Case Study Shawn and Jasmine

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Case Scenario

Shawn and Jasmine want to establish a business that produces and sells hand-woven sweaters. Jasmine's parents are willing to provide capital to the new venture, but they do not want to become personally responsible for business losses beyond the amount they invest. At the same time, Jasmine's mother expects to have a significant role in managing the business if she contributes money.

The central question is whether Shawn, Jasmine, and Jasmine's parents should form a limited partnership in which the parents serve as limited partners. A related question is whether a limited liability company would provide a more suitable structure for the business.

A limited partnership could satisfy some of the family's objectives, particularly the parents' desire to limit their exposure to business debts. However, it may not be the most practical structure because it creates different legal roles for general and limited partners. An LLC would probably be the better option because it can protect all four owners from personal liability while allowing them to establish management and voting rights through a carefully drafted operating agreement.

Because the case does not identify the state in which the business will be formed, the analysis must rely on general principles of United States business law. Partnership and LLC laws are enacted at the state level, and the exact rights, liabilities, filing requirements, and tax consequences may differ among jurisdictions.

Forming a Limited Partnership

A limited partnership is an entity composed of at least one general partner and at least one limited partner. The general partner normally manages the business and makes decisions concerning its daily operations. Limited partners usually contribute capital and share in profits without assuming the same personal responsibility for partnership obligations as the general partner.

Under this arrangement, Shawn and Jasmine could become general partners because they intend to establish and operate the sweater business. Jasmine's parents could become limited partners by contributing capital. If the business failed and its assets were insufficient to pay its obligations, the parents would ordinarily risk the amount they invested but would not be personally responsible for the remaining partnership debts solely because they were limited partners.

This structure would address the parents' concern about losing personal assets beyond their capital contributions. However, it would create a serious disadvantage for Shawn and Jasmine. As general partners, they could become personally responsible for the debts and obligations of the business. If the partnership could not pay a supplier, landlord, employee, lender, or customer, a creditor might be able to pursue the personal assets of the general partners, subject to the law of the applicable state.

The allocation of risk would therefore be unequal. Jasmine's parents would receive limited liability, while Shawn and Jasmine could face broader personal exposure even though all four individuals would benefit financially from the enterprise.

The Traditional Control Rule for Limited Partners

The original case analysis raises an important concern about Jasmine's mother wanting a significant role in management. Historically, limited-partnership statutes distinguished sharply between passive limited partners and active general partners. Under the traditional "control rule," a limited partner who took part in controlling the business could, in some circumstances, become liable to people who reasonably believed that the individual was acting as a general partner.

Under that older approach, Jasmine's mother would face a difficult choice. She could remain a relatively passive investor and preserve her limited-partner status, or she could participate significantly in management and risk personal liability. If her investment depended on receiving meaningful decision-making authority, a traditional limited partnership would not fully satisfy her expectations.

The original conclusion that an LLC would be more appropriate is therefore understandable. An LLC expressly permits owners to possess both management rights and limited liability. However, the traditional control rule is no longer a universal statement of limited-partnership law.

The Modern Rule on Limited-Partner Participation

The Uniform Limited Partnership Act of 2001 substantially changed the relationship between management participation and limited-partner liability. Section 303 of the model legislation provides that a limited partner is not personally liable for a partnership obligation solely because that person is or acts as a limited partner, even when the limited partner participates in management and control (Uniform Law Commission, 2013a).

States adopting this modern approach no longer require a limited partner to remain entirely passive to preserve the liability shield. For example, a limited partner may be able to vote on important matters, provide advice, supervise aspects of the business, or participate in management without automatically becoming responsible for all partnership debts.

Accordingly, it would be too broad to state that Jasmine's mother must lose limited liability merely because she wants a significant voice in the business. Her legal position would depend on the limited-partnership statute adopted by the state of formation, the partnership agreement, the way she represents herself to third parties, and her specific conduct.

Some states may retain statutory language, judicial precedents, or exceptions that differ from the modern model. Furthermore, a limited-liability shield does not protect a person from responsibility for that person's own wrongful conduct. Jasmine's mother could still be liable for her own fraud, negligent acts, contractual guarantees, or other independently actionable conduct even if she remained protected from ordinary partnership obligations.

Therefore, the family would need to examine the law of the relevant state before relying on the assumption that a limited partner may freely control the business without additional exposure.

