

# ***IT 2540 - Income tax : capital gains : application to disposals of partnership assets and partnership interests***

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 This ruling contains references to repealed provisions, some of which may have been rewritten. The ruling still has effect. Paragraph 32 in [TR 2006/10](#) provides further guidance on the status and binding effect of public rulings where the law has been repealed or repealed and rewritten. The legislative references at the end of the ruling indicate the repealed provisions and, where applicable, the rewritten provisions.

 Note: Paragraphs 13 and 14 of this Ruling do not apply to the acquisition or disposal of an interest in a 'no goodwill' professional practice occurring after 4 May 2016. ATO guidance on these transactions is now outlined in *Administrative treatment: acquisitions and disposals of interests in 'no goodwill' professional partnerships, trusts and incorporated practices*.

TAXATION RULING NO. IT 2540

INCOME TAX : CAPITAL GAINS : APPLICATION TO DISPOSALS  
OF PARTNERSHIP ASSETS AND PARTNERSHIP INTERESTS

F.O.I. EMBARGO: May be released

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		160ZZS

PREAMBLE This Ruling discusses the operation of the capital gains and losses provisions, Part IIIA of the Income Tax Assessment Act 1936 ('the Act'), in relation to partnerships. In particular, the Ruling discusses the application of the capital gains and capital losses provisions to disposals of partnership assets and to dealings by partners in relation to the interest they hold in the partnership.

Note: Paragraphs 13 and 14 of this Ruling do not apply to the acquisition or disposal of an interest in a 'no goodwill' professional practice occurring after 4 May 2016. ATO guidance on these transactions is now outlined in Administrative treatment: acquisitions and disposals of interests in 'no goodwill' professional partnerships, trusts and incorporated practices.

RULING Basis of application of Part IIIA to partnership assets

2. Under general law in relation to partnerships, a partnership is not a separate legal entity distinct from the individual partners who comprise the partnership. Accordingly, the partnership does not own property in its own right; title to the partnership assets is legally vested in the partners, even though an individual partner may have no separate title to specific partnership assets. This view accords with the opinion expressed by the majority (Barwick CJ., Stephen, Mason and Wilson JJ.) of the Full High Court of Australia in FCT v. Everett (1980) 143 CLR 440 at page 446 :

"Although a partner has no title to specific property owned by the partnership, he has a beneficial interest in the partnership assets, indeed in each and every asset of the partnership."

That case concerned the assignment by a partner of part of his interest in a partnership and, in the context of discussing the nature of the assignee's interest in the partnership, the majority went on to say, at p.448 :

"What is more, legal title to the assets of the partnership continues to vest in the partners to the exclusion of the assignee and he has no access to the assets."

3. The agreement between the partners may vary the terms by which legal ownership of the partnership assets is allocated between partners, for example, an individual partner may be the owner of all the partnership assets to the exclusion of other partners whose entitlement relates only to the income of the partnership. However, that position is merely a corollary of the general principle that ownership of the partnership assets is not vested in the partnership itself.

4. It has been suggested that Part IIIA may apply to a partnership even though the partnership cannot own assets.

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is based on the fact that a partnership is treated as if it a separate entity for certain income tax purposes. However, in its application, Part IIIA variously refers to a person who an asset (for example, in sections 160C, 160L and 160M). It is considered that the structure of Part IIIA leads to the conclusion that a net capital gain or net capital loss does not accrue to, or is not incurred by, a partnership. In terms of Part IIIA partnership assets are not owned by the partnership, but rather by the individual partners, hence any gain or loss disposal accrues to, or is incurred by, the individual partners who owned the assets.

5. Of course there are specific provisions in the Act, Division 5 of Part III, which deal exclusively with partnerships. The provisions of Division 5 establish the rules for income tax purposes by which a partner's interest in the assessable income of a partnership is determined. Subsection 92(1) provides, inter alia, that the assessable income of a partner includes an interest in the "net income" of the partnership of the year of income. "Net income" is defined by section 90 to mean, in effect, an amount equal to the

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income of the partnership, calculated as if the partnership a taxpayer, less all deductions other than concessional deductions, carry-forward losses, etc. Corresponding in subsection 92(2) determine a deduction allowable to a for a partnership loss.

6. While section 160Z0 of the Act requires a net capital gain to be included in the assessable income of a taxpayer, it does so only once the net capital gain has first accrued to the

taxpayer. As indicated in the preceding paragraphs, it is considered that no such gain can accrue to a partnership. Therefore, even though the partnership itself is treated as a taxpayer for purposes of calculating the "net income" of the partnership, that "net income" does not include a net capital gain on the disposal of a partnership asset. Similarly, a capital loss determined under paragraph 160Z(1)(c) in respect of the disposal of a partnership asset is not a partnership loss; rather, the loss is incurred by the partners in their own right.

