GSTR 2003/D4 - Goods and Services Tax: general law partnerships

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There is an Erratum notice for this document.
This document has been finalised.

Draft Goods and Services Tax Ruling
Goods and Services Tax: general law partnerships

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Preamble

This document is a draft for industry and professional comment. As such, it represents the preliminary, though considered views of the Australian Taxation Office. This draft may not be relied on by taxpayers and practitioners, as it is not a ruling or advice in terms of section 37 of the ***Taxation Administration Act 1953****. When officially released it will be a public ruling for the purposes of section 37 and may be relied upon by any person to whom it applies.*

What this Ruling is about

1. This Ruling explains how the *A New Tax System (Goods and Services Tax) Act 1999* ('GST Act') applies to transactions involving general law partnerships.[1]

2. In particular, this ruling explains:

- the GST consequences of supplies and acquisitions made between a general law partnership and its partners, specifically:
  - on formation of the partnership;
  - during its operation; and
  - on its dissolution.
- the meaning of an interest in or under the capital of a partnership in subregulation 40-5.09(3) of the A New Tax System (Goods and Services Tax) Regulations 1999 ('GST regulations');
- the GST consequences of:
  - a reconstitution of a general law partnership;
  - in kind capital contributions to a general law partnership by its partners; and
  - in kind distributions by a general law partnership to its partners.

[1] See paragraph 11 for what we mean by a general law partnership.

3. This Ruling does not apply to tax law partnerships.[2]

4. This ruling does not apply to limited partnerships.

5. This ruling also does not apply to partial assignments of interests in a partnership of the kind described in *Federal Commissioner of Taxation v. Everett*.[3]

6. Unless otherwise stated, all legislative references in this Ruling are to the GST Act, and all references to the regulations are to the GST regulations.

Date of effect

7. This draft Ruling represents the preliminary, though considered, view of the Australian Taxation Office. This draft may not be relied on by taxpayers or practitioners. When the final Ruling is officially released, it will explain our view of the law as it applies from 1 July 2000.

8. The final Ruling will be a public ruling for the purposes of section 37 of the *Taxation Administration Act 1953* ('TAA') and may be relied upon, after it is issued, by any entity to which it applies. Goods and Services Tax Ruling GSTR 1999/1 explains the GST rulings system and our view of when you can rely on our interpretation of the law in GST public and private rulings.

9. If the final public ruling conflicts with a previous private ruling that you have obtained, the public ruling prevails. However, if you have relied on a private ruling, you are protected in respect of what you have done up to the date of issue of the final public ruling. This means that if you have underpaid an amount of GST, you are not liable for the shortfall prior to the later ruling. Similarly, you are not liable to repay an amount overpaid by the Commissioner as a refund.

Background

10. A partnership is defined in section 195-1 of the GST Act by reference to the definition of a partnership in section 995-1 of the *Income Tax Assessment Act 1997* ('ITAA 1997'). That definition states that a partnership is:

> An association of persons carrying on business as partners or in receipt of ordinary income or statutory income jointly, but does not include a company.[4]

[2] See paragraph 12 for what we mean by a tax law partnership.
[3] (1980) 143 CLR 440; 80 ATC 4076; 10 ATR 608.

11. The first limb of the definition refers to 'an association of persons carrying on business as partners'. This reflects the general law definition of a partnership, which is 'the relation which subsists between persons carrying on a business in common with a view of profit'.[5] We refer to this type of partnership as a general law partnership.

12. The second limb refers to an association of persons that is not in business, but that is nevertheless in receipt of ordinary income or statutory income jointly. We refer to an association of persons under the second limb as a tax law partnership.

13. A general law partnership is formed when persons commence carrying on business together with a view of profit under an agreement, either written or oral. The 'relation' or the 'association' is one that arises under an agreement.

14. Under general law, a partnership is not an entity. The general law regards the business as being carried on by the persons that are in partnership. The term 'partnership' is merely descriptive of the relation between persons carrying on business with a view of profit.

15. The position under the GST Act is different. The definition of an entity includes a partnership.[6] A consequence of this is that the GST Act applies to partnership transactions, in particular dealings between partners and the partnership, in a manner that does not reflect the general law treatment of those transactions.

16. In this ruling, unless otherwise stated:

- a reference to a partnership is a reference to a general law partnership as defined in paragraph 11 of this Ruling;
- a reference to a registered partnership is a reference to a partnership that is either registered or required to be registered for GST purposes. Similarly, a reference to an unregistered partnership is a reference to a partnership that is neither registered nor required to be registered;
- a reference to a member of a partnership is a reference to a partner of a partnership;

[4] Section 195-1 of the GST Act, and section 995-1 of the ITAA 1997.
[5] The general law definition is set out in the partnership act of each state and territory as follows: subsection 7(1) WA, subsection 5 (1) Qld, subsection 5(1) Vic, subsection 1(1) SA, subsection 1(1) NSW, subsection 6(1) ACT, subsection 6(1) Tas, subsection 5(1) NT. This definition is adopted from the common law.
[6] Paragraph 184-1(1)(e).

- a reference to supplies and acquisitions is a reference, where appropriate, to supplies, acquisitions and importations; and
- all supplies and acquisitions are connected with Australia.

Ruling with explanation

GST and general law partnerships

17. For the purposes of the GST Act, 'an association of persons carrying on business as partners' means a general law partnership.

How and when a general law partnership is formed

18. A partnership is formed when two or more entities commence carrying on a business as partners. Whether and from what date a general law partnership exists are questions of fact. They are determined having regard to the partnership agreement and the circumstances surrounding the formation. The execution of a partnership agreement is the strongest evidence of a partnership being formed at a particular time.

19. The partnership agreement does not have to be in writing. Where there is no written agreement, the question of when a partnership is formed is determined having regard to the intention of the parties as evidenced by their conduct, the manner in which they deal with each other and with other parties, and other circumstances. Other circumstances may include the date of registration of a business or firm name, and the date on which partnership bank accounts are opened.

General law partnership as an entity for GST purposes

20. The GST Act definition of entity includes a partnership. The moment that a partnership is formed, it is an entity for GST purposes.

21. At general law, a partnership is not recognised as an entity distinct from its partners.[7] The general law definition of a partnership refers to the relation that exists between persons carrying on business in common with a view of profit. It is the partners that carry on a

[7] Ed RC I'Anson Banks, 1995, *Lindley and Banks on partnership* (Lindley and Banks), 17th edition, Sweet & Maxwell, London, paragraph 3-04.

business together and not the partnership as an entity separate from the partners. As was stated by William J in *FC of T v. Happ* (*Happ*):[8]

> Businesses are carried on by the individuals who are in partnership and not by the partnership firm as a separate conception.

22. A partnership has been treated as a separate entity for some income tax purposes. For example, under section 90 of the *Income Tax Assessment Act 1936* ('ITAA 1936'), the net income of the partnership is calculated 'as if the partnership was a taxpayer'. The assessable income or deductions of a partner must include their individual interest in the net income or partnership loss, respectively.

23. There is judicial authority for the proposition that, for limited purposes under the ITAA 1936, a partnership is treated as an entity separate from its partners. In *Rowe v. Federal Commissioner of Taxation,*[9] the full Federal Court recognised that:

> The Income Tax Assessment Act, 1936 ('the Act') does, for some purposes, treat a partnership as if it were a distinct entity from those who constitute it. Section 91 of the Act requires that a partnership shall furnish a return of the income of the partnership. Section 92 includes in the assessable income of a partner not a share of the gross income derived but 'his individual interest in the net income of the partnership of the year of income'. Section 90 defines the net income of a partnership as meaning the assessable income of the partnership, calculated as if the partnership were a taxpayer, less allowable deductions other than concessional deductions and deductions in respect of past losses. These provisions of the Act are, however, essentially for accounting purposes.[10]

24. Similar observations were made by Taylor J in *FC of T v. Beville*,[11] by Lockhart J in *FC of T v. Sahhar*[12] and by Stephen J in *Tikva Investments Pty. Ltd. v. FC of T.* [13]

25. The concept of a partnership as an entity separate from the partners has been extended under the GST Act. We consider that the GST Act treats a partnership as an entity for all purposes of the Act.[14]

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[8] 9 A.T.D. 447, at page 450. Referred to by the full Federal Court in *Rowe v. Federal Commissioner of Taxation* 82 ATC 4243 at page 4244.
[9] 82 ATC 4243.
[10] 82 ATC 4243 at pages 4243 to 4244.
[11] 10 A.T.D. 170 at page 172.
[12] 85 ATC 4072 at page 4075.
[13] 72 ATC 4231 at pages 4237 to 4238.
[14] The note to subsection 184-1(1) supports this conclusion. The note provides that the term 'entity' covers groups of legal persons, and other things that in practice are treated as having a separate identity in the same way as a legal person does.