The General Partners' Liability Problem

Even where Jasmine's parents could manage the business without losing limited liability, the proposed structure would not solve the exposure faced by Shawn and Jasmine as general partners. Under a conventional limited partnership, at least one person or entity generally occupies the general-partner position and manages the enterprise.

If Shawn and Jasmine personally serve as the general partners, they may be directly responsible for the partnership's obligations. This possibility is especially important for a product-based business. A sweater company may enter leases, purchase materials on credit, hire workers, borrow money, sign distribution contracts, and face claims involving defective products, workplace injuries, advertising, intellectual property, or customer disputes.

One method of reducing this risk would be to create a separate LLC or corporation to act as the general partner. Shawn and Jasmine could then own and manage that entity instead of personally serving as general partners. Another possible structure is a limited liability limited partnership, where authorized by state law. These arrangements can reduce personal exposure but add organizational layers, filing requirements, legal expenses, and administrative complexity.

For a relatively small family-owned business, forming one LLC directly may accomplish the same basic objectives more simply.

Would an LLC Be a Suitable Alternative?

A limited liability company would be a strong option for Shawn, Jasmine, and Jasmine's parents. An LLC is a legal entity created under state law that combines elements commonly associated with corporations and partnerships. Its members generally receive protection from personal responsibility for company debts while retaining considerable flexibility in allocating management authority, voting rights, profits, and distributions.

Under the Revised Uniform Limited Liability Company Act, an LLC's debts and obligations belong to the company rather than to its members or managers solely because of their ownership or management status (Uniform Law Commission, 2013b). This means that Shawn, Jasmine, and Jasmine's parents could all become members without automatically placing their homes, savings, or other personal property at risk for ordinary business liabilities.

The liability protection is not absolute. A member remains responsible for personal misconduct and may voluntarily assume liability by signing a personal guarantee. Courts may also disregard the separation between the owner and the company in exceptional circumstances involving abuse of the entity, fraud, or serious failure to treat it as a separate business. Nevertheless, an LLC normally provides a more balanced liability structure than a conventional limited partnership in which Shawn and Jasmine serve personally as general partners.

Member-Managed and Manager-Managed LLCs

An LLC may generally be organized as either member-managed or manager-managed, depending on state law and the terms of its operating agreement.

In a member-managed LLC, the members participate directly in operating the business. Shawn, Jasmine, and Jasmine's parents could all vote on company matters. The operating agreement could specify whether each member has one vote or whether voting power is based on ownership percentage, capital contribution, or another agreed formula.

This structure would satisfy Jasmine's mother's desire to participate significantly in management. However, it could also produce conflict if each family member has equal authority but contributes different amounts of money, labor, experience, or time.

A manager-managed LLC would allow the family to assign daily operational responsibility to selected individuals. Shawn and Jasmine could serve as managers because they are establishing and running the sweater business, while Jasmine's parents could remain members with voting rights over major decisions. Alternatively, Jasmine's mother could become one of the managers if the family wants her to exercise direct authority.

A manager-managed structure would not necessarily deprive the parents of influence. The operating agreement could require their approval for major matters such as borrowing above a stated amount, admitting new members, changing the nature of the business, selling substantial company assets, amending the operating agreement, or dissolving the company.

The flexibility to separate routine management from major strategic decisions is one of the strongest reasons to choose an LLC for this case.

Importance of the Operating Agreement

The family should not rely only on verbal promises or informal understandings. A written operating agreement would be essential because it could define the legal and financial relationship among the four members.

The agreement should identify each person's initial contribution and ownership interest. It should explain whether additional contributions may be required and what happens if one member cannot or does not want to provide more capital. The document should also specify how profits, losses, and cash distributions will be allocated.

Ownership percentage, profit allocation, and voting power do not always have to be identical, although tax and state-law consequences must be considered. Jasmine's parents might contribute most of the money while Shawn and Jasmine contribute labor, designs, supplier relationships, and daily management. The operating agreement could recognize these different contributions without leaving the parties uncertain about their rights.

Management provisions should clarify which decisions managers can make independently and which require approval from the members. For example, Shawn and Jasmine might have authority to purchase ordinary supplies, set prices, hire workers, advertise products, and negotiate routine customer orders. Decisions involving substantial loans, ownership changes, expansion into a new market, or the sale of the company could require a larger vote.

