

BEFORE THE INTERPRETATION AND APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition)	<u>D</u> <u>E</u> <u>T</u> <u>E</u> <u>R</u> <u>M</u> <u>I</u> <u>N</u> <u>A</u> <u>T</u> <u>I</u> <u>O</u> <u>N</u>
for Refund of)	
)	No. 88-457
[Petitioner])	
)	
of)	Registration No. . . .
)	Warrant No. . . .
[Taxpayer])	
)	
)	

- [1] **MISC:** LIMITED PARTNERSHIP -- ASSESSMENT -- LIMITED PARTNER -- LIABILITY. A limited partner will not be personally liable for a limited partnership's obligations if that limited partner is not an active participant in the control of the business.
- [1] **MISC:** LIMITED PARTNERSHIP -- ASSESSMENT -- LIMITED PARTNER -- LIABILITY. The State of Washington, as a creditor, may enforce a limited partnership's obligation against a limited partner to the extent that that partner's obligation has not already been paid to the partnership.
- [3] **MISC:** LIMITED PARTNERSHIP -- LIMITED PARTNER -- GOOD FAITH -- INVALID PARTNERSHIP -- RCW 25.10.200 - - RETROACTIVE PROTECTION. In accordance with RCW 25.10.200, a person who has made a contribution to a business enterprise, and erroneously but in good faith believes that he has become a limited partner therein, and has so represented himself to the Department, will not be held to be a general partner when he has, within a reasonable time of ascertaining the mistake, withdrawn from future equity participation in the enterprise by executing a Certificate of Withdrawal.

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

NATURE OF ACTION:

Petition concerning the liability of a limited partner for partnership taxes.

FACTS:

Bauer, A.L.J. -- The above-referenced warrant was issued in the amount of \$ X on August 6, 1985.

In early 1984, the petitioner sought and obtained an attorney's advice beforehand on how she could provide some startup money for her son's business, but avoid general liability in the future if it failed. Her attorney advised her that so long as she did not participate in the management or operation of the business, as a limited partner she would not be personally liable for its debts. In April of that year, the petitioner signed a limited partnership agreement to evidence a \$5,000 contribution she made to her son's painting business (hereafter "taxpayer"). A copy of the cancelled \$5,000 check has been provided. She entered into the limited partnership agreement in good faith believing that she would have the protections the law accords to a limited partner. Although she signed the partnership agreement in her attorney's office, however, her attorney failed to tell either her son or her that limited partnership agreements must be filed with the Secretary of State. The agreement was not filed as required.

In May of 1984, the son filed a registration form with the Department of Revenue. He checked the box for partnership and added the handwritten word "limited" to show that the business was a limited partnership. Only two partners were listed, himself and the petitioner, and the Department form did not require any further designation or title for the partners. However, at the bottom of the form, the son signed and listed his title as "Owner/General Partner."

At approximately the same time, the son filed applications for account with the Department of Labor and Industries and Employment Security Department, similarly identifying the taxpayer as a limited partnership, and listing himself as general partner and the petitioner as the limited partner.

The son operated the business and the petitioner took no part in its management or operation. The son failed to pay the state revenue taxes and other state and federal assessments when due. By the fall of 1985, the Department of Revenue and other state agencies were taking collection action on unpaid taxes and other deficiencies. The IRS levied on a business bank account. The petitioner advised the Department of Revenue that she was a limited partner. However, both the Department and a second lawyer she consulted informed her that she would be held responsible as a general partner because the limited partnership agreement had not been filed with the Secretary of State.

The second attorney failed to tell the petitioner of the protections of RCW 25.10.200 which, with limited exceptions, gives the full protections of a limited partnership retroactively to an individual who erroneously but in good faith enters a limited partnership if that person later files a certificate of withdrawal from future equity participation with the Washington Secretary of State. Only persons who transacted business with the entity before the filing of the withdrawal, and who had an actual good faith belief at the time that the individual involved was a general partner, can treat the individual as a general partner.

The petitioner, who was unaware of RCW 25.10.200, feared that unless she paid, the Department of Revenue would seize her personal property to collect on the outstanding state revenue tax liabilities of the partnership that her son had neglected to pay. The Department of Revenue had filed a warrant against her personally as well as the partnership and the son. Because of her fears and the mistaken legal advice, in late 1985 and 1986 the petitioner paid approximately \$2,900 to the Department of Revenue on the taxpayer-partnership's account.

Still operating under the advice of the second attorney, who told her that she would be held liable as a general partner, the petitioner in early 1986 published a notice of withdrawal from the partnership. She took this step for the purpose of terminating her involvement and winding up the partnership. Around this same time, the son closed the taxpayer's account with the Department of Revenue and opened a new one in his own name.

The petitioner's current legal representative has since advised the taxpayer of her rights under RCW 25.10.200 to be treated retroactively as a limited partner. The petitioner filed her Certificate of Withdrawal with the Secretary of

State under RCW 25.10.200 on September 8, 1987 promptly after learning of her rights, and now seeks a refund for taxes she paid on the partnership's behalf.

PETITIONER'S EXCEPTIONS:

The petitioner claims she paid the taxpayer's state revenue taxes only because of the mistaken legal advice she received and under the fear of seizure of her personal property. Had she known of the protections of RCW 25.10.200, she would have claimed them at the time.