26. As an entity, a general law partnership can make supplies and acquisitions under the GST Act. A partnership may register for GST, is liable for GST on taxable supplies that it makes,[15] and is entitled to input tax credits for creditable acquisitions it makes. Supplies and acquisitions that are made by partners as partners of a partnership are regarded as supplies and acquisitions by the partnership. This position is confirmed by subsection 184-5(1) which provides:

> For the avoidance of doubt, a supply, acquisition or importation made by or on behalf of a partner of a partnership in his or her capacity as a partner:
>
> (a) is taken to be a supply, acquisition or importation made by the partnership; and
>
> (b) is not taken to be a supply, acquisition or importation made by that partner or any other partner of the partnership.

27. Whether a partner makes a supply or acquisition in the capacity of a partner is a question of fact. Factors that may indicate that a supply is made by a partner in the capacity of a partner include:

- The consideration for the supply is paid to a common fund, or to all the partners;
- The supply is of a kind typically made in the type of enterprise carried on by the partnership; and
- The invoice or tax invoice shows the firm or business name, or the names of all the partners as supplier.

28. Factors that may indicate that an acquisition is made by a partner in the capacity of a partner include:

- The acquisition is used in the enterprise of the partnership;
- The acquisition is made with the consent of all the partners; and
- All the partners contribute to the cost of the acquisition.

[15] However, under section 50 of the TAA, the obligations on a partnership are imposed on each partner, and the partners are jointly and severally liable to pay GST.

Carrying on an enterprise

29. Under paragraph 9-20(1)(a), an enterprise includes an activity or activities 'in the form of a business'.[16] This has a wider meaning than the concept of 'carrying on business' in the definition of a partnership. We consider that a general law partnership is carrying on an enterprise[17] and may register for GST from the time of its formation.

Supplies and acquisitions made by the partnership on formation

30. Upon formation of a partnership, the partners acquire interests in the partnership. The mutual obligations that each partner undertakes, including capital contributions or the promise to provide labour, skills or services in the conduct of the partnership business, are consideration for the supply of interests in the partnership. Capital contributions can be either in money or in kind.

Interests in a partnership

31. An interest in a partnership is a right to a proportion of the surplus after the realisation of the assets and payment of the debts and other liabilities of the partnership[18] and is inclusive of a partner's entitlement to his or her share in the capital of the partnership.[19]

32. On a partnership coming into existence, its partners hold interests in the partnership. A partner's interest in the partnership may increase or decrease over time. A partner's interest is extinguished if the partner exits the partnership, unless the partner sells or assigns their interest to another entity. No interests in the partnership are held once the partnership ceases to exist.

33. For GST purposes, transactions involving the acquisition, disposal, or changes in the level of interests held in a partnership are considered in the context of financial supplies.

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[16] See Goods and Services Tax Determination GSTD 2000/8: Goods and Services Tax: what is an 'enterprise' for the purposes of *A New Tax System (Goods and Services Tax) Act 1999*? Does MT 2000/1 have equal application to the meaning of 'enterprise' for GST purposes?

[17] An exception to this is a partnership of individuals or mostly individuals carrying on an activity or activities without a reasonable expectation of profit or gain. This is not carrying on an enterprise (paragraph 9-20(2)(c)).

[18] See *Canny Gabriel Castle Jackson Advertising Pty. Ltd. and anor v. Volume Sales (Finance) Pty. Ltd.* (1974) 131 CLR 321 at page 327; *FC of T v. Everett* 80 ATC 4076 at page 4079; *Bakewell v. DFC of T* (SA) (1937) 58 CLR 743 per Dixon J and Evatt J at page 770.

[19] A partner's interest in the capital of a partnership cannot be quantified and assigned separately from the interest or share in the partnership – see *Kelly v. IRC* (NZ) (1970) NZLR 161 at page 164 referred to by the majority in *FC of T v. Everett* 80 ATC 4076 at pages 4080 to 4081.

Financial supplies

34. Section 40-5 provides that financial supplies are input taxed and that their meaning is given by the regulations. Subdivision 40-A of the regulations is about financial supplies. In accordance with subregulation 40-5.09(1), the provision, acquisition or disposal of an interest in or under securities, including the capital of a partnership, is a financial supply if:

(a) the provision, acquisition or disposal is:

(i) for consideration;

(ii) in the course or furtherance of an enterprise; and

(iii) connected with Australia.

(b) the supplier is:

(i) registered or required to be registered; and

(ii) a financial supply provider in relation to supply of the interest.[20]

35. Goods and Services Tax Ruling GSTR 2002/2, dealing with the GST treatment of financial supplies and related supplies and acquisitions, explains and clarifies when something is a financial supply. GSTR 2002/2 uses the term 'financial interest' to describe a supply that may be a financial supply because it is mentioned in an item in the table in subregulation 40-5.09(3) and is capable of satisfying the tests in subregulation 40-5.09(1).[21]

36. Item 10 in the table in subregulation 40-5.09(3) ('item 10') includes as securities 'the capital of a partnership or trust'.[22] Part 8 of Schedule 7 to the regulations includes 'interests in a partnership' within its list of examples for item 10.

37. As 'interest in a partnership' and 'interest in the capital of a partnership' are each mentioned in the regulations, it is important to understand the difference between the two terms for the purpose of applying the GST provisions.

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[20] Subregulation 40-5.09(1).
[21] See paragraph 24 of GSTR 2002/2.
[22] See paragraph (d) of item 10. In this ruling, we only discuss the meaning of the capital of a partnership.

Interest in a partnership and interest in or under the capital of a partnership

38. For GST purposes, an 'interest' is anything that is recognised at law or in equity as property in any form. [23]

39. The capital of a partnership, as described by Lindley[24], is:

> the aggregate of the sums contributed by its members for the purpose of commencing or carrying on the partnership business, and intended to be risked by them in that business. The capital of a partnership is not therefore the same as its property: the capital is a sum fixed by the agreement of the partners; whilst the actual assets of the firm vary from day to day, and includes everything belonging to the firm and having any money value.

40. This description has been referred to with approval in both *Rowella Pty Ltd v. Abfam Nominees Pty Ltd*[25] (*Rowella*) and in *Federal Commissioner of Taxation v. J.D. Roberts, Federal Commissioner of Taxation v. Smith (Roberts*).[26]

41. In the context of subregulation 40-5.09(3), we consider that the term 'capital of a partnership' is wider than the definition in Lindley. In this context, we consider that the term 'capital of a partnership' is to be read broadly, as a reference to the net capital of the partnership and includes:

- undrawn profit distributions;
- advances by the partners or other funds which have actually been invested in the partnership less amounts of capital that are withdrawn by the partners from time to time;
- any capital appreciation of assets contributed unless otherwise excluded by virtue of the partnership agreement; and
- the goodwill of the firm.

42. A partner's interest *in* the capital of a partnership is, for the purposes of item 10, a reference to the partner's interest in the net capital. This is commonly represented by the balance of the partner's capital account.

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[23] Regulation 40-5.02.
[24] Ed R. C. I'Anson Banks, LL.B, Lindley and Banks, 1995, 17th edn, (1995) Sweet.& Maxwell, at paragraph 17-01.
[25] (1989) 64 ALJR 121 at page 122, 89 ALR 513, (1989) 168 CLR 301.
[26] (1992) 108 ALR 385 at page 397; 92 ATC 4380; 23 ATR 494.

43. In our view, the term 'interest in a partnership' is not synonymous with the term 'interest in the capital of a partnership'. Neither an interest in a partnership nor an interest in the capital of a partnership is a security as defined in subsection 92(1) of the *Corporations Act 2001*.[27] However, as item 10 refers to securities including the capital of a partnership or trust, an interest in a partnership can be the supply of a financial interest if it is an interest in or under the capital of a partnership. As an interest in a partnership is not the same as an interest in the capital of a partnership, a literal interpretation of paragraph (d) of item 10 would mean that the supply of an interest in a partnership would not be a financial supply.

