is expelled as a general partner by judicial determination; (3) the person is dissociated as a general partner by becoming a debtor in bankruptcy; or (4) in the case of

a person that is not an individual, trust other than a business trust, or estate, the person is expelled or otherwise dissociated as a general partner because it willfully dissolved or terminated. *Id*. A person that wrongfully dissociates as a general partner is liable to the limited partnership and to the other partners for damages caused by the dissociation. *Id*. The liability is in addition to any other obligation of the general partner to the limited partnership or to the other partners. *Id*.

Upon a person's dissociation as a general partner, the person's right to participate as a general partner in the management and conduct of the partnership's activities terminates. Minn. Stat. § 321.0605. The person's duty of loyalty and duty of care as a general partner continue only with regard to matters arising and events occurring before the person's dissociation as a general partner. *Id*. The person may sign and deliver to the secretary of state a statement of dissociation pertaining to the person and, at the request of the limited partnership, shall sign an amendment to the certificate of limited partnership which states that the person has dissociated. *Id*. A person's dissociation as a general partner does not of itself discharge the person from any obligation to the limited partnership or the other partners which the person incurred while a general partner. *Id*. at subd. (b).

3. Limited Liability Companies

Minn. Stat. § 322B.80 was amended to provide that the dissolution of a member has no effect on the existence of an LLC. Thus, a member’s death, voluntary withdrawal or bankruptcy does not impact the LLC, which it had under the previous regime. Modern LLCs are identical to corporations in this respect. However, LLCs retain the tax benefits of partnerships.

4. Corporations

An individual owner may withdraw from a corporation by simply selling his shares in the corporation.

5. Tenancies-in-Common

A cotenant may withdraw from a tenancy-in-common by conveying his interest in the tenancy-in-common.

I. Winding Up of the Business

1. General Partnerships and Limited Liability Partnerships

In general, non-continuing partners or their heirs have the option of forcing a partnership to wind up. However, the partnership can continue even after dissociation. By default, each partner is entitled to repayment of contributions (whether capital or advances) to the partnership when the business is wound up. However, this does not apply to services contributed by a partner in the absence of an agreement that says otherwise.

The partnership or the last surviving partner has the right to obtain winding up the business by the court. Minn. Stat. § 323A.0802. However, the business is not automatically wound up upon dissociation of a partner. At any time after the dissolution of a partnership and before the winding up of its business is completed, all of the partners, including any dissociating partner, may waive the right to have the partnership's business wound up and the partnership terminated. *Id*. In that event, the partnership resumes carrying on its business as if dissociation had never occurred, and any liability incurred by the partnership or a partner after the dissociation and before the waiver is determined as if dissociation had never occurred. The rights of a third party accruing

under section Minn. Stat. § 323A.0804(1), or arising out of conduct in reliance on the dissolution before the third party knew or received a notification of the waiver may not be adversely affected. Once a partner In general, the partnership continues until the business is wound up only for the purposes of winding up the business. Minn. Stat. § 323A.0802

2. Limited Partnerships and Limited Liability Limited Partnerships

In general, a limited partnership is wound up in the same manner as a general partnership. However, it can be wound up by the consent of all general partners and of limited partners owning a majority of the rights to receive distributions as limited partners. A limited partnership may also be wound up after the dissociation of a person as a general partner if the limited partnership does not have a remaining general partner after 90 days unless before consent to continue the activities of the limited partnership and admit at least one general partner is given by limited partners owning a majority of the rights to receive distributions. Minn. Stat. § 321.0801. On application by a partner the district court may order dissolution of a limited partnership if it is not reasonably practicable to carry on the activities of the limited partnership in conformity with the partnership agreement. Minn. Stat. § 321.0802.

A limited partnership continues after dissolution only for the purpose of winding up its activities. Minn. Stat. § 321.0803. A person may be appointed to wind up the business and to take on the duties of a general partner in doing so. *Id*. On the application of any partner, the district court may also order judicial supervision of the winding up, including the appointment of a person to wind up the dissolved limited partnership's activities. *Id*.

