IT 2501 - Income tax : assignment of partnership interests

Note: Paragraph 9 of this Ruling does not apply to assignments entered into after 30 June 2015 and certain other assignments. ATO guidance on the potential application of Part IVA to the assignment of a partnership interest is set out in Everett assignments.

TAXATION RULING NO. IT 2501

INCOME TAX : ASSIGNMENT OF PARTNERSHIP INTERESTS

F.O.I. EMBARGO: May be released

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85/8024-3
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DATE OF EFFECT: Immediate

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DATE ORIG. MEMO ISSUED:

F.O.I. INDEX DETAIL

REFERENCE NO:	SUBJECT REFS:	LEGISLAT. REFS:
I 1211379	ASSIGNMENT OF INCOME	90
	PARTNERSHIP INTERESTS - ASSIGNMENTS	92
		102
	TRUST - INCOME ASSIGNED TO	102B
		260
		PART IVA

OTHER RULINGS ON TOPIC: IT 2003, IT 2330

PREAMBLE Since the circulation of Taxation Ruling Nos IT 2003 and IT 2330 a number of matters have arisen which require clarification in the light of the decision of the Full High Court in FC of T v Galland 18 ATR 33; 86 ATC 4885.

2. In IT 2003 it was stated that an assignment of a partnership interest would not be regarded as being effective for taxation purposes where the assignment was to a trust in which the assignor was either a beneficiary or a contingent beneficiary, the reason being that the assignment would not be absolute. The majority decision of the Full High Court in FC of T v Everett (1980) 143 CLR 440; 80 ATC 4076 was not seen as covering this aspect.

3. The view was also held that such assignments could only operate in relation to assessable income derived by the partnership after the date of the assignment. Again, Everett's Case was not seen as deciding this issue.

4. In the course of the progress of Galland's case through the various Courts both these issues were decided in the taxpayer's favour. The facts of the case were as follows. At all material times during the 1980 income year, the taxpayer carried on business as a solicitor in partnership with his father. In June 1980, the taxpayer obtained his father's consent to the assignment of 49% of his 50% interest in the partnership to a proposed discretionary trust for the taxpayer and his family. A trust was settled by the taxpayer's brother on 27 June 1980 under which the taxpayer and his family were made discretionary beneficiaries and the taxpayer was given power to remove any trustee and to revoke any of the trusts of the settlement.

Later on the same day, the taxpayer assigned 49% of his partnership interest to the trustee company of the trust, which subsequently distributed the income attributable to the assigned interest for the whole of the year in dispute to the taxpayer's wife and daughter. The taxpayer and his father were the directors of the corporate trustee.

5. Before the High Court, the Commissioner's basic submission was that the assignment was only operative to assign the income attributable to the assigned interest for the period 28 June 1980 to 30 June 1980 because the taxpayer had already derived the partnership income for the period 1 July 1979 to 27 June 1980, when the assignment was executed. In support of this the Commissioner had sought to argue that gross income is derived by the partners of a partnership when professional fees are recovered or recoverable. The Commissioner had also sought leave to argue that the assignment was void under section 260 of the Act and to challenge the correctness of the Everett decision. The application was refused on the basis that it was too late in the history of the litigation for these arguments to be considered. The Court then rejected the Commissioner's basic submission, holding instead that the assignment operated to assign to the assignee all of the partnership income attributable to the assigned interest. It held that, by the operation of sections 90 and 92 of the Act, a partner's assessable income includes his share of the net income of the partnership which, during the continuance of the partnership, is ascertained at the end of the year of income.

6. The Court also re-affirmed the view expressed in Everett that a partner's interest in the net income of the partnership derives from the partner's interest in the partnership and not from the partner's personal exertion. The Court held that the assignment by the taxpayer, on 27 June 1980, of 49% of his interest operated to assign to the assignee 49% of the net income of the partnership attributable to the taxpayer's interest for the whole of the year of income ended 30 June 1980, notwithstanding the usual practical operation of partnerships where partners draw money as required during the year from fees received. Accordingly, the tax liability will fall on persons who, at the end of the year of income, have enforceable equitable rights to receive a share of the partnership income.

7. In earlier proceedings in Galland's case before the Supreme Court of New South Wales and the Federal Court of Australia, the Courts rejected challenges to the effectiveness of the assignment for income tax purposes. In particular, it was submitted by the Commissioner that the "strings" attached to the assignment, viz., the powers of control retained by the taxpayer over both the partnership interest assigned and the assignee corporate trustee, and his interest as a beneficiary in the discretionary trust, made the assignment ineffective for tax purposes. It was also submitted that the income purportedly assigned to the trustee company was properly assessable to the taxpayer under section 102 of the Act because the bare trust created by the assignment was revocable at the instance of the taxpayer.

8. Both the Supreme Court and the Federal Court rejected these propositions. As stated in the reasons of David Hunt J at 84 ATC 4060 and in the joint judgment of Bowen CJ and Fisher J at 84 ATC 4896 (with whom Beaumont J. agreed on this point at 84 ATC 4901), the assignor's status as beneficiary of the family trust and director of the assignee trustee company arises not from the bare trust he created by virtue of the assignment but rather from the earlier family trust, which was not created by him. The High Court in granting special leave to appeal against the Federal Court decision limited the grounds of appeal so as to exclude grounds relating to section 102.

RULING

9. Valid assignments on all fours with the Everett or Galland decisions will be accepted for tax purposes and will not be regarded as caught by section 260 or Part IVA.

10. As earlier outlined, submissions based on section 102 were unsuccessful in Galland's case. From information available in this office, however, it appears that the arrangements by which other taxpayers sought to attach "strings" to their assignments were quite varied. It is not accepted that all those cases are necessarily determined by Galland. The potential application of section 102 must be determined having regard to the circumstances of each particular case.

11. In some cases taxpayers who made assignments with strings attached subsequently expressly and effectively disclaimed any interest in the assigned share in the partnership. Cases of that kind will generally be accepted as effective.

12. However, there are other cases which are regarded as clearly distinguishable from Galland and which appear to fall within section 102; for example, cases have been met where the power to revoke the bare trust created by the assignment exists in the assignment itself or its supporting documentation. These cases may have the additional feature that the assignor is a beneficiary of the assignee discretionary trust.

13. As a general rule, in cases where the relevant deed of assignment contains a revocation clause exercisable either by the assignor or by partners other than the assignor, the view is taken that section 102 applies and the assignment should not be regarded as effectively alienating the income for tax purposes from the partner seeking to assign the interest.

14. Apart from cases that may fall within section 102, the Galland and Everett decisions will be applied to the extent indicated above. IT 2003 is therefore now overruled insofar as it suggests that trusts will not be accepted where an assignor is either a beneficiary or contingent beneficiary. The principles to be applied to income splitting cases generally will continue to be those set out in IT 2330, subject to the views expressed in this Ruling concerning assignments of partnership interests.

COMMISSIONER OF TAXATION
27 October 1988