44. We acknowledge that, in interpreting paragraph (d) of item 10, the regulation can be read literally or more purposively. We do not consider it appropriate to adopt a narrow definition of the term 'interest in or under the capital of a partnership' in item 10. If the paragraph is interpreted literally, something (an interest in a partnership) that is intended to be a financial supply might not be a financial supply. Having regard to this, we read the relevant provisions more purposively to give effect to what was intended.[28]

45. We consider that an interest in a partnership is an interest *under* the capital of a partnership in the sense that an interest in a partnership is secured by a partner upon the undertaking of obligations by each partner. This reading is a more purposive interpretation under the rules of statutory interpretation. It gives effect to the clear intention, expressed in Part 8 of Schedule 7 to the regulations, for the supply of an interest in a partnership to be a financial supply if the requirements of subregulation 40-5.09(1) are met.

46. We consider that for GST purposes, the term 'interest in or under the capital of a partnership' in item 10 includes all the interests that a partner acquires from the partnership as a consequence of being a partner in that partnership. This includes a partner's interest in the partnership. The supply of an interest in a partnership is the supply of an interest in a security under subregulation 40-5.09(3).

Partnership as supplier of the interest in the partnership

47. In determining the GST consequences of supplies of interests in a partnership, it is important to determine whether these are supplies made by the partners to each other under the terms of the partnership agreement or whether they are supplies by the partnership to the partners.

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[27] The term 'securities' is defined in the dictionary to the regulations by reference to subsection 92(1) of the Corporations Law.

[28] *Cooper Brookes (Wollongong) Pty Ltd v Federal Commissioner of Taxation* (1981) 147 CLR 297.

48. We consider the more appropriate view to be that the interest in a partnership is supplied by the partnership and not by the partners to each other. An interest is created by the partnership upon supply.

Supply of an interest in a partnership as a financial supply

49. An interest in a partnership is a financial interest. It will be a financial supply if the requirements of subregulation 40-5.09(1) are met in relation to it. These requirements are listed at paragraph 34, and are explained further in paragraphs 50 to 57.

General law partnership as a financial supply provider

50. For the purposes of Division 40 of the regulations, a general law partnership is a financial supply provider. We consider that the partnership entity creates an interest in the partnership in making the supply of that interest. This is a consequence of the acceptance of a partnership as an entity and the fact that partners may act in the capacity of partners.[29] Therefore, the partnership is a financial supply provider under paragraph 40-5.06(1)(b) of the regulations.

51. Subregulation 40-5.06(2) specifies that the entity acquiring a financial interest is also the financial supply provider in relation to that interest. As a result, a partner, in acquiring an interest, may also make a financial supply. GSTR 2002/2 refers to this as an acquisition-supply.[30]

Consideration for the supply of an interest in a partnership

52. The obligations that each partner undertakes, including capital contributions, or the promise to provide labour, skills or services in the conduct of the partnership business, are consideration for the supply of interests in the partnership.

Supply of an interest in a partnership made in the course or furtherance of an enterprise

53. We take the view that the supply of an interest in a partnership is made in the course or furtherance of the enterprise that the partnership carries on. It is consideration for the acquisition of capital, or, the promise to provide labour, skills or services in the conduct of the partnership business, from the partners to enable the

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[29] Section 184-5(1).

[30] For further information on acquisition-supplies, see GSTR 2002/2, Goods and Services Tax: GST treatment of financial supplies and related supplies and acquisitions. Note particularly paragraph 110 of that Ruling.

partnership enterprise to be carried on. The supply of the interest in the partnership has the necessary connection with the enterprise to make the supply 'in the course or furtherance of the enterprise'.

54. The explanatory memorandum to A New Tax System (Goods and Services Tax) Bill 1999 supports this view. The explanatory memorandum, at paragraph 3.10 states:

> *In the course or furtherance* is not defined, but is broad enough to cover any supplies made in connection with your enterprise. An act done for the purpose or object of furthering an enterprise, or achieving its goals, is a furtherance of an enterprise although it may not always be in the course of that enterprise.

55. The above view is also supported by New Zealand's Taxation Review Authority (TRA) *Case 28*,[31] in which Bathgate DJ found:[32]

> An act done for the purpose or object of furthering the taxable activity, or achieving its goal, can be to help, achieve, or advance, and thus a "furtherance" of a taxable activity.[33]

Registration

56. Where its projected annual turnover is expected to exceed the registration turnover threshold,[34] a partnership is required to be registered upon formation. The registration turnover threshold is $50,000 (or a higher amount as specified in the regulations).[35]

57. A partnership may be registered from a particular date.[36] A partnership that undertakes activities in the commencement of its enterprise can be registered for GST. In the event that the enterprise does not proceed, there is a cessation of the enterprise. The partnership is dissolved and it will need to apply for the cancellation of its registration.

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[31] (1991) 15 TRNZ 952.
[32] 15 TRNZ 952 at page 958.
[33] The New Zealand law specifies that GST applies only to a supply made in the course or furtherance of a taxable activity. The courts have given a broad meaning to 'course or furtherance'.
[34] Section 23-5. Also see GSTR 2001/7: meaning of annual turnover, including the effect of section 188-25 on projected annual turnover. Note that the value of input taxed supplies is not included in the calculation of current or projected annual turnover.
[35] Section 23-15. The registration turnover threshold for non-profit bodies is $100,000 or a higher amount as specified in the regulations.
[36] Subsection 23-10(2).

58. This may result in increasing adjustments for the partnership under Division 138. A partnership whose registration has been cancelled may still have acquisitions and importations for which entitlements to input tax credits have arisen. Division 138 provides for an increasing adjustment to cancel those input tax credits.[37]

Acquisitions by a partnership upon formation

59. Upon formation, a general law partnership, as an entity for GST purposes, acquires capital from the partners. This may be either in money or in kind or the promise to provide services, labour or skills in the conduct of the partnership's business. A partnership acquires an in kind capital contribution in carrying on its enterprise.

60. The acquisition by a general law partnership of an in kind capital contribution is a creditable acquisition if all the requirements of section 11-5 are met in relation to the acquisition.

Supplies and acquisitions made by the partners on formation

61. A partner does not carry on an enterprise as a partner in a partnership. Therefore, a partner cannot register for GST in relation to the enterprise of the partnership.

62. Where a registered partner enters into the partnership and makes an in kind capital contribution in the course or furtherance of their own enterprise, the in kind capital contribution is a supply that may be taxable, input taxed or GST-free. A capital contribution of money is not a supply.[38]

Example 1: Formation of the partnership and GST consequences

63. *Kate and Sydney form a partnership operating a wholesale pie business and they register the partnership for GST. They acquire equal interests in the partnership. In Kate's case, this is for a capital contribution of $20,000 in money, which is not a supply by Kate. Sydney's capital contribution is a delivery van with a GST inclusive market value of $20,000. This is a supply made by Sydney for consideration being the interest in the partnership.*

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[37] Section 138-1.

[38] A supply of money is not a supply under section 9-10(4) (unless it is consideration for a supply of money).

64. It has been suggested that the supply as an in kind capital contribution of a thing acquired in the partner's own enterprise is not made in the course or furtherance of that partner's own enterprise. We consider that the supply, sale or disposal of business assets will be in the course or furtherance of the enterprise in which those assets are used. There is support for this view in *TRA Case 6*, in which Bathgate DJ noted:[39]

> If capital assets are used in the carrying on of a taxable activity the sale of those assets, or some of them, can readibly [sic] be in the course or furtherance of that activity… "In the course or furtherance of" a taxable activity is not an altogether different concept from the income tax situation of "... in gaining or producing, assessable income". It may be that to discover whether a supply is in the course or furtherance of a taxable activity some discernible nexus should be apparent between the activity and the supply. It would not appear inappropriate. …it is a question of fact and degree as to whether a supply is in the course or furtherance of a taxable activity carried on by the person concerned. There must obviously be a discernable relationship between the supply and the activity in the form of a nexus for the supply to be in the course or furtherance of the activity.

Example 2: Taxable supply of in kind capital contribution

65. *Sydney, from Example 1, is registered in relation to a separate enterprise he carries on. He acquired the van in carrying on that enterprise. The subsequent supply of the van as an in kind capital contribution to the partnership is a supply that Sydney makes in the course of his separate enterprise. As the supply is for consideration, being the interest in the partnership, and Sydney is registered, the supply of the van to the partnership is a taxable supply.*

66. The acquisition by a partner of an interest in the partnership is not a creditable acquisition as its supply to the partner is not a taxable supply.[40] The partner, in acquiring a financial interest, also makes an acquisition-supply.[41]

Example 3: Supplies of interests in the partnership

67. Kate and Sydney, from Example 1, have each been supplied with an interest in the partnership. These supplies of financial interests are financial supplies because the partnership meets all the requirements of subregulation 40-5.09(1) in relation to them. In acquiring these financial supplies, Kate and Sydney have also made acquisition-supplies.