7. Division 5 of Part III determines the nature of a partner's interest in the net income of the partnership of which he or she is a member and his or her interest in a partnership loss for the purposes of the Act. The Division does not override the general principle that the partnership itself is not a separate entity and does not own assets. These conclusions are consistent with the views expressed by Stephen J. in *Tikva Investments Pty Ltd v. FCT* (1972) 128 CLR 158 at p.168 :

"If then, when Tikva became a member, a new association of persons came into being it is of that new association that s.90 speaks when it refers to assessable income of a partnership being calculated as if the partnership were a taxpayer; for the purpose of calculation of assessable income, but for that purpose only, a new taxpayer is brought into existence. For all other relevant purposes, it is with the individual members that the Act is concerned. It follows...that the Act effects no general departure from the ordinary position in English law according to which a partnership is not a separate legal entity, distinct from the members composing it."

#### Practical issues

8. There are two broad circumstances that need to be considered in relation to the application of Part IIIA at the partner level on the disposal of partnership assets. The first is the application of the Part on the disposal of a partner's interest in the partnership, whether in whole or in part. The second issue concerns the consequences, in terms of Part IIIA, for the individual partners who have an interest in the assets of the partnership where there is a disposal of one or more of those assets.

(1) Disposal by a partner of an interest in the partnership assets on the disposal of a partnership interest

9. On the acquisition or disposal of a partnership interest it will be necessary for a partner to account for his or her

interest in the partnership assets. The disposal of the partnership interest generally means that there is a disposal of the partner's interest in each of the individual partnership assets. Subject to what follows, in order to determine any capital gain or capital loss to the partner in respect of his or her interest in each of the assets, it will be necessary to determine the portion of the disposal proceeds attributable to each of those interests. Similarly, on the acquisition of a partnership interest, the consideration paid should be apportioned to the interests in each of the partnership assets acquired, so that on their subsequent disposal, the capital gain or capital loss to the partner can be determined.

10. A partner's interest in the partnership and in the partnership assets may change from time to time. This could occur on the admission to, or retirement from, the partnership of any of the partners. To the extent that a partner's original interest has changed, there may have been a part disposal of his or her interests in the partnership assets (for instance, where there is an admission of a new member to the partnership) or the partner may have acquired additional interests in the partnership assets (for example, where another partner retires from the partnership). Thus, although a partner's original interest may have been acquired prior to 20 September 1985, the partner may have acquired new interests in assets since that date. Therefore, at the time of disposal of his or her partnership interest or of particular partnership assets, the partner may be disposing of assets acquired before 20 September 1985 and other assets acquired (partly or wholly) on or after that date. This follows from the central theme of this Ruling, that is, in looking at the disposal of a partnership interest or a partnership asset, Part IIIA applies to the individual partner on the basis of what asset that partner owns, the date on which the partner acquired the asset and any consideration given in respect of its acquisition.

11. It should be noted that for the purposes of the capital gains tax provisions the retirement or admission of a partner does not necessarily affect the other partners' continuing interests in the partnership assets or in the partnership as a whole. The continuing interest means that part of the interest in each of the partnership assets and the partnership itself which a partner has after the admission or retirement and which the partner also had before the admission or retirement.

12. In cases where the number of partners in a partnership is small, the cost base and acquisition date of a relevant partner's interests in the partnership assets should be able to be determined without undue difficulty.

13. For large partnerships, which can have memberships numbering in the hundreds (for example, some major legal and accountancy partnerships) the situation is potentially more complex. In some cases, the potential problems are overcome because the ownership of the assets used by the partnership is vested in a service company or trust. In other cases, it will generally be accepted, provided the evidence reasonably supports the conclusion, that the partners are dealing with each other at arm's length. Any consideration paid or received on the acquisition or disposal of an interest in the partnership will be used for Part IIIA purposes in determining the cost base or disposal proceeds of the interests in the partnership assets that the partnership interest represents. This will mean that if, for example, the partnership arrangement is such that no amount is payable for the acquisition or disposal of goodwill, it will be accepted for

the purposes of Part IIIA that the value of the goodwill is nil. This treatment will also apply to partners of smaller partnerships who deal with each other at arm's length, where those dealings take place in an ordinary commercial context.