3. Corporations

A corporation may dissolve in one of four ways: "(a) By the incorporators pursuant to section 302A.711; (b) By the shareholders pursuant to sections 302A.721 to 302A.7291; (c) By order of a court pursuant to sections 302A.741 to 302A765; or (d) By the secretary of state according to section 302A.821." § 302A.701.

4. Tenancies-in-Common

A tenancy in common can be terminated by each cotenant transferring his/her interest in the property to a single owner.

J. Choice of Law

Limited Liability Companies provide several advantages over partnerships. LLC's are relatively new in the world of business. Wyoming enacted the nation's first limited liability company act in 1977. Five years later, Florida followed Wyoming by enacting an LLC statute of its own. LLC's did not generate national interest until 1988, when the Internal Revenue Service ruled that an LLC organized under a scheme similar to the Wyoming LLC Act would be classified as a partnership, rather than a corporation, for income tax purposes (Rev. Rule 88-76, 1988-2 C.B. 360). By 1995, every state in the country had enacted legislation authorizing businesses to organize under an LLC structure.

The Minnesota Limited Liability Company Act (hereinafter, the "Minnesota LLC Act", or "the Act") was codified in 1992 at Minnesota Statutes Chapter 322B, and became effective on January 1, 1993. The Minnesota LLC Act created a hybrid entity by incorporating the management and control provisions of the Minnesota Business Corporation Act (Minnesota Statutes Chapter 302A) and the financial, transfer and

dissolution provisions of the Uniform Limited Partnership Act. Accordingly, the Minnesota LLC Act allows income and losses to flow through to its members, just as it would in a partnership. Unlike a partnership, members of an LLC are (for the most part) not personally liable for the debts and obligations of the company, as in a Minnesota corporation.

The Minnesota LLC Act is quite similar to Minnesota Statutes Chapter 302A, which governs Minnesota business corporations. However, the original Act differed in some important respects.[9] Historically, in order to obtain partnership tax treatment for an LLC, the entity was required to lack at least two of the four elements recognized in federal tax law as characteristics of a corporation. The four elements that are characteristic of a corporation are: (1) limited liability, (2) centralized management, (3) continuity of life, and (4) free transferability of ownership interests. See former Treas. Reg. § 301.7701-2(a)(1).

By definition, LLCs have limited liability. In most cases, LLCs also have centralized management. Therefore, in order to obtain partnership tax treatment, LLCs usually had to lack continuity of life and free transferability of ownership interests. LLCs avoided the continuity of life aspect of corporations by adopting measures that allowed LLCs to dissolve with relative ease. One member of the LLC could dissolve the entity, regardless of provisions in the member control agreement that said otherwise. In this respect, LLCs were similar to partnerships. Conversely, transfers of an LLCs ownership rights (both financial rights and rights of governance) required the consent of all or a

[9] The Minnesota LLC Act was amended in 1992 to accommodate to the IRS "Check-the-Box" regulation, which automatically classified LLC's as partnerships for income tax purposes.

majority of members. By requiring a majority of members to approve a transfer of ownership rights, an LLC's ownership rights were not freely transferable.

Taxation -- "Check the Box" Provisions -- On December 17, 1996, the IRS adopted the so-called "Check-the-Box" Regulations, which became effective January 1, 1997 (Treas. Reg. §§ 301.7701-1 through 301.7701-4). Under those Regulations, all LLCs were automatically classified as partnerships for income tax purposes, and LLCs were no longer required to avoid two corporate characteristics in order to maintain their status as an LLC.

The Minnesota LLC Act was amended in 1999 to address the new "Check-the-Box" Regulations. Substantive changes were made relating to an LLC's duration and its ability to attain LLC status with only one member. In addition, the amendment allowed members to give advance dissolution avoidance consent and advance dissolution business continuation consent.