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[39] (1988) 12 TRNZ 107 at page 111.
[40] See paragraph 11-5(b).
[41] See paragraph 51 of this Ruling.

In kind capital contribution – change in creditable purpose?

68. A partner making an in kind capital contribution is making two supplies to the partnership, being the supply of the in kind capital contribution and the acquisition-supply of the interest in the partnership. Where the thing supplied by the partner to the partnership was a creditable acquisition by the partner in carrying on a separate enterprise, it has been suggested that there is a change in the partner's creditable purpose. The change relates to making the acquisition-supply, which is an input taxed supply.[42]

69. We consider that the acquisition by the partner has a more direct and immediate link[43] with the supply of the in kind capital contribution made by the partner than with the acquisition-supply of a partnership interest. The partner's entitlement to input tax credits, therefore, is not affected by the acquisition-supply of a partnership interest.

Example 4: In kind capital contribution - change in creditable purpose

70. *Sydney, from Examples 1, 2 and 3, acquired the van in carrying on his separate enterprise, solely for a creditable purpose. His capital contribution of the van to the partnership is made in return for the interest in the partnership, which is connected to the acquisition-supply he makes. However, the acquisition of the van has a more immediate and direct link with Sydney's taxable supply of it to the partnership than with making the acquisition-supply. There has been no change in Sydney's creditable purpose in acquiring the van.*

Single entity selling an interest in its enterprise to form a partnership

71. When a single entity takes a partner into its business, the agreement to do so frequently provides for the new partner to purchase a share of the business or a share of the assets of the business.

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[42] See paragraph 129-50(2)(a). For a further explanation, see GSTR 2000/15: determining the extent of creditable purpose for claiming input tax credits and for making adjustments for changes in extent of creditable purpose.

[43] See also, *Southampton Leisure Holdings PLC Case 17716*, VAT Tribunal Decisions.

72. For GST purposes, this transaction results in the formation of a partnership and an acquisition of an interest in the partnership by each partner. The consideration provided by the 'purchaser' for the interest in the partnership is the amount payable to the 'vendor' in respect of the acquisition of the interest in the business.

73. We regard this transaction as the supply of an enterprise to the partnership by the entity selling the business, with the consideration being a supply of an interest in the partnership, together with a payment of money.

74. If the supply of the enterprise meets the requirements of subdivision 38-J, the supply is a supply of a going concern that is GST-free. [44]

Operation of the partnership

Supplies from a general law partnership to a partner

75. During its operation, a partnership may make supplies to a partner that are taxable, GST-free or input taxed.[45] The supply is a taxable supply if it satisfies the requirements of section 9-5. Where a partnership makes a supply to the partners or their associates in the course or furtherance of its enterprise without consideration or for inadequate consideration, Division 72 may apply.

The application of Division 72

76. Division 72 ensures that supplies to, and acquisitions from, associates without consideration are brought within the GST system, and that supplies to associates for inadequate consideration are properly valued for GST purposes.[46] As a partnership and its partners are associates under the GST Act,[47] Division 72 may apply to supplies between a partnership and its partners.

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[44] For further discussion on the supply of a going concern, see paragraphs 98 to 101.

[45] For example, in making a loan to a partner, a partnership supplies an interest in or under a credit arrangement, which is a financial supply if all the requirements of subregulation 40-5.09(1) are satisfied.

[46] See section 72-1.

[47] 'Associate' is defined in section 195-1 of the GST Act by reference to section 318 of the ITAA 1936. The definition is very wide and includes other partners of the partnership, spouses and children of any partner, certain other relatives and their spouses, companies that are controlled by a partner or associates and, if the company is also a partner, any associates of the company.

77. Subdivision 72-A may apply to a supply made between a partnership and its partners where the supply is without consideration.[48] The effect of this subdivision is that such a supply is not stopped from being a taxable supply where the recipient of the supply either is not registered or required to be registered, or acquires the thing supplied otherwise than solely for a creditable purpose.

78. Subdivision 72-C may apply to a supply made between a partnership and its partners where the consideration for the supply is inadequate.[49] The subdivision does not apply if the recipient is both registered and makes the acquisition for a solely creditable purpose.

79. Where Division 72 applies to a supply that is made without consideration or for inadequate consideration, the value of the supply is its GST exclusive market value.[50]

Example 5: Supply by a partnership to a partner for no consideration

80. *Shylock and Partners, a firm of solicitors, supplies conveyancing services to clients in the course of the enterprise it carries on. The partnership does the conveyancing for Portia, a partner, on her purchase of a private residence. Portia does not carry on any enterprise separate from the partnership and is not registered for GST. She provides no consideration to the partnership for the supply of the conveyancing services. The GST exclusive market value of the services supplied is $1000.*

81. *The supply of the conveyancing services to Portia attracts the application of Division 72 because the supply was made in the course or furtherance of the partnership's enterprise without consideration, she is an associate of the partnership and she is not registered. The partnership is liable for GST of $100.*

Acquisition by a partnership for private or domestic use

82. If a general law partnership acquires goods or services that have an intended use that is partly for private or domestic purposes and partly in carrying on the partnership enterprise, the acquisition is partly for a creditable purpose. The partnership needs to apportion its claim for an input tax credit under section 11-30 to the extent that the acquisition is for a creditable purpose.

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[48] Supplies from unregistered partners will never be taxable supplies by the partner or creditable acquisitions by the partnership. Division 72 does not apply to supplies by unregistered entities.

[49] Inadequate consideration is consideration that is less than the GST inclusive market value, see subsection 72-70(1).

[50] Sections 72-10 and 72-70.

Example 6: Acquisition partly for a creditable purpose

83. *Nigel and Sue are partners in a partnership. The partnership purchases a car that is intended to be used partly for partnership business and partly for private purposes. The partnership estimates that the business use of the car will be 60% and it claims an input tax credit based on this estimate of creditable purpose.*[51] *The partnership is not able to claim an input tax credit to the extent that the acquisition of the car is of a private or domestic nature, that is, 40%.*

Changes in creditable purpose

84. A supply by a partnership of a thing acquired, to a partner, is an application of the thing by the partnership. Section 129-55 provides:

> Apply, in relation to a thing acquired or imported includes:
>
> (a) supply the thing;
>
> (b) consume, dispose of or destroy the thing; and
>
> (c) allow another entity to consume, dispose of or destroy the thing.

85. Where a general law partnership allows a partner to use for a private or domestic purpose, a thing that it acquired in carrying on its enterprise, the partnership applies the thing within the meaning of section 129-55.

86. As the application is of a private or domestic nature, there is a change in the extent of creditable purpose for the acquisition by the partnership. A change in the extent of creditable purpose results from the actual application for a creditable purpose, of a thing acquired, being greater or less than its intended application for that purpose. The partnership may need to make an adjustment under either Division 129, or, if the thing acquired was goods, Division 130.

Division 129

87. Division 129 may apply in relation to any thing that is acquired and to any change in extent of creditable purpose. If the actual application for a creditable purpose is less than its intended application for that purpose, the partnership may have an increasing adjustment for the adjustment period[52] for the acquisition. If the actual application is greater than its intended application for that

[51] GST Bulletin 2000/2: How to claim input tax credits for car expenses, gives guidance on methods of apportionment of input tax credits for motor vehicles.
[52] Section 129-20 defines adjustment periods for acquisitions and importations.

purpose, the partnership may have a decreasing adjustment for the adjustment period for the acquisition.

Example 7: Adjustment for change of extent of creditable purpose

88. *Nigel and Sue, from Example 3, subsequently realise that the business use of the car is actually 70%. The partnership has a decreasing adjustment in its first adjustment period, which reflects the change in creditable purpose from 60% to 70%.*[53]

Division 130

89. Division 130 is limited in its application to acquisitions of goods and to changes in extent of creditable purpose, from solely for a creditable purpose to solely for a private or domestic purpose. Where the partnership acquired goods solely for a creditable purpose, but subsequently applies these goods solely to a private or domestic use, the partnership has an increasing adjustment under Division 130. Division 130 does not apply if the partnership previously had an adjustment under Division 129 for the acquisition or importation.

