

Chapter 2

Partnerships and Limited Liability Partnerships

TRUE/FALSE QUESTIONS

- B1. No partner is deemed to be an agent of the other partners and of the partnership.

ANSWER: F
BUSPROG: Analytic

PAGES: Section 1
AICPA: BB-Legal

- B2. A majority of the states treat a partnership as an entity for most purposes.

ANSWER: T
BUSPROG: Analytic

PAGES: Section 1
AICPA: BB-Legal

- B3. The intent to associate is a key element of a partnership.

ANSWER: T
BUSPROG: Analytic

PAGES: Section 1
AICPA: BB-Legal

- B4. One can join a partnership even if all other partners do not consent.

ANSWER: F
BUSPROG: Analytic

PAGES: Section 1
AICPA: BB-Legal

- B5. The partnership is a pass-through entity *and* a taxpaying entity.

ANSWER: F
BUSPROG: Analytic

PAGES: Section 1
AICPA: BB-Legal

- B6. If no fixed duration of the partnership is specified, the partnership is a *partnership in perpetuity*, which means that the partnership cannot be dissolved.

ANSWER: F PAGES: Section 2
BUSPROG: Analytic AICPA: BB-Legal

- B7. The majority rule controls in decisions that significantly affect the nature of the partnership or that are outside the ordinary course of the partnership business.

ANSWER: F PAGES: Section 2
BUSPROG: Analytic AICPA: BB-Legal

- B8. Devoting time, energy, and skill to partnership business is a partner's duty and is *not* a compensable service.

ANSWER: T PAGES: Section 2
BUSPROG: Analytic AICPA: BB-Legal

- B9. Every act of the partner concerning partnership business and "business of the kind" and every contract signed in the partnership's name bind the partner, but not the firm.

ANSWER: F PAGES: Section 2
BUSPROG: Analytic AICPA: BB-Legal

- B10. A partner may pursue his or her own interests without automatically violating the partner's fiduciary duties to the partnership and the other partners.

ANSWER: T PAGES: Section 2
BUSPROG: Analytic AICPA: BB-Legal

- B11. Limits on a partner's authority normally are effective only with respect to third parties who are notified of the limitation.

ANSWER: T PAGES: Section 2
BUSPROG: Analytic AICPA: BB-Legal

B12. Dissociation normally entitles the partner to buy his or her interest from the partnership.

ANSWER: F PAGES: Section 3
BUSPROG: Analytic AICPA: BB-Legal

B13. On a partner's dissociation, the partner's duty of loyalty ends.

ANSWER: T PAGES: Section 3
BUSPROG: Analytic AICPA: BB-Legal

B14. After a partner dissociates from a continuing partnership, the partnership is no longer bound by the acts of the dissociated partner, even on a theory of apparent authority.

ANSWER: F PAGES: Section 3
BUSPROG: Analytic AICPA: BB-Legal

B15. On dissolution, the creditors of the partnership, but *not* the creditors of the individual partners, can make claims on the partnership's assets.

ANSWER: F PAGES: Section 4
BUSPROG: Analytic AICPA: BB-Legal

B16. A limited liability partnership may exempt its partners from personal liability for *any* partnership obligation.

ANSWER: T PAGES: Section 5
BUSPROG: Analytic AICPA: BB-Legal

B17. In a limited partnership, a *limited* partner has full responsibility for the partnership and for all its debts.

ANSWER: F PAGES: Section 6
BUSPROG: Analytic AICPA: BB-Legal

B18. In a limited partnership, a general partner's dissociation from the firm normally will lead to dissolution unless all partners agree to continue the business.

ANSWER: T PAGES: Section 6
BUSPROG: Analytic AICPA: BB-Legal

B19. A limited partnership cannot be dissolved by court decree.

ANSWER: F
BUSPROG: Analytic

PAGES: Section 6
AICPA: BB-Legal

B20. A limited liability limited partnership is a type of limited partnership.