14. In the case of large professional partnerships, where the partners' dealings with each other are at arm's length, it will only be where consideration is paid by a partner on entering

the partnership or where a partner receives a payment on leaving

the partnership that Part IIIA will have any practical effect. Where consideration is neither paid by a person on entering the partnership, nor received on retirement from the partnership, the partner will not realise a capital gain or incur a capital loss on the disposal of particular assets. However, as noted above, the admission or retirement of a partner may affect the proportionate ownership of the partnership assets by the individual partners and therefore may affect the extent of a continuing partner's interest in the partnership. This would

be relevant in the event of a subsequent disposal of the partnership assets for consideration, or where consideration is paid to a partner on retirement from the partnership.

15. Where a partner has interests in the partnership assets which were acquired on or before 19 September 1985 and also after that date, on a subsequent disposal of an interest in the partnership assets, for example, on the admission of a new member to the partnership, where identification of the actual asset disposed of is not possible it will be open to the

partner to decide which of those interests in the partnership assets he or she is disposing of.

16. In the case of a merger of two or more partnerships there

is no departure from the general rules contained in Part IIIA relating to the acquisition and disposal of assets and the

treatment of non-cash consideration; each partner disposes of some of his or her existing interests in the partnership assets and acquires new interests in other assets. In applying Part IIIA, paragraphs 160ZH(4)(b) and 160ZD(1)(b), have the effect that the market value of property given or received on the acquisition or disposal of an asset is the consideration in respect of that acquisition or disposal.

(2) Disposal of partnership asset

17. The other issue to be addressed in this Ruling relating to the disposal of interests in partnership assets concerns the effect for the individual partners of the disposal of a particular partnership asset. The matter is particularly relevant in the circumstances of large partnerships (not using

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service company or service trust structure) where gains or losses are realised or incurred on the disposal of partnership assets.

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18. Where there is a disposal of a partnership asset to a party, each of the partners disposes of his or her fractional interest in the asset. For example, take the situation where a partnership comprised of 10 partners disposes of a block of

land

for \$150,000 which was originally purchased for \$90,000. In this case, each partner is taken to have disposed of his or her interest in the land; however, individual partners may have acquired their interests at different times (for example, some may have done so before 20 September 1985 and others on or

after

that date) and may have paid different amounts as consideration for the acquisition of those interests. If the partners own equal interests in the land, each will be taken as receiving \$15,000 as disposal proceeds. If the land had been acquired after 19 September 1985, each member who was a partner at the time of acquisition would have a cost base of \$9,000 in respect of the acquisition of his or her interest in the land, and the capital gain would be calculated on that basis. If another partner entered the partnership after the acquisition of the land and paid \$12,000 for his or her interest in the land, that partner would have a cost base of \$12,000 and would therefore realise a capital gain of \$3,000 (subject to indexation) on the disposal.

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19. Again, the interest of an individual partner in an asset have changed since it was originally acquired, for example, by the admission or retirement of partners. In addition, if the asset was acquired before 20 September 1985, but admissions or retirements to the partnership have since occurred, an individual partner's interest in the asset may have changed and a proportion of that interest may have a post-19 September 1985 acquisition date. To illustrate, take the example in the preceding paragraph but assume the land was acquired by the partnership, comprised of the 10 partners, before 20 September 1985. If there were no change in the composition of the

partnership, when the land was subsequently sold there would be no capital gain or loss to any of the partners - each partner's interest in the partnership asset having been acquired prior to the commencement of Part IIIA. However, if one of the partners retired after 19 September 1985 and the remaining 9 partners acquired a proportion of the retiring partner's interest in the land for \$1,000, although the retiring partner has no capital gains tax consequences, the other partners have each acquired a new post-19 September 1985 interest in the asset, i.e., one-ninth of the retiring partner's 10 per cent interest in the land. On the subsequent sale of the block of land for

\$150,000,

assuming there have been no other changes, each partner would realise a capital gain (again subject to indexation) in respect of that new interest. While this example deals with the retirement of a partner, similar types of adjustment will be required where a new partner is admitted to a partnership.

20. Where there has been a change in the interests of the individual partners in an asset since its acquisition, the onus rests on each partner to determine any capital gain or capital loss on the disposal of his or her interest in that asset. To calculate that gain or loss the partner would need to have regard to various factors, including the acquisition date of

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asset disposed of, the acquisition date of the partner's interest in the partnership, any costs attributable to the asset's acquisition and any changes in the membership of the partnership which affect the partner's interest.

21. In the case of large professional partnerships the question has also arisen whether, in circumstances where a partnership asset which is subject to depreciation allowances is sold, the individual partners must each account for the disposal in their individual returns. In view of the practical difficulties

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could otherwise result, it has been decided that where a depreciable partnership asset is disposed of and no capital

gain

arises on the disposal of the asset to any of the partners, the individual partners are not required to disclose the disposal

of

the asset in their individual returns. In line with the existing practice in relation to depreciable partnership

assets,

the disposal may be accounted for in the partnership return.