90. For the purposes of Division 130, it is the private or domestic use by the partnership that is relevant. We consider that when goods are removed by a partnership for private consumption by a partner, there is an application solely to private and domestic use by the partnership. The application to a private or domestic use by a partnership under Division 130 does not involve a supply made in the course or furtherance of the partnership's enterprise.[54]

Example 8: Goods own use

91. *Duncan and Tracey in partnership commence their business as retailers of fine china on 1 December 2002. The partnership claims input tax credits on all acquisitions of china, based on the acquisitions being solely for a creditable purpose. The partnership subsequently allows Duncan to take home some of the china for his family's private usage. In doing this, the partnership's application of the china is*

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[53] For further information about making adjustments under Division 129, see Goods and services tax ruling GSTR 2000/24: Division 129 – making adjustments for changes in extent of creditable purpose.

[54] For further discussion on the operation of Division 130, see GSTD 2003/2: are there GST consequences when a partner in a partnership takes goods held as trading stock for private or domestic use?; and GSTR 2003/6: transfers of enterprise assets as a result of property distributions under the *Family Law Act 1975* or in similar circumstances. Note also the operation of section 17 of *A New Tax System (Goods and Services Transition) Act 1999* in respect of assessable goods held for the purposes of sale or exchange (trading stock) on hand at 1 July 2000.

solely to a private or domestic use. The partnership has an increasing adjustment under Division 130 for the china that Duncan takes home.

Supplies from a partner to the partnership

92. A supply that a registered partner makes to the partnership is a taxable supply if it satisfies the requirements of section 9-5. A supply may be in the form of an in kind capital contribution,[55] or a business transaction that does not involve a contribution of capital.

Example 9: Supply by a registered partner to the partnership

93. *William is a partner in a GST registered partnership, which manufactures model aeroplanes. He also carries on his own enterprise making parts for model aeroplanes and is registered for GST in relation to that enterprise. A film studio orders a specially designed model aeroplane from the partnership. William, from his own business, sells the parts to the partnership for the manufacture of the model. The partnership pays adequate consideration for the parts to William.*

94. *As the supply meets all the requirements of section 9-5, William makes a taxable supply.*

95. Where a registered partner makes a supply to the partnership without consideration, or for inadequate consideration, the supply may be taxable on application of Division 72.[56]

96. A supply by a partner to a partnership may also be GST-free or input taxed. A sale by a registered partner of an enterprise to a partnership may be the supply of a going concern that is GST-free if the requirements of subdivision 38-J are met.[57] A loan or advance made by a registered partner to a partnership may be a financial supply (under item 2 of subregulation 40-5.09(3)).[58]

Example 10: Partner making a financial supply to the partnership

97. Paul and Art operate a music store in partnership. In order to fund a new stock of sheet music, Paul lends $5,000 to the partnership. Paul carries on a separately registered enterprise as a money lender. In making the loan, Paul is making a financial supply to the

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[55] Capital contributions can be made at any time, not only upon formation.
[56] See a more detailed discussion of Division 72 at paragraphs 76 to 81.
[57] The supply of going concerns is discussed at paragraphs 98 to 101.
[58] An interest in or under a credit arrangement-see paragraphs 37-42 of Goods and Services Tax Ruling GSTR 2002/2: GST treatment of financial supplies and related supplies and acquisitions.

partnership of an interest in or under a credit arrangement, for consideration of an interest in a debt.

Can a general law partnership make a supply of a going concern?

98. We consider that a general law partnership can make a supply of a going concern.[59] Under subsection 38-325(2), a partnership supplies a going concern if the supply is made under an arrangement where:

- the partnership supplies to the recipient all of the things necessary for the continued operation of an enterprise; and
- the partnership carries on or will carry on the enterprise until the day of the supply.

99. The supply of a going concern is GST-free if the requirements of subsection 38-325(1) are met. Those requirements are:

- the supply is for consideration;
- the recipient of the supply is registered or required to be registered; and
- the supplier and the recipient have agreed in writing that the supply is of a going concern.

100. A general law partnership may make the supply of a going concern to another partnership comprising some of the same partners as the partnership making the supply. [60]

101. Where a supply is GST-free as a going concern, no input tax credits are available to the purchaser.

Reimbursements

102. A partner making an acquisition in relation to the enterprise of the partnership ordinarily makes it in the capacity as partner. However, partners may incur expenses that are directly related to their activities as partners of the partnership but not actually incurred in their capacities as partners. An example is a partner making calls from a private telephone to partnership clients.

103. When the partnership reimburses the partner for the expense, under Division 111 the reimbursement is treated as consideration for an acquisition that the partnership makes from the partner. This

[59] See paragraphs 190-194 of GSTR 2002/5, GST: When is a supply of a going concern GST-free.

[60] See paragraph 194 of GSTR 2002/5, which discusses the sale by a sole trader to a partnership of which he is a member.

Division allows registered entities to claim input tax credits on certain acquisitions made by their employees, agents, officers or partners where such expenses are reimbursed. A registered partnership is entitled to an input tax credit if the requirements of Division 111 are satisfied.

104. One of the requirements of this Division is that the supply to the partner must be taxable. The partner needs to provide the partnership with the tax invoice it obtained for this supply, as the partnership may claim an input tax credit if it holds this tax invoice.[61]

105. Where a partner makes an acquisition and is acting in the capacity of a partner of the partnership, the acquisition is taken to be by the partnership.[62] The question of reimbursements in this instance will not arise (see subsection 111-5(3A)).

Dissolution of a partnership

106. At general law, dissolution of a partnership may be brought about in a number of different ways, including by a change in its membership or by a cessation of its business. Where the partnership no longer carries on a business, it is dissolved and wound up. However, on departure of a partner (upon resignation, retirement or death), the partnership may either be wound up or the continuing partners may agree that the business or firm may be carried on by the continuing partners, with or without new partners.[63] In the latter situation, there may be no change in the outward appearance of the partnership firm or business.

107. A dissolution leading to the winding up of the partnership is called a general dissolution. A dissolution that does not result in the winding up of a partnership is called a technical dissolution.[64] A technical dissolution occurs where the assets and liabilities of the partnership are taken over by the continuing partners (and any new partners) and the partnership business is continued without any apparent break.

[61] Section 111-15.
[62] Subsection 184-5(1).
[63] This is often described as a reconstituted partnership.
[64] A technical dissolution is also referred to as a 'notional' dissolution.

General dissolution

108. A general dissolution of a partnership may be brought about in a number of ways. These include:

- by mutual agreement between the partners;
- upon the expiration of time if the partnership is for a fixed period of time;
- by the death or bankruptcy of a partner; and
- permanent cessation of the business carried on.[65]

109. When a partnership dissolution leads to its winding up, the partners retain their authority to bind the other members of the partnership for the purpose of winding up the affairs of the partnership, and only for that purpose. Their other rights and obligations also continue for this purpose. See for instance, subsection 41(1) of Queensland's *Partnership Act 1891*:

> After the dissolution of a partnership the authority of each partner to bind the firm, and the other rights and obligations of the partners, continue notwithstanding the dissolution so far as may be necessary to wind up the affairs of the partnership, and to complete transactions begun but unfinished at the time of the dissolution, but not otherwise.[66]

110. Effectively, a partnership continues, although only for the purpose of winding up. As stated in Lindley:

> For the purposes of winding up, the partnership is deemed to continue; the good faith and honourable conduct due from every partner to his co-partners during the continuance of the partnership being equally due so long as its affairs remain unsettled; and that which was partnership property before, continuing to be so for the purpose of dissolution, as the rights of the partners require.[67]

GST consequences of a general dissolution

111. For GST purposes, some or all of the partners may continue to carry on the enterprise of the partnership during its winding up. The definition of 'carrying on an enterprise' in section 195-1 includes doing anything in the course of termination of the enterprise.[68] The activities that are carried out as part of the winding up are in 'carrying

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[65] See R. C. I'Anson Banks, LL.B, Lindley and Banks, 1995, 17th edn, (1995) Sweet & Maxwell, paragraph 24-38. Note that a temporary cessation of the business will not be taken to be a dissolution of the partnership.

[66] See partnership acts of other States and Territories: WA, s.49; Vic, s.42; SA, s.38; NSW, s.38; ACT, s.44; Tas, s.43; NT, s.42.

[67] See R. C. I'Anson Banks, LL.B, Lindley and Banks, 1995, 17th edn, (1995) Sweet & Maxwell, paragraph 25-54 (5).

[68] Section 195-1 of the GST Act.

on an enterprise'. A partnership is wound up upon the final distribution to the partners. We consider that the final distribution forms part of carrying on the partnership's enterprise.

Supplies made by the partnership on winding up a partnership

112. Realising business assets as part of winding up a partnership involves the partnership making supplies in the course or furtherance of an enterprise that it carries on. Those supplies are taxable supplies if all the requirements of section 9-5 are satisfied.