Single-Member LLCs in Minnesota -- The original statutory position required that there be two or more members of an LLC. (Laws: 1992 Chapter 517, Article 2, Section 6). This grew out of the partnership requirement for two or more partners. In 1997, the law was changed through an amendment to Chapter 322B, which reduced the requirement to one member. (Laws: 1997 Chapter 10, Article 2, Section 1). Minn. Stat. § 322B.11, entitled Member Requirement provides, "[a] Limited Liability Company shall have one or more members."

LLC ownership of real estate avoids ancillary probates. If an individual owns real estate in a foreign state, a probate will be required in that state to distribute the property when the owner dies. However, if the real estate is owned by an LLC, there is no real

estate in the foreign state to probate when the Minnesota-domiciled owner dies. The asset is now an intangible to be dealt with in the Minnesota probate.

Since an LLC membership interest is an intangible asset, its place of domicile is the same as that of its owners. Therefore, an LLC's remotely owned property does not require ancillary probates upon the death of a member. It represents an intangible ownership interest where the LLC is domiciled, and will be distributed in the probate proceeding in that forum.

Furthermore, property owned by an LLC will be kept confidential in a probate proceeding, whereas it would otherwise be disclosed. A probate requires a certain amount of disclosure, such as the identity, nature and value of the deceased's property. To the extent that property is owned by an LLC, the disclosure will be limited to merely an interest in an LLC. The specific assets held by the LLC do not have to be disclosed.

Only the managers of a Minnesota LLC have authority to enter into contracts that bind the LLC. Corporations operate the same way through officers of the corporation. All of the general partners of either a limited or general partnership can enter into contracts that bind those entities. This factor severely limits and possibly eliminates the use of general and limited partnerships except in special circumstances.

Borrowing done by a corporation (whether S-corporation or C-corporation) only produces basis inside the corporation. It does not increase the shareholder's basis in his stock (i.e. the "outside basis"). Nor does borrowing increase the shareholder's ability to receive tax-free distribution. The opposite is true for LLCs. Therefore, the more highly leveraged the transaction, the greater the benefit of an LLC.

VII. Corporate Joint Ventures

If there is one area where LLCs have always been the entity of choice, it is in corporate joint ventures. Often these projects are conducted as general partnerships because the income tax pass-through of the partnership (i.e. avoidance of double taxation) coupled with the right of each partner to participate equally in management, overshadow any perceived need to limit liability exposure.

Often, joint ventures are not adequately capitalized so that even if a corporation was used as the joint venture vehicle, it might be possible to pierce the liability shield or use the Uniform Fraudulent Transfer Act to extend liability to the owners. *See* Minn. Stat. § 513.44(a)(i). Over the last decade, restrictions on the corporate income tax rules related to the dividend received deduction as opposed to ever increasing business liability risks, place an increased strain on the general partnership form for corporate joint ventures.

The LLC resolves these potential problems. The liability risk of the joint venture business is confined to the LLC itself, subject to the aforementioned risk involving the Uniform Fraudulent Transfer Act and other veil-piercing strategies *see* Minn. Stat. § 322B.303(2). The corporate joint venture investor has partnership pass-through taxation available with respect to the LLC's income or loss. This fact provides the corporate joint venture investor with the major benefits of filing a "consolidated" corporate tax return with the LLC even though the corporate investor owns less than 80% of the LLC.

The Minnesota LLC Act provides that members share voting control in proportion to their economic interests in the LLC *see* Minn. Stat. § 322B.356(2). However, that structure can be changed by the terms of the member control agreement. Thus, a partnership model of equal participation may be drafted into the documents.

Since LLCs are structured in a manner similar to subsidiaries, having a Board (of Governors) and officers (called managers), most participants in a corporate joint venture are quite comfortable with the operating relationships established by a Minnesota LLC.

