IT 2218 - Income tax: Partners' Salaries

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TAXATION RULING NO. IT 2218

INCOME TAX: PARTNERS' SALARIES

F.O.I. EMBARGO: May be released

REF H.O. REF: J52/90 P.5 DATE OF EFFECT:
MEMORANDA 12 Aug. 1969
24 Dec. 1970
15 March 1979

B.O. REF: DATE ORIG. MEMO ISSUED: 12 Aug. 1969

FOI INDEX DETAIL

REFERENCE NO:	SUBJECT REFS:	LEGISLAT. REFS:
I 1199725	PARTNERS' SALARIES	90 92

PREAMBLE In a recent decision of a Taxation Board of Review, reported as Case No. S75, 85 ATC 544 : 28 CTBR(NS) Case 81, the Board had to determine the individual interests of two taxpayers in the net income of a partnership in circumstances where one of the partners was paid a salary.

2. The partners were husband and wife and, although there was no written partnership agreement, it was their wish and understanding that the business profits would be shared equally after payment of a salary to the wife who was the main operative in the partnership business. There was no agreement on the amount of salary to be paid to the wife. The evidence before the Board suggested that the salary in each of the years under review was paid in a lump sum immediately prior to the end of the year.

3. The net income of the partnership in each year, i.e. the net income prior to taking into account the salary paid to the wife, was not sufficient to pay the wife's salary. In the result, the Board of Review concluded that the wife was assessable on the net income of the partnership. In the terminology of section 92 of the Income Tax Assessment Act, the individual interest of the wife in the net income of the partnership was an amount equal to the net income while the individual interest of the husband was nil.

RULING 4. The decision of the Board is not to be taken as altering the long established practice of this office in relation to partners' salaries. Although a salary paid to a partner does not represent salary or wages for the purposes of the tax instalment deduction provisions in Division 2 of Part VI of the Act and is not in itself a loss or outgoing within the meaning of sub-section 51(1), nevertheless it may well constitute a legitimate distribution of the profits of a partnership which should be taken into account in determining a partners' individual interest in the net income of a partnership.

5. In genuine cases involving the payment of a salary to a

partner, i.e. where the payment of the salary is bona fide and is not only reasonable in amount but has its origin in the terms of the partnership agreement, it has been the practice of this office to take the salary into account in determining the individual interest of each partner in the net income or loss of the partnership. This practice will continue.

6. Situations may arise, however, where it becomes apparent that the salary paid to a partner is excessive in the light of the duties and responsibilities of the particular partner. In many of these situations it will emerge that there is a disparity between the incomes of the partners and a salary is paid to one partner for the purposes of minimising overall tax liability. In other situations the agreement to pay a salary to one partner may not be entered into until or after the end of the year of income - it is well settled that an agreement of this nature would not have retrospective effect. In situations to which this paragraph applies distribution of partnership net income taking into account the payment of salary should not be accepted. The net income of the partnership should be distributed according to the basic agreement between the partners for the sharing of profits and losses.

COMMISSIONER OF TAXATION
14 November 1985

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