The petitioner claims she at all times acted in good faith as a limited partner and her son also acted as the sole general partner in control of the business. On the advice of counsel they both signed the limited partnership agreement before the son went into the business. The various registration documents with state agencies are completely consistent with the petitioner's role strictly as a limited partner. The failure to file the limited partnership agreement with the Secretary of State was a technical defect that RCW 25.10.200 allows the good faith limited partner to cure. Since the petitioner has filed the Certificate of Withdrawal under RCW 25.10.200, she is entitled under Washington law to the protection of a limited partner. Therefore, the petitioner claims that she is entitled to receive a refund of the state revenue taxes of the taxpayer which she wrongfully paid, and requests that she receive interest on that amount to the extent allowed by law.

ISSUES:

The sole issue for our determination is whether a person who in good faith enters into a limited partner agreement which is not filed with the Secretary of State, but who is reasonably identified to the Department as a limited partner, is entitled to the protections of RCW 25.10.200, assuming compliance with that statute's provisions.

DISCUSSION:

[1] RCW 25.10.190 provides for the limited liability of a limited partner if he does not participate in the control of the business:

(1) Except as provided in subsection (4) of this section, a limited partner is not liable for the obligations of a limited partnership unless the

limited partner is also a general partner or, in addition to the exercising of rights and powers as a limited partner, the limited partner participates in the control of the business. However, if the limited partner participates in the control of the business, the limited partner is liable only to persons who transact business with the limited partnership reasonably believing, based upon the limited partner's conduct, that the limited partner is a general partner.

Thus, the general rule is that a limited partner will not be personally liable for a limited partnership's obligations if he is not an active participant in the control of the business.

[2] RCW 25.10.280(2), however, does provide for liability to creditors up to the amount of the limited partner's required contribution:

(2) Unless otherwise provided in the partnership agreement, the obligation of a partner to make a contribution or return money or other property paid or distributed in violation of this chapter may be compromised only by consent of the all the partners. Notwithstanding the compromise, a creditor of a limited partnership who extends credit, or whose claim arises, after the entering into of a partnership agreement or an amendment thereto which, in either case, reflects the obligation, and before the amendment or cancellation thereof to reflect the compromise, may enforce the original obligation to the extent that, in extending credit, the creditor reasonably relied on the obligation of a partner to make a contribution. [Emphasis added.]

The State of Washington, then, as a creditor which has reasonably relied on the obligation of the limited partner, may enforce a limited partnership's obligation against that limited partner to the extent that that partner's obligation has not already been paid to the partnership.

Clearly, because the petitioner had already paid her contribution in full to the partnership at the time the warrant was issued, she would have been protected from the tax liability here at issue had the partnership been validly filed with the Office of the Secretary of State.

[3] The question then becomes whether RCW 25.10.200 retroactively grants her the protection she would have otherwise had if the partnership had been validly registered. RCW 25.10.200 provides as follows:

(1) Except as provided in subsection (2) of this section, a person who makes a contribution to a business enterprise and erroneously but in good faith believes that he or she has become a limited partner in the enterprise is not a general partner in the enterprise and is not bound by its obligations by reason of making the contribution, receiving distributions from the enterprise, or exercising any rights of a limited partner, if, within a reasonable time after ascertaining the mistake, the person:

(a) Causes an appropriate certificate of limited partnership or a certificate of amendment to be executed and filed; or

(b) Withdraws from future equity participation in the enterprise by executing and filing in the office of the secretary of state a certificate or statement declaring withdrawal under this section.

(2) A person who makes a contribution of the kind described in subsection (1) of this section is liable as a general partner to any third party who transacts business with the enterprise (a) before the person withdraws and an appropriate certificate is filed to show withdrawal, or (b) before an appropriate certificate is filed to show that the person is not a general partner, but in either case only if the third party actually believed in good faith that the person was a general partner at the time of the transaction.

[Emphasis added.]

Thus, in accordance with RCW 25.10.200, a person who has made a contribution to a business enterprise, and erroneously but in good faith believes that he has become a limited partner therein, and has so represented himself to the Department, will not be held to be a general partner when he has, within a reasonable time of ascertaining the mistake, withdrawn from future equity participation in the enterprise by executing a Certificate of Withdrawal.

Here, the petitioner made her full contribution to the partnership, and in good faith believed she was a limited partner with all the protections that entailed. Within a reasonable time of ascertaining the mistake, and immediately upon her learning of the protections afforded by RCW 25.10.200, she filed a Certificate of Withdrawal with the Office of the Secretary of State. Finally, the Department cannot claim that it believed that the petitioner was a general partner when the unpaid taxes accrued. The partnership was clearly identified as a limited partnership on its Application for Certificate of Registration, and her son identified himself as the general partner. Because there were only two partners listed, the petitioner was unquestionably the only partner who could have been the limited partner in the enterprise.

We thus hold that the petitioner can avail herself of the protections of RCW 25.10.200, and is entitled to a refund of those taxes - with interest at the statutory rate - paid on behalf of the taxpayer. This decision is not to be construed, however, to grant relief to the taxpayer or its general partner for taxes still due and owing.

DECISION AND DISPOSITION:

The petition is granted. A refund of taxes paid by the petitioner, and interest at the statutory rate on that amount, will be issued to her. The warrant for taxes due will be reissued in the taxpayer's and general partner's name.

DATED this 30th day of November 1988.