The agreement should also address conflicts of interest and family disagreements. It may include procedures for resolving deadlocks, mediating disputes, removing a manager, buying out a member, valuing an ownership interest, and responding to death, disability, divorce, or bankruptcy. These provisions are especially important in a family business because personal relationships can make commercial disputes more difficult.

The U.S. Small Business Administration describes an LLC operating agreement as the document that establishes the company's financial and functional decision-making structure, including the duties, powers, and responsibilities of its members (U.S. Small Business Administration, 2025a). A detailed agreement would therefore allow Jasmine's mother to receive a meaningful role without leaving Shawn and Jasmine uncertain about the limits of her authority.

Tax Considerations

The decision between a limited partnership and an LLC should not be based solely on liability. Tax classification, employment taxes, expected distributions, compensation for services, and the owners' long-term objectives must also be considered.

A domestic LLC with two or more members is generally classified as a partnership for federal income-tax purposes unless it elects to be taxed as a corporation (Internal Revenue Service, 2025). Under the default partnership classification, the LLC normally files an informational return, while profits and losses pass through to its members. The members report their allocated shares on their individual tax returns, even when the business does not distribute all available cash.

A limited partnership is also normally taxed as a partnership. However, the tax treatment of active and passive owners, guaranteed payments, self-employment income, capital accounts, and allocated losses may differ according to each person's role and the details of the arrangement.

The LLC does not necessarily reduce taxes merely because it provides limited liability. It instead offers different classification options and organizational flexibility. Shawn, Jasmine, and the parents should obtain professional tax advice before deciding how ownership, compensation, and distributions will be structured.

Practical Comparison of the Two Structures

A limited partnership could work if the family clearly wants two classes of participants. Shawn and Jasmine could control daily operations as general partners, while the parents principally contribute capital as limited partners. In a state following modern legislation, Jasmine's mother might also exercise agreed management rights without automatically becoming liable for every partnership obligation.

However, the structure would remain less attractive if Shawn and Jasmine must personally accept general-partner liability. Using another entity as the general partner could reduce this risk but would increase complexity.

An LLC provides a more direct arrangement. All four individuals can be members, all can receive a liability shield for ordinary company debts, and their management rights can be tailored through the operating agreement. The family does not have to divide itself rigidly into general and limited partners.

The LLC is also more consistent with Jasmine's mother's stated expectations. She wants both investment protection and significant influence. A member-managed LLC could give her direct participation, while a manager-managed LLC could give her approval rights over specified major decisions.

Recommended Business Structure

Shawn, Jasmine, and Jasmine's parents should probably form a multi-member LLC rather than a conventional limited partnership. The LLC is more likely to satisfy all three central objectives in the case:

1. Jasmine's parents want to limit potential losses to their investment.
2. Jasmine's mother wants a meaningful role in management.
3. Shawn and Jasmine need to operate the business without accepting unnecessary personal liability as general partners.

The operating agreement should identify Shawn and Jasmine as the individuals primarily responsible for daily operations while giving the parents clearly defined rights regarding major financial and strategic decisions. It should also establish ownership percentages, distributions, salaries or other compensation, voting rules, transfer restrictions, exit procedures, and dispute-resolution mechanisms.

The family should maintain a separate company bank account, record financial transactions accurately, sign contracts in the LLC's name, obtain suitable insurance, and avoid mixing personal and business assets. These practices help demonstrate that the LLC is a genuine legal entity rather than an informal extension of the owners.

Conclusion

A limited partnership could protect Jasmine's parents from ordinary partnership debts, and modern law may allow Jasmine's mother to participate in management without automatically losing that protection. Therefore, the older claim that any management participation necessarily converts a limited partner into a personally liable general partner is not universally accurate.

Nevertheless, a limited partnership would create unnecessary difficulties for Shawn and Jasmine if they personally became general partners. They could face personal exposure for business obligations, while the parents received more complete protection. Creating an LLC or corporation to serve as the general partner could address this problem, but it would make the structure more complicated.

A multi-member LLC offers a clearer solution. It can provide liability protection to Shawn, Jasmine, and both parents while allowing them to allocate management authority according to their contributions and expectations. With a comprehensive operating agreement, the family can give Jasmine's mother a significant voice, preserve Shawn and Jasmine's ability to run daily operations, and establish procedures for financial decisions and future disputes.

The LLC is therefore the most suitable option based on the facts provided, although the final structure should be reviewed under the law of the state in which the business will be formed.

References

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