



WEEKLY COMMENT: FRIDAY 8 NOVEMBER 2013

1. Inland Revenue recently released two Questions We've Been Asked concerning partnerships, with a deadline for comment of 29 November 2013:

(a) *Income tax – Entry of a new partner into a partnership – effect on continuing partners; and*

(b) *GST – Transfer of interest in a partnership .*

Entry of a new partner: income tax implications

2. A partnership is transparent: s. HG 2 treats each partner as carrying on the partnership's activity, and as holding the partnership's property in proportion to the partner's share of the partnership.
3. Under partnership law, when a partner leaves and/or a new partner enters a partnership, the original partnership is dissolved and a new partnership is formed. This would arguably have the effect of all partners disposing of (and, subsequently, reacquiring) their interests each time a partner leaves a partnership.
4. However, the definition of "dispose" in s YA 1, for a partner, excludes when their partner's interests may be treated as disposed of by operation of law because another partner disposes of that partner's interests (unless the partnership is finally dissolved).
5. Therefore, there will only be a disposal of a partner's interest when a new partner joins if there is, as a result, some change in the partner's interest in the partnership property.

Income tax effect of the entry of a new partner in a variety of circumstances

6. The specific exclusion in the s. YA 1 definition of "dispose" does not mean that the entry of a new partner into a partnership will never trigger a tax event for the continuing partners. The income tax effect of the entry of a new partner depends on the circumstances:
 - (a) If a new partner purchases the partnership interests of an exiting partner, there will be an acquisition by the new partner and a disposal by the exiting partner, but there will be no disposal by the continuing partners because the continuing partners' "partner's interests" remain the same before and after the disposal by the exiting partner; for example, if 2 partners each have a 50% share in a farming partnership, and one of the partners sells their 50% share to a new partner, the other (continuing) partner will not be regarded as having disposed of their partnership interest.

- (b) If a new partner purchases a share of the continuing partners' partnership assets, then there will be a partial disposal by those continuing partners, because those partners will have disposed of part of their partnership interests to the new partner; for example if 2 partners each have a 50% interest in a forestry partnership, and a new (third) partner joins and acquires 80% of each of the existing partners' interests, the 2 initial partners will have disposed of some of their "partner's interests" and they will need to determine whether they should account for tax according to the provisions of ss HG 5 to HG 10.
- (c) If a new partner introduces additional capital to the partnership, the Commissioner considers that the correct view is that the initial (continuing) partners will have each disposed of part of their partnership interests as a result of which there will be a taxable event; for example if 2 partners each have a 50% interest in a partnership whose only asset is land worth \$200,000, and a new (third) partner joins and contributes \$100,000, each of the 3 partners will then own a one-third share of the land and a one-third share of the \$100,000; therefore, the 2 initial partners will each have disposed part of their share of the land to third partner, and they will need to determine whether they should account for tax according to the provisions of ss HG 5 to HG 10.

GST consequences of a transfer of an interest in a partnership

7. The draft QWBA on GST consequences updates and replaces Question 108 published in *Public Information Bulletin* No 158, p 26 (November 1986) and an item entitled "GST Treatment of the Sale of an Interest in a Taxable Activity" published in *Public Information Bulletin* No 164, p 31 (August 1987), both of which dealt with the GST treatment of the sale of an interest in a partnership.

GST consequences of the transfer of an interest in an ordinary partnership

8. An ordinary partnership under the *Partnership Act 1908*, (which is not a limited partnership), is an unincorporated body of persons that does not have a legal personality separate from its members. Section 57 of the GST Act states that the GST registration shall be in the name of the body, and the members of the body shall not themselves be registered in relation to the carrying on of a taxable activity by the unincorporated body.
9. In the Commissioner's view, s. 57 does not specify that the supply of an interest in a partnership has no GST effect. The statement in s. 57(2)(e) that "any change in the members of the body shall have no effect for (GST) purposes" means that a change of members does not create a new incorporated body for GST purposes – i.e. a partnership is treated as being the same registered person before and after a change of members. It does not mean that a supply of an interest in a partnership has no GST effect.
10. However, the effect of s. 57 is that:
- (a) A partner is not liable to register for GST for the activities of the partnership;
 - (b) Supplies made by the partnership do not count towards determining whether the partner has to register for GST in their own right;
 - (c) If a partner is registered for GST in their own right, a transfer of their interest in the partnership will be subject to GST only if it is a supply made in the course or furtherance of a taxable activity carried on by that partner (ie, not the partnership taxable activity).

11. It follows that in the usual circumstances when a partner's share is transferred to another partner, there will be no GST consequences.
12. There will be no GST consequences even when a partner's share is sold together with some other taxable activity. Example 2 in the draft QWBA illustrates this. A partner separately owns the building in which the partnership business is carried on, and sells the building to a new entering partner at the same time and together with his share of the partnership. The supply of the building is the supply of a taxable activity and is subject to GST, but the supply of the partnership interest is not subject to GST.
13. Example 3 in the draft QWBA illustrates the circumstances where a partner previously carried on the partnership business on his own. A subsequent sale of his partnership interest will not be treated as a sale of a taxable activity merely because he carried on the business before it was taken over by the partnership. Once the business has been transferred to the partnership, the individual partner is no longer a GST-registered person in relation to that business. Therefore, the subsequent sale of his partnership interest is not a supply in the course or furtherance of that taxable activity.

GST consequences of the transfer of an interest in a limited partnership

14. A limited partnership registered under the *Limited Partnerships Act 2008*, "is a separate legal person" and is, therefore, a body corporate. The supply of an interest in a partnership that is a body corporate is an exempt supply and not subject to GST because:
 - (a) Under s. 3(2) of the GST Act "any interest in or right to a share in the capital of a body corporate" is an "equity security"; and
 - (b) The "issue, allotment or transfer of ownership of an equity security" is included as "financial services" in s. 3(1)(d); and
 - (c) Supplies of financial services are "exempt supplies" under s. 14(1)(a) of the GST Act.
15. Therefore, the transfer of an interest in a limited partnership will be an exempt supply for GST purposes.



Arun David, Director,
DavidCo Limited