ANSWER: T
BUSPROG: Analytic

PAGES: Section 6
AICPA: BB-Legal

MULTIPLE CHOICE QUESTIONS

B1. Noah and Orin do business as partners in Personnel Providers, an employment agency. In most states, for purposes of suing and being sued, Personnel Providers would be treated as

- a. an aggregate of the individual partners.
- b. a natural person.
- c. an entity.
- d. a non-existent party.

ANSWER: C
BUSPROG: Reflective

PAGES: Section 1
AICPA: BB-Legal

B2. Luke and Maya form Northwest Air Express, a general partnership. The essential elements of this partnership do *not* include

- a. a sharing of profits and losses.
- b. a joint ownership of the business.
- c. an equal right to management in the business.
- d. goodwill.

ANSWER: D
BUSPROG: Reflective

PAGES: Section 1
AICPA: BB-Legal

B3. Pualani and Quentin do business as partners in Rio Vista Builders, a residential construction firm. For federal income tax purposes, Rio Vista would be treated as

- a. a pass-through entity.
- b. a natural person.
- c. a tax-paying entity.
- d. a partnership by estoppel.

ANSWER: A PAGES: Section 1
BUSPROG: Reflective AICPA: BB-Legal

B4. Sable and Rex agree while talking on the phone to form a partnership—The Home Source—to deal in transfers of real property. To be enforceable, their agreement must

- a. be filed in the appropriate state office.
- b. be in writing.
- c. involve the exchange of valid consideration.
- d. not involve a third party.

ANSWER: B PAGES: Section 2
BUSPROG: Reflective AICPA: BB-Legal

B5. Bayside Marina Company and Canoes & Kayaks Inc., share officers, directors, employees, property, and equipment. In reliance on Bayside Marina's reputation, Delivery Transport, Inc., contracts to perform services for Canoes & Kayaks, but the firm does not pay. In terms of liability to Delivery Transport, a court is most likely to treat Bayside Marina and Canoes & Kayaks as

- a. a pass-through entity.
- b. a natural person.
- c. a tax-paying entity.
- d. a partnership by estoppel.

ANSWER: D PAGES: Section 2
BUSPROG: Reflective AICPA: BB-Legal

6 TEST BANK B—UNIT ONE: BUSINESS ORGANIZATIONS

- B6. Sweet Selections is a general partnership that sells candy, cards, and flowers. Sweet Selections has ten partners. Jill and Amy each have a 25 percent interest in the partnership. All the other members have a 10 percent interest. To pass a management decision
- a. a majority of the partners must agree to the decision.
 - b. both Jill and Amy must agree to the decision.
 - c. Jill or Amy must agree to the decision.
 - d. 30 percent of the partners must agree to the decision.

ANSWER: A PAGES: Section 2
BUSPROG: Reflective AICPA: BB-Legal

- B7. Quisa and Reilly are partners in Sport Bikes, which rents and sells bikes, bike accessories, and related gear. Quisa manages the business. Unless the partnership agreement states otherwise, Quisa is
- a. entitled to compensation in proportion to her effect on the business.
 - b. entitled to compensation in proportion to her effort.
 - c. entitled to compensation in proportion to her capital contribution.
 - d. not entitled to compensation.

ANSWER: D PAGES: Section 2
BUSPROG: Reflective AICPA: BB-Legal

- B8. Corbin, a partner in Dentists & Orthodontists Clinic, applies for a loan with Evermore Bank allegedly on the firm's behalf but without the authorization of the other partners. Evermore knows that Corbin is not authorized to take out the loan. If Corbin defaults on the loan, liability for its unpaid amount will be imposed on
- a. Corbin and Doctors, jointly.
 - b. Corbin only.
 - c. Doctors only.
 - d. Evermore only.

ANSWER: B PAGES: Section 2
BUSPROG: Reflective AICPA: BB-Legal

- B9. Oliana is a partner in Pacific Traders. In the majority of states, with respect to any partnership obligations that Oliana does not participate in, know about, or ratify, Oliana would be liable for
- a. none of the obligations.
 - b. all of the obligations, jointly and severally.
 - c. all of the obligations, jointly but not severally.
 - d. only the contractual obligations.

