



Scottish Law Commission

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ISSUED ON BEHALF OF THE SCOTTISH LAW COMMISSION

NOT FOR PUBLICATION OR BROADCAST

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THE LIMITED PARTNERSHIPS ACT 1907

On 6 November the Law Commission and the Scottish Law Commission will publish a Joint Consultation Paper on the Limited Partnerships Act 1907. The Commissions are consulting in order both to update the law and to remove doubts which have caused concern to users of limited partnerships and their advisers.¹

A limited partnership is an ordinary partnership with certain modifications made by the Limited Partnerships Act 1907. The main difference between an ordinary and a limited partnership is that in a limited partnership only active partners ("general partners") are fully liable whereas those who merely invest ("limited partners") are, as long as they do not engage in management, liable to third parties only to the extent of their capital contribution.

The role of limited partnerships

At the outset it must be pointed out that limited partnerships perform a different role from that of the limited liability partnership ("LLP"), which has recently been introduced into the United Kingdom.² The LLP is designed as a business vehicle for professional or trading partnerships. It enables partners, who are actively involved in the business of their partnership, to limit their liability for the partnership's debts and obligations. Although it is treated as a partnership, it is subject to accounting and other rules closer to those of a company. The LLP was introduced in response to concerns by professional practitioners about their possible exposure to massive claims for damages arising from the alleged negligence of one or more of their partners.

The limited partnership is a useful vehicle for investors who do not wish to take an active role in the management of their funds. They may use it to create an investment fund under the control of a general partner who alone has unlimited liability for the partnership's obligations. The limited partner is only liable to the extent of his contributions, provided he

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does not take part in the management of the partnership business. The limited partnership offers the investor privacy, as the accounts of the partnership are not generally disclosed. Like other partnerships, it also provides the benefit of fiscal transparency – the partnership is not treated as an entity distinct from its members for the purpose of income tax or capital gains tax.

Over the last 10 years, limited partnerships have been used increasingly for property investment.³ The tax-transparent structure of the limited partnership makes it an attractive vehicle for institutional investors, such as pension funds or insurance companies, which are partially or wholly tax-exempt. It enables them to invest jointly with tax-paying entities, such as property companies, without losing their tax advantages. The same features have made them suitable for use in urban regeneration projects, bringing together public authorities (such as English Partnerships), institutional investors and property developers.⁴

On 26 May 1987 the Inland Revenue and the Department of Trade and Industry approved a statement on the use of limited partnerships as venture capital investment funds.⁵ Since then, limited partnerships have become the standard structure used by venture capitalists not only for United Kingdom funds but also for European funds. The venture capital industry in the United Kingdom is the largest and most developed in Europe, accounting for almost half of total European venture capital investment in 1998. However, it appears that there is no room for complacency as various European jurisdictions are developing structures in a bid to increase their share of the European venture capital industry.

Limited partnerships have been used in Scotland in agricultural tenancies for many years. Since 1997, Scottish limited partnerships have also been used as vehicles for investment in Lloyds as their separate legal personality enables them to become names.⁶

The need for reform

There is a strong case for updating the 1907 Act to enable the UK to continue to maintain its competitive position in the venture capital market. A recent Treasury report, while confirming the importance of limited partnerships to the private equity industry in the United Kingdom, has also drawn attention to the problems caused by the use of a "generic and rather archaic" piece of legislation.⁷ It refers in particular to the difficulty caused by the 20-partner limit and the uncertain status of limited partners engaged in overseeing investment activity.

As a result of preliminary consultations with, amongst others, the venture capital industry, a number of significant practical problems with the 1907 Act have been identified. The review of partnership law provides an opportunity to put forward remedies. This opportunity occurs against a background in which various jurisdictions – including Bermuda, the Cayman Islands, Delaware, Guernsey, Ireland, and Jersey – have introduced or modernised legislation on limited partnerships.

The Chairmen of the Commissions, Mr Justice Carnwath CVO and Lord Gill, agree that:

"The limited partnership is a very important business vehicle in certain specialised fields, such as venture capital and property development. It has flourished despite the obvious imperfections of the 1907 Act. There is now strong pressure from those operating in this specialised field for improvements to enable the law in the United Kingdom to continue to compete effectively with

foreign jurisdictions, such as Delaware and the Channel Islands, which have recently overhauled their limited partnership statutes."

The Law Commissions ask for comments by 11 January 2002.

NOTES TO EDITORS

1. The Scottish Law Commission and The Law Commission were set up by the Law Commissions Act 1965 to promote the reform of the law.
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Mr Patrick Hodge QC	Professor Hugh Beale
Professor Gerard Maher	Mr Stuart Bridge
Professor Kenneth Reid	Professor Martin Partington
Professor Joseph Thomson	Judge Alan Wilkie QC
3. The paper may be viewed at www.scotlawcom.gov.uk or www.lawcom.gov.uk or purchased from The Stationery Office Bookshops (£24.50).



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- ¹ This Consultation Paper forms part of the joint review of partnership law which the Law Commission and the Scottish Law Commission have undertaken at the request of the Minister of State at the Department of Trade and Industry. The Commissions have already published a detailed consultation paper on the general law of partnership. See Partnership Law: A Joint Consultation Paper – LCCP159 / SLCDP111 – published on 13 September 2000.
 - ² The Limited Liability Partnerships Act 2000 was enacted in July 2000.
 - ³ It is estimated that limited partnerships account for some £10bn of property investments, with shopping centres and retail warehousing forming the largest category.
 - ⁴ For example, the English Cities Fund, established as a limited partnership by Amec plc, English Partnerships and Legal and General Assurance. The need for such initiatives was underlined by the White Paper “Our towns and cities – delivering an urban renaissance” (Nov 2000) DETR Cm 4911.
 - ⁵ The statement explains that a limited partnership established for the purpose of raising funds for investment into companies will be regarded as carrying on a business and will represent a partnership within the definition in s 1 of the Partnership Act 1890 for the purposes of United Kingdom taxation. The income and capital gains arising within the partnership will be subject to tax upon receipt by the partnership as the income and gains of the partners who are entitled to them.
 - ⁶ The Lloyds’ membership bye-laws only permit legal persons to be Lloyds names, thereby excluding English limited and general partnerships.
 - ⁷ The Myners Review. In the 2000 Budget, the Chancellor asked Paul Myners to investigate possible distortions in institutional investment decision-making. Mr Myners published his report on 6 March 2001.