VIII. Venture Capital Projects

Venture capital projects have a different orientation than corporate joint ventures. The venture capital partner is an investor who brings capital to the project. The venture capital partner typically does not want to participate in the development or management of the project except to the extent necessary to protect its investment and insure its exit strategy. Typically, the venture capital partner is not looking for a long-term investment relationship. Rather, it hopes to sell its investment position relatively quickly at a significant gain. The only risk the venture capital partner intends to take is the loss of its investment. To accommodate these goals, venture capital projects are typically "C" corporations in which the venture capital partner holds a significant stock interest, albeit a minority interest, or invests through loans that are convertible into common stock. The venture capital partner protects its investment through disproportionately high representation on the Board of Directors through super-majority voting provisions and possible agreements that restrict certain activities such as dividend payment.

LLCs provide all of these benefits. LLCs also provide pass-through tax treatment which makes start-up losses available to the venture capital partner. Typically, these losses are foregone by the venture capital partner. With an LLC, the venture capital partner can enjoy immediate tax deductions for ongoing operating losses instead of waiting until the project is sold or discontinued. Similarly, the exit strategy to sell assets is now available without the double-tax cost of an asset sale by a C-corporation.

However, one should not assume that the venture capital partner wants pass-through treatment. The impact of current tax losses must be discussed and analyzed.

IX. Use of Subsidiaries in Planning

A. Limited Liability Companies Compared to Corporate Subsidiaries

The choice of entity determination between an LLC and a corporate subsidiary will largely depend on the number of shareholders in the proposed subsidiary and your client's percentage of ownership in the proposed subsidiary. If there are more than one shareholder in the proposed subsidiary and your client has an ownership interest of at least 80%, the choice of entity determination will be less important to your client. However, the other owners of the proposed subsidiary will probably be quite interested in using an LLC.

If there is only one shareholder in the proposed subsidiary, your client will likely be indifferent as to whether the subsidiary is a wholly-owned corporation or a wholly-owned Minnesota LLC. The corporate subsidiary provides liability protection. In addition, the parent and subsidiary can file a "consolidated" federal income tax return, which is better than a partnership (i.e. LLC) tax treatment because inter-company income is entirely eliminated in the consolidated return. This is not necessarily the case in the partnership context. Historically, a wholly-owned LLC was not possible because an LLC needed at least two members. However, as a result of the check-the-box Regulations, which treat a single-member LLC as a disregarded entity for income tax purposes, most states (including Minnesota) amended their LLC acts to permit single-member LLCs and the distinction between consolidated reporting and partnership reporting is moot.

If the subsidiary is to have two or more shareholders, the consolidated return option will not be available for at least one and possibly all of the owners. In that case, the pass-through nature of the LLC becomes the only substitute for consolidated filing, and, as a result, the LLC is the clear entity of choice.

B. The New Alternative to Subsidiary LLC Structures: The Series LLC

In an ideal situation, someone with multiple properties would have a separate LLC for each property. This, however, isn't always feasible because of administrative costs and filing fees that are required to establish and maintain each LLC.

In response to the growing use of single member LLCs by real estate developers and investors to create parent-subsidiary structures, several states – most notably Delaware, Nevada and Illinois – have amended their LLC statutes to allow for what has come to be known as a "Series LLC". In a Series LLC, separate "series" are created within a single LLC. Each series can have its own assets and its own debts and obligations (which are enforceable only against that series) as well its own classes or groups of members. By creating a series LLC, a real estate owner can segregate each separate property within a separate series, thereby insulating each property from the debts and liabilities of the other "series". This structure has the same effect as the single member LLC "parent-subsidiary" structure without the attendant administrative costs and filing fees. For example, a series LLC files a single tax return.

The most practical application of the series LLC is to facilitate the ownership of multiple parcels of real property. Another application, stemming from the fact that each series can have its own separate business purposes, arises in the instance where the real property owner also owns an operating entity which utilizes the property as its place of

business. Rather than form two (2) separate entities, a single series LLC can be used with one series containing the real property and the other series containing the business operations.

The series LLC will remain a developing area of the law but already holds promise for real estate developers and investors.