ANSWER: B PAGES: Section 2
BUSPROG: Reflective AICPA: BB-Legal

Fact Pattern 2-1B (Questions B10–B13 apply)

Bryn, Cornell, and Duke are general partners in Equity Lending, a consumer credit, mortgage, and investment firm. Their agreement states that it is a breach of the agreement for any partner to assign his or her interest to a creditor without the consent of the other partners.

- B10. Refer to Fact Pattern 2-1B. Bryn, Cornell, and Duke decide to admit Giselle as a new partner in Equity Lending. Giselle's liability for partnership debts incurred before her admission is
- a. limited to her capital contribution to the firm.
 - b. limited to her personal assets.
 - c. nothing.
 - d. unlimited.

ANSWER: A PAGES: Section 2
BUSPROG: Reflective AICPA: BB-Legal

- B11. Refer to Fact Pattern 2-1B. Cornell's assignment of his interest in Equity Lending to Financial Consultants Corporation results in
- a. nothing with respect to Cornell or Equity Lending.
 - b. the automatic termination of Equity Lending's legal existence.
 - c. Cornell's liability for all of Equity Lending's debts.
 - d. Cornell's wrongful dissociation and liability for any damages.

ANSWER: D PAGES: Section 3
BUSPROG: Reflective AICPA: BB-Legal

B12. Refer to Fact Pattern 2-1B. Bryn's dissociation from the firm results in

- a. the automatic termination of the firm's legal existence.
- b. the partnership's buyout of Bryn's interest in the firm.
- c. the immediate maturity of all partnership debts.
- d. Bryn's purchase of her interest in the partnership from the firm.

ANSWER: B

PAGES: Section 3

BUSPROG: Reflective

AICPA: BB-Legal

B13. Refer to Fact Pattern 2-1B. The partners decide to dissolve Equity Lending. Duke collects and distributes the firm's assets. This results in

- a. nothing with respect to the firm's existence.
- b. the continuation of the firm's business.
- c. the termination of the firm's legal existence.
- d. the temporary suspension of the firm's business.

ANSWER: C

PAGES: Section 4

BUSPROG: Reflective

AICPA: BB-Legal

B14. Edgar, Jon, and Phoebe do business as partners in Reliable Movers. Phoebe develops a debilitating illness and can no longer work. Phoebe

- a. may dissociate from the partnership.
- b. may not dissociate from the partnership without the other partners' consent.
- c. must dissociate from the partnership.
- d. may terminate the partnership.

ANSWER: A

PAGES: Section 3

BUSPROG: Reflective

AICPA: BB-Legal

- B15. Round-Up Ranch and Smith & Jones, Accountants, are limited liability partnerships (LLPs). The major features of an LLP are that it limits the personal liability of the partners and
- a. it allows the partnership to continue as a pass-through tax entity.
 - b. LLP statutes do not vary from state to state.
 - c. it can only do business in the state in which it was formed.
 - d. only a few states have enacted LLP statutes.

ANSWER: A PAGES: Section 5
BUSPROG: Reflective AICPA: BB-Legal

- B16. Hillside Vineyards is a family limited liability partnership. All of the partners must be
- a. natural persons only.
 - b. natural persons or persons acting as fiduciaries for natural persons.
 - c. persons acting as fiduciaries for natural persons only.
 - d. related.

ANSWER: B PAGES: Section 5
BUSPROG: Reflective AICPA: BB-Legal

- B17. Nazih and Ovidia are limited partners in Physicians Medical Center, a limited partnership. In terms of the firm's books and information regarding partnership business, Nazih and Ovidia are entitled to
- a. access in proportion to their participation in management of the firm.
 - b. access to the parts that directly relate to their capital contributions.
 - c. no access.
 - d. complete access.

ANSWER: D PAGES: Section 6
BUSPROG: Reflective AICPA: BB-Legal

- B18. Nikki and Orlando are limited partners in Port City Exports, a limited partnership. To avoid personal liability for partnership obligations, they must *not*
- a. acquire an interest in the firm.
 - b. contribute property to the firm.
 - c. engage in activities independent of the firm's business.
 - d. participate in the firm's management.