113. Following the payment of the partnership debts and other liabilities after realisation of assets, any available surplus is applied in making distributions to the partners.[69]

114. Where not all of the assets[70] of the partnership are required to be sold in order to meet the debts and other liabilities of the partnership, remaining assets may be distributed to the partners.[71]

115. Where the partnership makes an in kind distribution to a partner in satisfaction of the partner's interest in the partnership, for GST purposes, it is something done in the course of the termination of the partnership's enterprise. We consider that the making of an in kind distribution is a supply in the course of the enterprise that the partnership carries on. The supply may be taxable, input taxed or GST-free.

116. The supply of the thing as an in kind distribution to the partner is made without consideration. This is because there is no payment, act or forbearance in connection with the supply.[72] The partner's interest in the partnership is extinguished when the distribution is made. The partner does not surrender that interest back to the partnership as consideration. This is discussed further in paragraphs 118 to 120. As the supply of the in kind distribution is made to an associate without consideration, we consider that Division 72 applies to the supply. The application of Division 72 is discussed at paragraphs 76 to 81.

117. Upon the making of a final distribution by the partnership, the partners' interests in the partnership are extinguished.[73] No GST

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[69] The distribution may be in respect of advances by a partner, return of capital or remaining surplus (the ultimate residue). We use the term distribution to cover any or all of the three.

[70] In this context, we refer to the asset to mean property of the partnership other than money as defined in section 195-1.

[71] See decision of the Privy Council in *Cameron v. Murdoch 63 ALR 575* supporting the conclusions reached by Brinsden J of the Supreme Court of Western Australia reported as Cameron v. Murdoch [1983] WAR 321.

[72] Subsection 9-15(1).

[73] The extinguishment of a partnership interest includes the extinguishment of the interest in the partnership capital.

consequence arises in respect of the extinguishment. Upon the extinguishment of every partner's interest, the partnership ceases to exist.

118. We do not consider that, upon the making of the final distributions by a partnership to the partners, the partners' interests in the partnership are surrendered to the partnership.

119. This conclusion is supported by comments made by their Honours, Lockhart J and Fitzgerald J in *FC of T v. Walsh (P.J. and B.J.)* (*Walsh*).[74] That case involved three companies that entered into a venture of acquiring property for the purpose of resale at a profit. One of the companies, Syncarpia Pty. Ltd., was acting as trustee of a family unit trust. Upon resale, the profits were shared among the participants in the venture. Both Lockhart J and Fitzgerald J concluded that the three companies were in a partnership. In his judgment Lockhart J stated:

> The partnership came to an end when the land was sold, the liabilities discharged and the net proceeds of sale distributed to each partner. The sum of $19,565.09 was received by Syncarpia in extinguishment of its interest in the partnership.[75]

120. Fitzgerald J came to a similar conclusion. In relation to the possibility that the partnership was a partnership under the first limb his Honour stated:[76]

> Upon the division between the partners of the partnership profit from the sale of the partnership asset, the partnership came to an end. … Syncarpia received its share of the partnership profit in satisfaction and extinguishment of its interest in the partnership…

Example 11: Supplies made by partnership to partners on winding up

121. *Jim and Jones, painters and decorators, decide to retire and wind up their GST registered partnership. The partnership plant and equipment are sold to another firm of decorators. However, not all of the partnership assets need to be sold to meet the debts and other liabilities of the partnership. The partnership is left with $6,000 in money, and a motor vehicle. The partnership's final distribution to Jim consists solely of the vehicle. Jones' final distribution will be in money. Neither partner carries on an enterprise separate from the partnership.*

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[74] 83 ATC 4407.

[75] 83 ATC 4407 at page 4427. His Honour did not state definitively whether the partnership was one under the first limb of the definition of partnership or the second limb of the definition.

[76] 83 ATC 4407 at 4435.

122. *The supply of plant and equipment is made to the other firm of decorators in the course or furtherance of the partnership's enterprise, and is a taxable supply by the partnership.*

123. *Jim's interest in the partnership is extinguished upon the making of the final distribution to him. The supply of the vehicle, though made in the course or furtherance of the partnership's enterprise, is made without consideration. As Jim is an associate of the partnership and is not registered, subdivision 72-A applies to the supply. As a result, the partnership makes a taxable supply to Jim. As the GST exclusive market value of the vehicle is $5,000, the partnership has a GST liability of $500. After discharging this liability, the partnership has $5,500 in money.*

124. *The partnership makes final distribution of the remaining $5,500 in money to Jones. This is not a supply. Jim's final distribution is the vehicle with a GST inclusive market value of $5,500.*

Supplies made by the partners on winding up a partnership

125. The final distribution to the partners, in money or in kind, is not consideration for any supply made by the partner. As explained in paragraph 116, the partner does not surrender their interest in the partnership. Their interest is extinguished upon the final distribution.

126. If, after payment of debts and other liabilities of the partnership, there is a surplus, the partners ordinarily would not make any supplies to the partnership. As upon the making of final distributions by a partnership, the partners' interests in the partnership are extinguished, the partners do not make any supplies to the partnership. Where, however, the partnership has a deficiency upon winding up, the partners may contribute moneys or other assets to ensure that the partnership meets its debts and other liabilities. In this case, the partners' interests in the partnership are not extinguished until the partnership has met its debts and other liabilities.

127. The contribution of money by a partner to make good a partnership deficiency is not a supply. The supply of other assets by a registered partner to the partnership, if made in the course or furtherance of their separate enterprise, is a taxable supply if the requirements of section 9-5 are met. The partnership acquires the assets in the course of the termination of its enterprise, that is, in carrying on its enterprise. It therefore makes a creditable acquisition of the asset provided by the partner. Where the assets are supplied by an unregistered partner, the supply by the partner is not a taxable supply and the acquisition is not a creditable acquisition.

Technical Dissolution

128. Under general law, any change in the membership of a general law partnership leads to its dissolution. However, as previously discussed in paragraphs 106 and 107, the dissolution may not lead to the winding up of the partnership. The continuing partners and any new partner may conduct the business of the partnership without any break in its continuity. We refer to this as a reconstituted partnership.

129. Whether or not there is a reconstituted partnership depends on the intention of the parties and the terms and conditions of the partnership agreement.

130. A written partnership agreement may expressly provide for the continuation of the firm or business in the event of a change in the membership of the partnership. This provision is often referred to as a continuity clause. In the absence of a written agreement, a continuity clause may be implied by the conduct of the partners following the retirement or death of a partner, or introduction of a new partner.

Effectiveness of continuity clauses

131. The effectiveness of continuity clauses has been discussed in a number of cases. In *S.J. Mackie Pty Ltd v. Dalziell Medical Practice Pty Ltd (Dalziell)*,[77] two proprietary companies carried on the practice of radiology as partners pursuant to an agreement. A radiologist who was employed by the partnership was offered and accepted as a partner. Some months later, he was excluded from the partnership and he sought an account of the profits and a share of the goodwill of the partnership. The original partnership deed included a clause stipulating that the partnership:

> …shall be a continuing partnership and shall not be dissolved by the transfer or purported transfer of any unit or other interest in the partnership.

132. The full Court of the Supreme Court of Queensland took the view that a non-dissolution clause did not negate the basic principle of partnership law that any change in membership destroyed the existing partnership. The court found it 'impossible to give literal effect to a provision … that the partnership is a continuing partnership not dissolved by transfer of a unit or other interest in the partnership'.[78]

133. Similarly, *F C of T v. Jeffries*[79] found that a partnership was dissolved when the outgoing partner assigned his interest in the partnership. In *Hadlee and Sydney Bridge Nominees Ltd v.*

[77] (1989) 2 Qd. R 87.
[78] (1989) 2 Qd. R 87 at page 90.
[79] 80 ATC 4659.

Commissioner of Inland Revenue (*Hadlee*),[80] Eichelbaum J expressed a similar view. *Dalziell* and *Hadlee* drew on comments made in the House of Lords decision, *Commissioners for General Purposes of Income Tax for City of London v. Gibbs and Others*[81] which held that the four remaining partners were a different partnership to the original five, with different rights, powers and division of property.

134. The Courts have, however, distinguished between a technical dissolution and a general dissolution and have shown a reluctance to order a partnership to be wound up on a change of members where there is an express or implied continuity clause and it is clear that the firm continues.

