TR 92/D28 - Income tax: whether business is carried on in partnership (including husband and wife partnerships).

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DRAFT TAXATION RULING TR 92/D28

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PLEASE ADDRESS ALL COMMENTS TO THE CONTACT OFFICER LISTED BELOW.

TITLE Income tax: Whether business is carried on in partnership (including husband and wife partnerships).

LAST DAY FOR COMMENTS : 29 October 1992

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. Draft Taxation Rulings may not be relied on by taxation officers, taxpayers and practitioners. It is only final Taxation Rulings which represent authoritative statements by the Taxation Office of its stance on the particular matters covered in the Ruling.

COMMISSIONER OF TAXATION

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Draft Taxation Ruling

Income tax: whether business is carried on in partnership (including 'husband and wife' partnerships)

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What this Ruling is about

1. This Ruling outlines factors we take into account in deciding whether persons are carrying on business as partners for income tax purposes. It has particular relevance to what are sometimes known as husband and wife partnerships.

2. This Ruling is not to be applied :

   (a) to situations where persons are in receipt of income jointly unless that income is derived from carrying on business; and

   (b) to Limited partnerships.

Ruling

3. There are no statutory rules in the income tax law for deciding whether persons are carrying on business as partners. The question of whether a partnership exists is one of fact. The existence of a partnership is evidenced by the actual conduct of the parties towards one another and towards third parties during the course of carrying on business.

4. We look at the following factors in deciding whether persons are carrying on business as partners in a given year of income :

Intention

- the mutual assent and intention of the parties

Conduct

(a) joint ownership of business assets

(b) registration of business name

(c) joint business account and the power to operate it

(d) extent to which parties are involved in the conduct of the business

(e) extent of capital contributions

(f) entitlements to a share of net profits

(g) business records

(h) trading in joint names and public recognition of the partnership

5. The weight to be given to these factors varies with the individual circumstances. The above list of factors is not exhaustive and no single factor is decisive.

Date of effect

6. This Ruling (that is, the final Taxation Ruling based on this Exposure Draft Taxation Ruling) applies (subject to any limitations imposed by statute) for years of income commencing both before and after the date on which it is issued. However, if a taxpayer has a private ruling which is inconsistent with this Ruling, then this Ruling will only apply to that taxpayer from and including the 1992-93 year of income unless a taxpayer asks that it apply to earlier income years.

Explanations

General

7. The term 'partnership' is defined in subsection 6(1) of the *Income Tax Assessment Act 1936* as follows:

> ' "partnership" means an association of persons carrying on business as partners or in receipt of income jointly, but does not include a company'.

8. This definition extends the meaning given to the word 'partnership' in State and Territory partnership law. According to the

statutory definitions in State and Territory partnership law, partnership is the relationship between parties carrying on a business in common with a view to profit. Income tax law does not distort the general law of partnership, nor does it disregard it (*Jolley* v. *FC of T 89*ATC 4197, (1989) 21 ATR 3253).

9. Whether a partnership exists is a question of fact and it is up to the person alleging a partnership to prove that fact (*Morden Rigg & Co and RB Eskrigge & Co* v. *Monks* (1923) 8 TC 450). To decide whether or not a partnership exists between parties, we closely examine the relationship between them. We apply objective tests to each fact situation to assess the nature of the relationship.

10. The essential element for a partnership to exist is the genuine intention of all the parties to act as partners. This intention must be demonstrated by the conduct of the parties.

11. We consider the matters outlined below in deciding whether persons are carrying on business as partners.

Intention

12. Mutual assent and intention to act as partners is the essential element in demonstrating the existence of a partnership between two or more persons. We accept a written or an oral agreement as *prima facie* evidence of such an intention.

13. A written agreement signed by all parties, although desirable, is not necessary to demonstrate mutual assent and intention. An agreement to act as partners may also be inferred from a course of conduct agreed to by all parties.

14. Generally, a lack of intention to be in partnership means that a partnership does not exist at law. Conversely, a stated intention of partnership is not, of itself, sufficient to establish a partnership, as the intention must be manifested by conduct (*Re Megevand; Ex Parte Delhasse* (1878) 7 Ch. D 511, *Montefiore* v. *Smith* (1876) 14 SCR (NSW) 245). The parties must understand what the partnership relationship entails, which requires more than a general understanding between them that they are in business as partners *(I. R .Commrs* v. *Williamson* (1928) 14 TC 335).