ANSWER: D

PAGES: Section 6

BUSPROG: Reflective

AICPA: BB-Legal

- B19. Commercial Credit & Finance is a limited partnership. Derry, Eleni, and Frey are the general partners. Derry dies. The partnership can
- a. continue only after a distribution of its assets.
 - b. continue only as a general partnership.
 - c. continue only if Eleni and Frey consent.
 - d. not continue because Derry's death dissolves the firm.

ANSWER: C

PAGES: Section 6

BUSPROG: Reflective

AICPA: BB-Legal

- B20. Buckley is a general partner in Cut-Rate Shipping, LLLP, a limited liability limited partnership, which cannot pay its debts. Buckley is personally liable for the debts
- a. in proportion to the number of partners in the firm.
 - b. to no extent.
 - c. to the extent of his capital contribution.
 - d. to the full extent.

ANSWER: C

PAGES: Section 6

BUSPROG: Reflective

AICPA: BB-Legal

ESSAY QUESTIONS

- B1. Sebastian was the manager of Thai Bistro, a restaurant specializing in Southeast Asian foods. Sebastian opened a bank account in Thai Bistro's name, signing the account signature card as "owner." Umeko, who was often at Thai Bistro and had free access to its office, told others that she was "an

owner” and “a partner.” She also opened a bank account in Thai Bistro’s name, and signed the account signature card as “owner.” Sebastian told Vijay, the owner of Wong Noodles, Inc., that Umeko was a member of a partnership that owned Thai Bistro. On this basis, Wong Noodles delivered its goods to Thai Bistro on credit. In reality, Thai Bistro was actually owned by a corporation. When the unpaid account totaled more than \$10,000, Wong Noodles filed a suit against Umeko to collect. On what basis might Umeko be liable for the debt?

ANSWER: The theory under which Umeko would most likely be liable for Thai Bistro’s debt to Wong Noodles is partnership by estoppel.

The first requirement of this theory is a representation, by a nonpartner or by another with the nonpartner’s consent, that the nonpartner is a partner. The second requirement is reliance on that representation.

In this case, Wong Noodles could prove both elements. Both Sebastian and Umeko made representations with respect to Umeko’s status in relation to Thai Bistro—they both signed bank cards as “owner,” Umeko was often at Thai Bistro and had free access to its office, Umeko told others that she was a “partner” in the business, which is what Sebastian also told Vijay. As for the reliance element, Wong Noodles extended credit to Thai Bistro only because Wong Noodles believed that Thai Bistro was owned by a partnership.

PAGES: Section 2

BUSPROG: Reflective

AICPA: BB-Decision Modeling

- B2. Fresco and Garcia form a partnership—HVAC Pros. Garcia’s capital contribution is \$10,000, and Fresco’s is \$15,000. The partnership agreement provides that profits are to be shared, with 40 percent for Garcia and 60 percent for Fresco. Later, Garcia makes a \$10,000 loan to the partnership when it needs working capital. When the partnership is dissolved, its assets are \$50,000, and its debts are \$8,000. How should the assets be distributed?

ANSWER: On the dissolution and winding up of a partnership, the order of liability payment of the assets is as follows: (a) debts owed to partnership creditors, including partners; and (b) capital contributions of partners and profits as provided or, in the absence of an agreement, equally [UPA 807].

In this question, the partnership’s creditors would be paid \$8,000 first, leaving a balance of \$42,000 from the \$50,000. Next, Garcia would be paid \$10,000 for the loan, or advance, leaving \$32,000. From this amount, Garcia would receive \$10,000 and Fresco \$15,000 as payment for their capital

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contributions, leaving a balance of \$7,000. The \$7,000 would be split as profits, with 40 percent going to Garcia (\$2,800) and 60 percent to Fresco (\$4,200).

PAGES: Section 4

BUSPROG: Reflective

AICPA: BB-Decision Modeling