135. In *Abbott v. Abbott* (*Abbott*),[82] the Court considered the question of whether there was a general dissolution of a partnership between a father and his five sons when one of them retired. The partnership agreement provided that: 'The death or retirement of any partner shall not terminate the partnership' and that: 'If any partner shall …do or suffer any act which would be a ground for the dissolution of the partnership by the court then he shall be considered as having retired.'[83]

136. Clauson J stated:

> If this were a partnership at will and one partner said, "I am determined to go out of this partnership" the effect would be that the partnership would come to an end as between all the partners, although the others might form some new partnership amongst themselves if they so desired.[84]

137. His Honour also said:

> So there is some limitation upon this character of the partnership; it is subject to the express agreement that a single partner cannot determine the partnership although he can determine it as between himself and the others. This involves the fact that if one intimates his desire to go out, the partnership shall continue among the remaining partners. The partners have agreed that the partnership shall continue, notwithstanding that one partner goes out, and they have also agreed that notwithstanding that one partner dies, the partnership shall continue. That does not mean that the partnership shall continue when all but one of the partners has died or retired, because there cannot be a partnership with one partner.[85]

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[80] 11 NZTC 6155.
[81] (1942) AC 402.
[82] (1936) 3 All ER 823.
[83] (1936) 3 All ER 823 at page 825.
[84] (1936) 3 All ER 823 at page 826.
[85] (1936) 3 All ER 823 at pages 826-827.

138. In *Sobell v. Boston and Others* (*Sobell*),[86] following an oral agreement between the plaintiff and the defendants, who were practicing as solicitors, the plaintiff left the partnership and the defendants continued to practice under the same name and from the same address. The plaintiff sought a declaration that the partnership was dissolved, an order for the sale of the assets and goodwill of the business and an account of sums due in respect of his share in the capital and profits.

139. The application was dismissed. Goff J considered that the determination that he had to make was whether, in light of the conduct of the parties, there was a general dissolution of the partnership or that the plaintiff had retired from the partnership leaving the partnership continuing between the remaining three partners. His Honour found that:

> …the true inference from their conduct is that the plaintiff retired… and the agreement did not work a dissolution.[87]

140. His Honour went on to say:

> …once given that it is found that a partner has retired, I do not see how, as a general rule he can be entitled to a sale which is inconsistent with retirement, involving as that does the other partners taking over the business for themselves … In my judgment, what he is entitled to is the value of his share at the date of his retirement, including, of course, the then goodwill, the ascertainment of which must at all events normally be a matter of inquiry, accounting and valuation, not sale.[88]

141. *Sobell*[89] was referred to with approval in *Chia & Ors v. Ireland* (*Chia*).[90] In *Chia*, the court was dealing with a dispute between an outgoing partner (Dr. Ireland) and continuing partners on the value of the outgoing partner's share. The outgoing partner had brought an action claiming that the partnership of medical practitioners had been dissolved and sought an order for winding up and for the taking of partnership accounts.

142. The appeal failed. The Court concluded that there had not been a general dissolution of the partnership but a retirement by Dr Ireland from a continuing business. Williams J observed:

> The distinction between a technical dissolution of partnership upon retirement of one partner from a continuing partnership and a general dissolution when the affairs of the business are fully wound up is of importance to this appeal. An appreciation of the distinction affects an understanding of the nature of the order under appeal and

[86] (1975) 1 WLR 1587.
[87] (1975) 1 WLR 1587 at page1590.
[88] (1975) 1 WLR 1587 at page 1591.
[89] (1975) 1 WLR 1587.
[90] No. SCGRG –99-648 (2000) SASC 47 (3 March 2000).

> the rights of the outgoing partner with respect to the remaining partners in a continuing enterprise when the partnership agreement is silent as to the consequences of dissolution.

143. In *Sweetman v. Commissioner of Inland Revenue (Fiji)*,[91] the court[92] dealt with the deductibility of expenditure incurred by a continuing partner in reimbursing clients of a partnership whose funds were misappropriated by a former partner.

144. The court held that the discharge by the continuing partnership of the liability of the old partnership to the clients of that partnership was calculated to enhance the earning capacity of the continuing partnership. In reaching its decision, the court said:

> Moreover, the professional practice conducted by the old and the new partnership was a continuous practice, marked only by a change in the composition of the partners as Mr. Benfield retired from the partnership. To treat the loss as a loss of the old partnership to the exclusion of the new partnership is, in our view, to ignore the circumstances that the practice was a continuing practice, despite the departure of Mr Benfield.[93]

145. In *Peterson v. Federal Commissioner of Taxation*,[94] the High Court accepted that a partnership was not dissolved upon the death of a partner as the partnership agreement expressly provided for its continuation on the death of a partner.

146. The partnership act of each state and territory recognises the notion of a reconstituted partnership. For example, subsection 44(1) of Western Australia's *Partnership Act 1895* states:

> Subject to any agreement between the partners every partnership is also dissolved by the death or bankruptcy of any partner.[95]

147. This provision recognises that partners may agree to the partnership continuing after the death or bankruptcy of a partner. This may occur either with or without any incoming partner. Where there is no such agreement, the death or bankruptcy of a partner leads to a general dissolution and a winding up of the partnership.

148. The question of the effectiveness of a continuity clause, express or implied, has given rise to differing views in the courts. Decisions such as those in *Dalziell* and *Hadlee* indicate that these clauses cannot be enforced. Conversely, the decisions in *Abbott*, *Sobell* and *Chia* indicate that continuity clauses may prevent the

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[91] 96 ATC 5107.
[92] The Supreme Court of Fiji comprising Lord Cook of Thornton, Sir Anthony Mason and Sir Maurice Casey.
[93] 96 ATC 5107 at page 5113.
[94] 106 CLR 395.
[95] See, also, subsection 36(1) Qld, subsection 37(1) Vic, subsection 33(1) SA, subsection 33(1) NSW, subsection 38(1) ACT, subsection 38(1) Tas; subsection 37(1) NT.

winding up of a partnership where it is apparent that the partnership's business continues to be carried on by the continuing partners. Provisions of the partnership act of each State and Territory support this position.

Continuity clauses – are they effective for GST purposes?

149. To regard a change in the membership of a partnership as leading to a winding up of an existing partnership and the formation of a new partnership would lead to administrative and compliance difficulties for the partnership and its partners. This would be the case particularly for partnerships that experience frequent membership changes. Every change in membership would require cancellation of the partnership's Australian Business Number (ABN) and GST registration, and re-application for a new ABN and GST registration by the continuing partners.

150. We consider that, for GST purposes, it is open and appropriate for the Commissioner to accept that a change in membership does not necessarily result in the general dissolution and winding up of the partnership.

151. We acknowledge that there is judicial support for the view that a continuity clause is ineffective to override the fundamental principle that a change in the membership of a partnership dissolves the old and leads to the formation of a new partnership.

152. However, other cases support the notion of a reconstituted partnership. This, combined with the practical and administrative considerations and the purposive intent behind the treatment of a partnership as an entity for GST purposes, supports our view that, at least for GST purposes, a continuity clause (whether express or implied) is effective.

153. In practical terms, the view that there can be continuity of a partnership for GST purposes means that the partnership is dissolved only as far as a retiring or deceased partner is concerned.[96] The retiring or deceased partner's interest in the partnership crystallises as a debt owing by the partnership to that partner. The reconstituted partnership continues as far as the continuing partners are concerned.

154. We consider that, for a partnership to be treated as reconstituted for GST purposes, there needs to be an express or implied continuity clause in the partnership agreement and there should be no break in the continuity of the enterprise or firm. Indicators of continuity of the enterprise or the firm include:

[96] (1936) 3 All ER 823 at page 827.

- the continuing partners retain substantially all of the partnership assets;
- the nature of the enterprise remains substantially unchanged;
- the client or customer base remains substantially unchanged; and
- the business name or name of the firm remains unchanged.

155. None of these indicators is conclusive evidence of a reconstituted partnership nor is its absence necessarily indicative of a dissolution that results in the winding up of the partnership. The position is determined on the facts and circumstances of each case.

Change in the membership of a two person partnership

156. A partnership can be a reconstituted partnership only where two or more partners remain. In a two-partner partnership, the departure of one through resignation, retirement or death will, of necessity, lead to a general dissolution and winding up of that partnership. As noted in *Abbott*, 'there cannot be a partnership with one partner'.[97]

157. An exception to this is a partner in a two-partner partnership selling or assigning their interest in the partnership to an incoming partner. Where this happens and the firm continues without any break in the continuity of the enterprise, for practical purposes we consider there is a change in members and a reconstituted partnership.

