


***TD 2002/24 - Income tax: what are the results for income tax purposes of entering into a 'partnership' of the type described in Taxpayer Alert TA 2002/4?***

 This cover sheet is provided for information only. It does not form part of *TD 2002/24 - Income tax: what are the results for income tax purposes of entering into a 'partnership' of the type described in Taxpayer Alert TA 2002/4?*



---

---

# Taxation Determination

---

## **Income tax: what are the results for income tax purposes of entering into a ‘partnership’ of the type described in Taxpayer Alert TA 2002/4?**

### **Preamble**

*The number, subject heading, date of effect and paragraphs 1 to 6 and 10 to 17 of this Taxation Determination are a ‘public ruling’ for the purposes of Part IVAAA of the **Taxation Administration Act 1953** and are legally binding on the Commissioner. The remainder of the Determination is administratively binding on the Commissioner. Taxation Rulings TR 92/1 and TR 97/16 together explain how a Determination is legally or administratively binding.*

### **Date of Effect**

*This Determination applies to years commencing both before and after its date of issue. However, this Determination does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of the Determination (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).*

### **Arrangements of the type described in Taxpayer Alert TA 2002/4**

1. Arrangements of the type described in Taxpayer Alert TA 2002/4 have all or most of the following elements:

- A taxpayer earning personal services income from the provision of professional services pays an arranger purportedly to organise a partnership with other unrelated taxpayers;<sup>1</sup>
- The taxpayer pays to the arranger an upfront fee and a continuing management fee;
- The taxpayer either renews existing contracts or enters into new contracts for the provision of personal services in the name of the partnership;
- Tax invoices for services provided are generally in the name of the purported partnership;
- The taxpayer directs the service acquirer to make payments either to the taxpayer as the representative of the purported partnership or to the arranger as agent for the partnership;

---

<sup>1</sup> This situation is different to that of an ordinary family partnership.

- If the payment for services are made directly to the taxpayer, that taxpayer pays to the arranger the GST in respect of the provision of the services and the continuing management fee;
- If the payment for services is made directly to the arranger by the service acquirer the arranger will deduct the applicable GST and the continuing management fee. The net amount is generally paid to the taxpayer who provided the services;
- The taxpayer's income from the purported partnership is based on the income generated by the taxpayer's personal services rather than a share of the net income of the partnership income; and
- The taxpayer assigns up to 49% of their alleged interest in the partnership to their spouse or a related party.

## **Is there a partnership under either the general or taxation law?**

2. Whether a partnership exists is a question of fact. After examining a number of alleged partnerships of the type described in paragraph 1, we have concluded that arrangements of this type are not partnerships under either the general law or the taxation law.
3. Participants in this arrangement do not intend to carry on a business in common or as partners. There is no intention to share the profits of the partnership. Nor are the participants in receipt of income jointly. Each individual participant derives his or her income directly from the provision of his or her personal services, and does not share in any income generated by the personal services of other participants in the arrangement.
4. The situations described in paragraph 1 should be contrasted with arrangements where, based on the objective evidence, it is clear from the outset of the arrangement that the parties have the intention of carrying on a business in common. Examples of such arrangements would include established legal and accounting practices.
5. Additionally, in the circumstances described in paragraph 1, as there is no partnership under either the general or income tax law, there is consequently no interest in a partnership that can form the subject of a valid assignment. The income derived by the individual participants is personal services income that cannot be assigned (see Taxation Ruling IT 2403 paragraph 7).
6. Since this arrangement does not give rise to a partnership, each participant must be viewed as providing personal services separately. All of the income generated by those personal services will be the assessable income of the participant. The individual whose personal services generated the income may be subject to the alienation provisions contained in Part 2-42 of the *Income Tax Assessment Act 1997* ('ITAA 1997').