Conduct

15. Mutual assent and intention must be demonstrated, but do not stand alone and must be assessed with all relevant circumstances, including the conduct of the parties (*Jolley 's case*).

(a) Joint ownership of business assets

16. We view the joint ownership of business assets, together with a joint liability to business debt, as indicative of a business partnership. All partners must be liable for the firm's debts not only to the extent of the partnership property, but also to the full extent of their personal resources.

17. In the situation of a husband and wife with a joint interest in family assets, the joint interest may not be indicative of a partnership. The joint ownership may be seen as a normal incident flowing from the ordinary family relationship of husband and wife. This was the view taken in *Case N56* 81 ATC 277; (1981) 25 CTBR (NS) *Case* 10.

(b) Registration of business name

18. We consider the registration of a business name by the parties under State or Territory law a positive factor in determining the existence of a partnership. Further, the use of a business name can be an external sign of the existence of a partnership to third parties.

(c) Joint business account and power to operate the account

19. The existence of a joint bank account, specifically named and used as a business account, is another positive factor in establishing that business is being carried on in partnership. We give this factor greater weight where:

(i) the bank at which the account is held is aware the parties are acting in partnership; and

(ii) all parties have the power to operate the account.

20. In the situation of husband and wife partnerships, we view the opening of a separate business bank account favourably. This is particularly so where an existing joint account may be used for non-business purposes.

(d) Extent to which parties are involved in the conduct of the business

21. While it is not essential that all partners actively participate in a partnership, such participation supports the existence of a partnership. Exclusive performance of all the work or activities of a business by one party will not, of itself, negate the conclusion that a partnership exists.

22. Irrespective of the numbers of parties actively engaged in the partnership, the test of whether a business is being carried on in partnership may be stated as:-

> "Is the person who carries on that business doing so as agent for all persons who are alleged to be partners?" (*Lang* v. *James Morrison & Co.Ltd* (1911) 13 CLR 1 at 11).

23. In husband and wife situations, we examine the conduct of each party to determine whether it is part of their ordinary domestic relationship or part of a business association.

(e) Extent of capital contributions

24. When we examine relationships between parties to determine whether they are in partnership, we assess the relative capital contributions of the parties to that relationship. Contributions may be made at the start of, or during, a partnership.

25. The sharing by the parties of contributions to assets and capital weighs in favour of the existence of a partnership.

(f) Entitlement to a share of net profits

26. Partners share between them the profits and losses of the partnership activity (*I R Commrs* v. *Williamson* (1928) 14 TC 335). We look at the rights of the parties to a share of the net income or loss of the partnership. A situation in which profits are shared in line with clearly stated rights and entitlements in the partnership agreement is *prima facie* evidence of the existence of a partnership.

(g) Business records

27. The existence of a partnership is supported when business activities are entered in records that are separate and distinct from those kept for other business and private activities. Business records include:

- books of account (with accounts for each partner's capital contribution, drawings and share of profit or loss);
- minutes of partnership meetings; and
- memoranda of decisions reached, especially regarding shares of income and losses.

28. The maintenance of business records in the name of the parties or in the name of the partnership, rather than in the name of one party only, is indicative of the existence of a partnership.

(h) Trading in joint names and public recognition of the partnership

29. The conclusion that a partnership exists is supported if the parties, by trading in joint names, make it clear to persons dealing with them that they are in partnership. Banks, suppliers and customers dealing with a partnership should be aware that they are trading with a partnership, as opposed to dealing with an individual. It is important that creditors of a partnership are aware that they are dealing with a partnership, as partners are obliged, jointly and severally, to meet the partnership debts to the full extent of their own resources.

30. The existence of the following is relevant :

(i) invoices, receipts,tenders, business letters and applications for approval in the partnership name;

(ii) written and oral contracts with the partnership; and

(iii) advertising in the partnership name.

Examples

Example 1

31. **Facts:** Mrs Tracklight is an interior decorator. She has decided to enter into 'partnership' with her husband, but they have no written partnership agreement. Mrs Tracklight continues to perform all decorating work and all receipts and other business documents are in her name only. Any cheques received are made out to her and she deposits them into a newly opened joint bank account. This account is used for household and business expenses. Mr Tracklight helps the business by answering the telephone. His wife believes that she and her husband are in partnership together and that she acts for the partnership.