GST consequences of a technical dissolution (reconstitution)

158. A reconstituted partnership retains its GST registration despite the change in its membership. The existing enterprise is carried on by the reconstituted partnership. As there is no winding up of the partnership, the change in membership does not give rise to any supplies or acquisition from one partnership to another partnership.

159. The GST treatment of a reconstituted partnership for the partners will depend on the circumstances of the reconstitution. A reconstitution may result from a partner selling or assigning their interest in the partnership. Alternatively a change in membership may occur without any sale or assignment by a partner of their interest in the partnership.

[97] (1936) 3 All ER 823 at page 827.

Sale or assignment of an interest in a partnership – partner to partner transaction

160. A sale or assignment of an interest in a partnership may be made by a continuing partner to an incoming partner, or by an outgoing partner to either a continuing or an incoming partner. The supply is a partner-to-partner transaction and does not involve the creation or supply of any new interest by the partnership. Such a sale or assignment is a supply by the partner of a financial interest, and is a financial supply if the requirements of subregulation 40-5.09(1) are satisfied. If the partner making the supply is unregistered, or the supply is not made in the course or furtherance of an enterprise carried on by the partner, no GST consequence arises in relation to the supply.[98]

161. Where an outgoing partner sells or assigns their interest to a continuing partner, there is an increase in the interest of that partner. Where a continuing partner sells or assigns a portion of their interest to an incoming partner, there is a decrease in the interest of the continuing partner. However, where an outgoing partner sells or assigns their interest to an incoming partner, there is no change in the interest of each of the continuing partners.

No sale or assignment of interests – partnership transaction

162. A reconstituted partnership may also involve the creation and supply by the partnership of a new interest in the partnership, rather than the supply by a partner of an existing interest. The GST consequences of such a reconstitution for the partnership, the outgoing partner and the incoming partner are set out in the following paragraphs.

Outgoing partner and partnership

163. For a retiring or deceased partner, the crystallisation of their interest in the partnership as a debt is not as a consequence of a supply of any new financial interest by the partnership.[99] A partner's interest in a partnership includes a right to share the surplus (if any) after repayment of debts and other liabilities. This right is acquired when the partnership is formed or when the partner joins the partnership. The crystallisation is of a right that the partner already has and is not a new right that is acquired.

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[98] It is considered that in most cases, the partners are unlikely to be carrying on an enterprise of dealing in partnership interests.

[99] Financial interests are explained at paragraph 35.

164. The crystallisation of the interest in the partnership as a debt results in the extinguishment of the retiring partner's interest in the partnership. Following this extinguishment, the partnership creates and supplies additional interests in the partnership to the continuing partners. This is a necessary consequence of the extinguishment of the retiring partner's interest. The supply of the additional interests is a financial supply by the partnership if the requirements of subregulation 40-5.09(1) are met.[100]

Incoming partner and partnership

165. Where a reconstitution results from the addition of a new partner (the incoming partner), there is a supply of a new interest in the partnership by the partnership to the incoming partner. The supply of the interest is a supply of a financial interest in the course or furtherance of the enterprise carried on by the partnership. The supply will be a financial supply if the other requirements of subregulation 40-5.09(1) are satisfied.

166. Consideration for the supply of the new interest is the capital contribution made by the incoming partner[101] or the promise of the supply of labour, skills or services in the conduct of the partnership business.

167. In these circumstances, there will be a reduction in the interests of the continuing partners. However, the change does not involve a supply by the continuing partners. The reduction is by way of an extinguishment, for consideration, of a portion of each partner's interest, sufficient to enable the partnership to create and supply the new interest to the incoming partner.

GST liabilities and obligations of partners before and after reconstitution

168. Retiring partners are only responsible for the GST liabilities and obligations of the reconstituted partnership before reconstitution and not for any after its reconstitution. Similarly, new partners are only responsible for the GST liabilities and obligations of the reconstituted partnership after its reconstitution and not for any before its reconstitution. However, the continuing partners are responsible

[100] Requirements for a financial supply are set out at paragraph 34.

[101] The incoming partner may also pay a premium to the continuing partners. This would not usually give rise to any GST consequence as the premium is either paid in money and is therefore not a supply or alternatively it is not a supply in the course or furtherance of an enterprise carried on by the partners. Premiums can also be paid by a person to a sole trader to form a partnership. See paragraph 25-06 R. C. I'Anson Banks, LL.B, Lindley and Banks, 1995, 17th edn, (1995).

for the GST liabilities and obligations of the partnership both before and after reconstitution.[102]

169. The acceptance, for GST purposes, of a reconstituted partnership and the fact that it retains its existing GST registration means that the reconstituted partnership and the retiring partner or partners need to inform the Commissioner of the change in the membership of the partnership. Where there is a failure to notify the Commissioner of a change in the membership of a general law partnership, recovery action may be contemplated against a retired partner for the unpaid GST liabilities arising after the reconstitution of the partnership.

170. To avoid this possibility, we consider it necessary that the Commissioner is notified of any change in the membership of a partnership. The notification may be by the retiring partner, the personal representative of a deceased partner, or the continuing partners and any incoming partner, or by a person authorised by those entities to deal with the Commissioner in relation to their GST affairs. In the case of a large partnership, a managing partner with the consent and authorisation of all partners, retiring, continuing or incoming, may make the notification.

Cancellation of Registration

171. A partnership may choose to cancel its GST registration if it no longer meets the annual turnover threshold.[103] However, a partnership is entitled to retain its GST registration until it has ceased to carry on its enterprise. This will be upon the making of the final distribution to the partners upon the winding up of the partnership.[104] Upon the making of the final distribution, the partnership ceases to exist for the purposes of the GST Act.

172. Under subsection 25-55(2), the Commissioner must cancel the partnership's registration, even if no application is made:

- if the Commissioner is satisfied that the partnership is not carrying on an enterprise; and

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[102] See section 50 of the TAA. The obligations on a partnership are imposed on each partner, and the partners are jointly and severally liable to pay GST.

[103] If the partnership holds any assets for which entitlements to input tax credits have arisen, at the time when its registration is cancelled, it may have increasing adjustments under Division 138. The adjustment is attributable to the concluding tax period for the partnership. See GSTR 2000/29: attributing GST payable, input tax credits and adjustments and particular attribution rules made under section 29-25, for further discussion on attributing adjustments. An entity's concluding tax period is determined under section 27-40.

[104] If there is a deficiency and the partners make good that deficiency, the partnership's enterprise is carried on until all of the partnership's liabilities are met.

- the Commissioner believes on reasonable grounds that the partnership is unlikely to carry on an enterprise for at least twelve months.

Alternative views

Reconstitution of a two-person partnership

173. It is not possible to have a reconstitution of a two-person partnership where one of the partners sells or assigns his or her interest in a partnership to another.

174. The departure of the outgoing partner must, of necessity, precede the acquisition of the partnership interest by the incoming partner. This results in there being no association of persons carrying on business for a period of time before the incoming partner forms an association with the remaining partner.

175. We consider that this approach gives rise to inconsistent treatment between two-person partnerships and other partnerships. Provided that the requirements set out in paragraph 154 for there to be a reconstituted partnership are met, it is appropriate for the Commissioner to take the view that there can be continuity of a two-person partnership in these circumstances.

The surrender of an interest by the partner

176. The supply of the partnership interest by any outgoing partner is to the partnership. At the time of leaving, the partner's interest crystallises as a debt due to the partner (unless the partner has already been paid out upon departure). This results in the substitution of one financial interest (interest in the partnership) for another financial interest (interest in or under a credit arrangement – Item 2 in subregulation 40-5.09(3)). The supply of the interest in or under a credit arrangement is a financial supply if the requirements of subregulation 40-5.09(1) are satisfied.

177. The substitution results in the surrender, by the outgoing partner, of an interest in the partnership to the partnership and a change in the interest of the continuing partners.

178. The surrender by the outgoing partner of their interest is a supply and is a financial supply if the requirements of subregulation 40-5.09(1) are satisfied. One of the requirements is that the supplier is registered. If the outgoing partner is unregistered, the supply is not a financial supply.

179. The same principles apply when partners give up a part of their interest in a partnership to, for instance, allow a new partner into the partnership.

180. We consider that this view does not accord with the view, expressed by the majority in *Walsh,*[105] that a partner's interest in a partnership is extinguished upon the making of a final distribution to the partners.

Your comments

181. We invite you to comment on this draft Goods and Services Tax Ruling. Please forward your comments to the contact officers by the due date.

Comments by Date: 14 May 2003

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Commissioner of Taxation
2 April 2003

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Related Rulings/Determinations:
GSTR 1999/1; GSTB 2000/2;
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