## **Why is there no partnership under either the general or income tax law?**

7. Under section 6 of the *Income Tax Assessment Act 1936* ('ITAA 1936') a partnership is defined as 'an association of persons carrying on business as partners or in receipt of income jointly'. The first limb of this definition refers to a partnership under general law; the second element is a statutory extension of the term. Both limbs require a

careful examination of the factual circumstances of each individual situation. A partnership under general law is an equitable relationship founded on agreement. The relationship which a partnership agreement establishes goes beyond one of simple contract. The essence of a partnership is that the relationship is one of mutual agency which requires the partners to have mutual rights and obligations. This means that each partner must have rights which he or she can enforce against each other partner and all other partners. In addition, a partner will owe obligations (such as a fiduciary duty to act in utmost good faith, and an obligation to indemnify other partners against personal liability) to each other partner and all other partners. The business must be carried on either by or on behalf of all the persons who are alleged to be partners.<sup>2</sup>

8. Another essential element for a partnership to exist is the intention of all the parties to carry on business in common as partners. This intention must be demonstrated by the conduct of the parties.<sup>3</sup> A written or oral agreement is prima facie evidence of an intention to create a partnership but not conclusive evidence. 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.<sup>4</sup>

9. We have also concluded that the participants are not in receipt of income jointly: each derives his or her own income. We have set out in TR 94/8, at paragraph 4, factors that would be taken into account in determining if a partnership exists.

#### **Does Part IVA of the Income Tax Assessment Act apply?**

10. In some cases, however, it may be that a partnership within the meaning of the ITAA 1936 may have been established. If that is the case, those cases are likely to attract the operation of the general anti-avoidance provisions of the income tax law (Part IVA of the ITAA 1936).

11. As the Note to section 86-10 of the ITAA 1997 states: 'The general anti-avoidance provisions of Part IVA of the ITAA 1936 may still apply to cases of alienation of personal services income that fall outside this Division'.

12. The application of Part IVA depends on a careful weighing of all the relevant circumstances of each case, and the relative weight that should be attached to each of those circumstances. Therefore, in the absence of all relevant information it is not possible to state definitively whether a particular scheme or transaction will attract Part IVA. However, arrangements of the type described in paragraph 1 above are considered likely to give rise to a scheme under section 177A comprising the establishment of the partnership and the assignment of part of a partner's interest in the partnership. This type of scheme is likely to give rise to a tax benefit under paragraph 177C(1)(a) in that but for the scheme the amount of income that was included in the assessable income of the assignee as a result of the assignment would have been included in the assessable income of the assignor. It is also considered that a reasonable person would conclude, having regard to the matters set

---

<sup>2</sup> *Re Ruddock* (1879) 5 VLR (IP & M) 51. See also *Checker Taxicab Co Ltd v. Stone* (1930) NZLR 169, where it was found that both parties were carrying on a business. Each party appears to have benefited from the carrying on of a business by the other. They were not, however, carrying on a joint business. The two businesses were in fact distinct.

<sup>3</sup> TR 94/8 paragraph 10

<sup>4</sup> *I.R. Commrs v. Williamson* (1928) 14 TC 335

out in section 177D, that one or more of the parties that entered into the scheme did so for the dominant purpose of enabling the assignor to obtain the tax benefit. Consequently, the Commissioner is likely to exercise his powers under section 177F to cancel the tax benefit and include in the assessable income of the assignor the income previously included in the assessable income of the assignee as a result of the assignment.

13. The arrangements in question must be distinguished from those dealt with in Taxation Ruling IT 2501 on 'Assignment of partnership interests'. IT 2501 deals with '[v]alid assignments on all fours with the *Everett* or *Gulland* decisions'. However, arrangements of the types described in paragraph 1 are fundamentally different from the assignments considered in *FCT v. Everett* (1980) 10 ATR 608;80 ATC 4076 and *FCT v. Gulland* 18 ATR 33;86 ATC 4885. Those cases did not concern themselves with schemes under which a partnership was brought into existence for the purpose of assigning an interest in that partnership. Nor did they concern a situation where both the formation of the partnership and the assignment were steps in a single scheme designed to give rise to a predetermined outcome.