32. **Result:** Mr Tracklight's role is a normal incident flowing from the ordinary domestic relationship of husband and wife. There is no express or implied representation to the public of the existence of a partnership. Mrs Tracklight is performing personal services and has

not discharged the burden of proving that the business was operated by a partnership.

Example 2

33. **Facts**: Mr and Mrs Frost carry on business reconditioning refrigerators, allegedly in partnership. There is no written partnership agreement, although Mrs Frost has expressed her willingness to join in partnership with her husband and he has agreed.

Mrs Frost contributes no money to the setting up of the business, although she actively participates in the building up of the business. Only a small amount of capital is involved in the establishment of the business.

Mrs Frost spends about 20 hours a week answering business calls and relaying instructions for the collection and delivery of refrigerators. Business accounts are kept in joint names.

Business income is paid into a joint bank account, although funds are subsequently withdrawn from the joint account and invested in Mr Frost's name only. Mrs Frost has agreed to this.

Some, but not all, receipts are made out in the name of the partnership.

34. **Result:** A partnership exists between Mr and Mrs Frost. The parties have agreed to share the profits of the enterprise equally in return for Mrs Frost providing services to the business. Mr and Mrs Frost have demonstrated the mutual assent and intention to act as partners.

Example 3

35. **Facts:** Mr Floppy is engaged by an employment agency to work as a computer programmer for a software company.

Mr Floppy claims that income arising from the agreement with the agency is not his income, but income of a partnership between himself and his de facto, Miss Megabyte. Miss Megabyte performs no services for the 'partnership'. No written agreement exists between the couple and a business name is registered only after work begins.

The employment agency makes cheques payable for work completed to the business and a joint bank account is used to bank these cheques. The bank account was in existence prior to the alleged agreement.

36. **Result:** No partnership exists. The income is derived solely by Mr Floppy, who personally entered into the agreement and was employed in his own right.

Example 4

37. **Facts:** Mr and Mrs Volta claim to conduct an electrical business as partners. Mr Volta does all electrical work and Mrs Volta answers the phone, types accounts, does the banking and purchases supplies.

Mr Volta has sole control over the business bank account and Mrs Volta's name does not appear on any of the bank's records of the account.

The books of account are kept in the name of the business and Mrs Volta does not receive any income from the partnership. There is no evidence that the parties intend to share profits or to receive income jointly.

A partnership return is lodged, splitting the income equally between Mr and Mrs Volta, but Mrs Volta admits that the arrangement has been entered into purely as a means of income splitting.

No partnership agreement is entered into and Mrs Volta does not intend to become a partner.

38. **Result:** No partnership exists. The parties do not intend to operate the business as a partnership and no partnership agreement is in place. The way in which the parties conduct themselves toward third parties does not demonstrate that they are conducting the business in partnership.

Example 5

39. **Facts:** Mr and Mrs Flagfall purport to conduct a taxi cab business in partnership from 1 July. Prior to this, Mr Flagfall carried on a taxi cab business for several years.

On 1 July, Mr and Mrs Flagfall enter into a written agreement which states that they agree to operate the taxi business in partnership. The agreement provides that the proceeds of the business are to be divided into equally, although no partnership accounts are prepared.

Mrs Flagfall does not contribute any capital and there is no actual division of profits. Third parties, including drivers employed in the business, are not aware that the business is conducted by both Mr and Mrs Flagfall.

40. **Result:** Mr and Mrs Flagfall, despite their written agreement, do not conduct themselves as partners.

Mr Flagfall fails to discharge the burden of proving that the business is carried on by himself and his wife in partnership. Therefore, the income of the business is derived solely by Mr Flagfall.

Commissioner of Taxation

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- Jolley v. F C of T 89 ATC 4197, (1989) 21 ATR 3253
- Lang v. James Morrison & Co Ltd (1911) 13 CLR 1
- Montefiore v. Smith (1876) 14 SCR (NSW) 245
- Morden Rigg & Co and RB Eskrigge & Co v. Monks (1923) 8 T.C. 450
- Case N56 81 ATC 277, (1981) 25 CTBR (NS) 10
- Re Megevand; Ex Parte Delhasse (1878) 7 Ch. D 511
- IR Commrs. v. Williamson (1928) 14 TC 335