LEGAL EYE

by Michael Bergman

The last months of 1986 saw a flurry of prospectuses, information circulars and offering memoranda being filed with the country's several securities commissions. Many commentators have noted that 1986's last minute dash to take advantage of feature film financing through tax shelters has been unusually heavy compared to the first five years of the '80s when film tax shelters were not in vogue. An interesting element of this recent spate of securities commission submissions has been the number of producers using the limited partnership approach.

Limited partnerships have been used by Canadian producers since the early '80s following the successful application of the limited partnership approach by several independent film producers in the United States. The current vogue of limited partnership owes much to the need to integrate three components for successful tax shelter film financing: equity investment in the film negative itself, investor participation beyond laying out the money and producer flexibility. To understand how limited partnership fulfills these three needs requires an understanding of the legal notion of partnership in general.

Partnership is a legal concept regulated by statute. Partnership is a contract whereby the partners contribute money, property or services as capital to the partnership in pursuit of a common objective from which each partner will participate in the profits and support the losses. The partners may create between themselves an imbalance between them: one partner may contribute less, one partner may be entitled to a greater share of the profits; one partner may be entitled to support a smaller portion of the losses than the other; one partner may be entitled to manage the partnership against the other's wishes. Nevertheless and regardless of the arrangements between the partners themselves, to the outside world all partners are equal and consequently equally responsible both for the management and the losses. Consequently each partner can be made to pay a debt in equal portions by a creditor although one partner may be entitled to reimbursement from the others where between them that partner has to support less of the losses. There is no limited liability like that applicable to shareholders of corporations. Partners are liable to third parties to an unlimited extent. Their personal property can be subject to seizure and execution to satisfy court judgments rendered against the partnership although usually the partnership property will be subject to seizure first and only if this proves insufficient would the personal property of a partner be affected.

Partnerships are dissolved when one of the partners withdraws, whether voluntarily or by death. On dissolution the property of the partnership is liquidated and distributed amongst the partners or their heirs. Where no agreement can be made on the method of distribution, application can be made to court for the appointment of a liquidator or a receiver. Given the possibility of differences and disputes over the liquidation of a partnership most partnership agreements contain provisions for the appointment of an arbitrator to settle this problem.

All partnerships must be registered, failing which the partners are liable to sanctions, ranging from fines to being precluded to sue for partnership claims in court. Once the partnership is registered all of the named partners can be sued for the partnership debts whether or not they are truly partners. For this reason it is important for the dissolution of a partnership to also be registered even if some of the partners subsequently re-form the partnership.

From this brief explanation many readers may conclude that incorporated companies are preferable entities and quite often they would be right. But partnerships can be a useful commercial vehicle for a number of reasons. Partners own the property of the partnership directly. They have a direct title and equity interest in all of the property of the partnership unlike shareholders who do not own the property of the corporation. Partnership is easy to dissolve and to re-form, the will of one of the partners to withdraw is sufficient. There are no minority or majority rights to deal with, no liquidation or winding up of corporations according to complicated rules to contend with. There is no complicated hierarchy of officers, directors, chairpersons and the like as is the case in corporations. There are no incorporation fees and no legal costs for the annual fulfillment of legal requirements to maintain the corporation and file reports on its status.

Limited partnerships are a special from of partnership. In limited partnerships the partners are divided between general partners and special partners. General partners have all the attributes of partners in regular partnerships as described above, special partners have a much more limited role. Unlike general partners they are liable for the partnership's debts only up to the amount of their capital contribution to the partnership. They have no role in the management of the partnership and they can withdraw from the partnership without causing the dissolution of the entire partnership. These attributes have the effect of offering a producer a certain degree of flexibility while enabling him to be free from being overly encumbered by the investor. In a limited partnership the special partner owns a portion of the partnership property up to the value of the special partner's contribution to the partnership. In film-limited partnerships the only property of the partnership is the negative itself. The effect is similar to the special partner having purchased a unit in a film under the more traditional film tax shelter financing method. Since the special partner has an ownership interest in the negative itself he is entitled to the benefits of the feature film tax shelter. As a special partner has no say in the management of the partnership, consequently the producer, who is usually the general partner, has complete freedom of action in the production of the film.

Most feature film-limited partnerships give special partners the option of withdrawing from the partnership by exchanging their status as a special partner for shares in the producing corporation which is the general partner. The value of these shares would be fixed at the time that the option is exercised. This scheme acts as an incentive for investors to take advantage of the limited partnership by enabling them to exchange their investment for shares. There are many pitfalls with these seemingly enticing incentives, from tax consequences on the recapture of depreciation taken on the original investment, the circumstances and means of determining the shares obtained in the general partner, to determining whether or not such an exchange is really worthwhile.

One of the problems of the current use of limited partnerships in Canadian film financing is that they still tend to be designed to finance one or two projects at a time and not as a means of attracting direct investments into ongoing feature film corporations. Taken as a whole the use of limited partnerships in Canadian feature film financing at least offers the investor a new angle on the traditional purchase of units in a feature film for tax shelter purposes. Whether the use of limited partnerships will spark a true resurgence in the use of tax shelters for feature film financing ultimitely depends on the abilities of the producer, both as filmmaker and business man, and the extent to which he is attentive to the investor's needs and requirements.

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Danger Bay

TORONTO – The **Danger Bay** television series has been renewed by both the Disney Channel in the United States and the CBC, Sunrise Films Limited has announced.

Shooting on 22 new episodes is scheduled to begin in May, 1987. It will be the forth season for the action-adventure series that is shot on location in British Columbia.

CBC drama head John Kennedy and Disney Channel programming vice-president Bruce Rider lauded the program and both said it has performed well on their networks.

Danger Bay, which features the adventures of a marine veterinarian and his family, is produced by a subsidiary of Sunrise Films Limited of Toronto.