### **Effect of assignment of an interest in the partnership**

14. On the assumptions that there is a partnership, that there is a valid assignment of an interest in that partnership for income tax purposes, and that Part IVA does not apply, then the assignment of the interest would result in a CGT liability (see paragraphs 24, 25 and 27 of Taxation Ruling IT 2540).

### ***Example***

15. *A number of individuals enter into an arrangement of the type described in paragraph 1 above. The following additional information was obtained as a result of audit activity undertaken by the ATO.*

- *Prior to joining the arrangement each of the participants provided his or her personal services either directly as a sole trader, or through a company or trust controlled by the participant;*
- *Under the arrangement, the participant assigns up to 49% of his or her interest in the purported partnership income to their spouse or a related party. This assignment results in substantially less income being derived by the participant and substantially less tax being paid than would have been paid in the absence of the assignment;*
- *Each individual participant continues to conduct their activities in isolation from the other participants;*
- *There is no property owned or leased by the purported partnership which is used as a common resource by the partners in deriving their income, such as business premises, support staff or equipment, that is used jointly by the purported partners to conduct the income earning activities of the purported business;*
- *The participants have little or no understanding of the arrangement and became a participant solely as a result of advice from the promotor of the*

*arrangement that this was an appropriate way to respond to the introduction of Part 2-42 (Personal Services Income legislation);*

- *When the participants were asked about their understanding of the document they signed regarding the assignment of part of their interest in the purported partnership, none understood what this document was about;*
- *Participants were asked what was their understanding of the alleged partnership agreement that they signed. They all demonstrated very little understanding of this document;*
- *Although contracts are in the name of the purported partnership the payment arrangements in most cases are for money to continue to be deposited to an account controlled by each individual participant; and*
- *The promotional and training material produced by the scheme promoters strongly emphasises the tax benefits of entering into the managed partnership arrangement. The material claims that an individual affected by the Personal Services Income legislation can not only avoid the 80/20 rule by joining a managed partnership but can also take advantage of the assignment rules (that have been proven by case law) to minimise tax and maximise deductions.*

16. *Whether a partnership exists is a question of fact. It is considered that on the basis of the facts listed above there is no intention on the part of the individuals to conduct a business in common. Nor is there any intention to share profits. Nor do the participants derive any income jointly. Consequently, there is not a partnership either under the general law, or under the income tax law.*

17. *Even if a partnership existed under the general and income tax law the circumstances indicated that some or all of the parties did not enter into the arrangement for sound commercial business reasons, but rather entered into the arrangement for the sole or dominant purpose of obtaining a tax benefit, being the non-inclusion of income in the participant's assessable income. Consequently, Part IVA is likely to apply.*

---

**Commissioner of Taxation**16 October 2002

---

*Previous draft:*

Not previously issued in draft form

*Subject references:*

- alienation
- anti-avoidance
- managed partnership
- partnership

*Related Rulings/Determinations*

IT 2403, IT 2501, IT 2540, TA 2002/4; TR 92/1;  
TR 92/20; TR 94/8; TR 97/16

*Legislative references:*

- ITAA 1936 6
- ITAA 1936 177A
- ITAA 1936 177C(1)(a)
- ITAA 1936 177D
- ITAA 1936 177F
- ITAA 1936 Part IVA
- TAA 1953 Part IVAA
- ITAA 1997 Part 2-42
- ITAA 1997 86-10

*Case references:*

# TD 2002/24

- 
- I.R. Commrs v. Williamson (1928) 14 TC 335
  - Checker Taxicab Co Ltd v. Stone (1930) NZLR 169
  - RE Ruddock (1879) 5VLR (IP&M) 51
  - FCT v Everett (1980) 10 ATR 608; 80 ATC 4076
  - FCT v Gulland 18 ATR 33;86 ATC 4885
- 

ATO references:

NO: 2002/007391

ISSN: 1038-8982