#### "Everett" Assignments

22. A further question that arises in relation to the application of Part IIIA to partnerships concerns what are referred to as "Everett" assignments; that is, where a partner in a partnership assigns part of his or her partnership

interest

in a similar situation to that before the High Court in *F.C. of T. v. Everett* (1980) 143 CLR 440. The issues that arise in relation to an Everett assignment for the purposes of applying Part IIIA concern the nature of the asset disposed of and the



consideration that is attributable to its disposal.

23. Everett's case concerned the correct taxation treatment of partnership income where a partner assigned part of his share in a partnership to his wife. The case did not specifically deal with the nature of the assignee's (i.e., the wife's) interest in the partnership. However, it is clear that the decision of the majority of the High Court - that the share of the partnership income attributable to the assigned partnership interest was assessable to the assignee - was founded on the premise that the effect of the assignment was to confer an immediate interest in the partnership to the assignee. At p.452, the majority said :

"The consequence in the present case is that because the respondent assigned present property, a chose in action, being a share of his interest in the partnership which carried with it the right to a proportionate share of future income attributable to his interest, the assignment became effective at once and conferred on his wife an immediate equitable entitlement as against the respondent and the other partners to such income referable to the share assigned as might subsequently be derived. This case is to be distinguished from ..... other cases in which there have been assignments of future income dissociated from the property or proprietary right to which that income is attributable."

24. For the purposes of Part IIIA, it is considered that the effect of an Everett assignment is that the partner disposes of part of his or her partnership interest, notwithstanding that the assignee only has an equitable interest in the assignor's partnership interest and that legal title to the partnership assets continues to vest in the partners to the exclusion of the assignee (see Everett's case at p.448). In line with the discussion earlier in this Ruling, the assignment of part of the partnership interest will be treated as a part disposal of the partner's interests in the partnership assets.

25. It would be very unusual for an Everett assignment to be made on an arm's length basis. Therefore, by the operation of subsection 160ZD(2), the consideration for the disposal of those interests in the partnership assets (that occurs as a result of the assignment of the partnership interest) will, for capital gains tax purposes, be their market value.

26. However, in considering the consequences in terms of Part IIIA of an Everett assignment, it is also necessary to consider the decision of Burt CJ. of the Supreme Court of Western Australia in Reynolds v. Commissioner of State Taxation (WA) 86 ATC 4528, 17 ATR 987. Reynolds' case involved the valuation of an assigned partnership interest, the valuation

being necessary in order to determine the stamp duty payable on the transfer of the partnership interest. It is significant that in Reynolds' case the assets used by the partnership were owned by an administration company and a service trust, so that the assignment of the partnership interest conferred no interest in those assets. The members of the partnership also did not recognise any value for goodwill.

27. Notwithstanding this, Burt CJ. decided that the assigned partnership interest was of value; its value derived from the value of the right that was attached to the partnership interest to receive a proportionate share of the future income of the partnership. That right was conferred on the assignee on the assignment of the partnership interest.

28. Where an Everett assignment is not made at arm's length, the valuation method adopted in Reynolds' case will usually be the appropriate method for determining the market value of the assigned partnership interest for the purposes of Part IIIA. Broadly, this will involve the determination of the price that a "hypothetical buyer" would pay for the assigned partnership interest having regard to the value of the right to the future income of the partnership which is attached to the interest.

29. As discussed in paragraphs 24 and 25, where the assets used by the partnership are owned by the partners rather than a service company or service trust, the assignment will also result in a part disposal of the partner's interests in those assets for consideration equal to their market value.

30. It is accepted that the partners in a professional partnership will usually deal with each other at arm's length. Therefore, in considering the application of Part IIIA to the disposal of a partnership interest by way of an Everett assignment, the cost base will be the consideration given by the partner to acquire the partnership interest. This will include the amount paid for the acquisition of any interests in the partnership assets that are disposed of by the assignment. For the purposes of the capital gains provisions, consideration for the acquisition of an asset is limited, by subsection 160ZH(4), to money paid or property given for the acquisition of the asset.

#### Section 160ZZS

31. Section 160ZZS applies to an asset acquired by a taxpayer before 20 September 1985 where there has been a change in the majority underlying interests in the asset since that date, to deem the asset to have been acquired after 19 September 1985. In the case of a partnership asset, section 160ZZS does not apply because, as stated in this Ruling, each partner owns an

interest in each of the partnership assets and Part IIIA  
applies on the disposal of those interests. The only potential  
application of section 160ZZS to a partnership asset is  
indirect; for example, where a partner in the partnership is a  
company, majority underlying interests in which have changed  
since 19 September 1985.

COMMISSIONER OF TAXATION  
22 June 1989