

The NTAA's Guide to a Partnership

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Law

The law is as stated 1 May 2015.

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What is a Partnership?

A partnership is not an entity – it is merely a form of shared ownership of property and an agreement to share certain benefits and obligations.

There are 2 types of partnership:

- (a) **General law partnership:** a relationship between parties carrying on a business with a view to a profit.

EXAMPLE – General law partnership

Kristen and James carry on a chocolate retail shop as a partnership where they split the profits 50/50. This is a general law partnership.

- (b) **Tax law partnership:** For income tax purposes, a partnership not only includes the general law definition of partnership, but also includes persons “in receipt of ordinary or statutory income jointly” (i.e., together).

EXAMPLE – Income tax partnership

Simon and Justine have a joint interest-bearing investment with the bank. This is not a partnership for general law purposes (as they are not in business) but is technically a partnership for income tax purposes.

A company is specifically excluded from the definition of partnership.

What factors are used to determine whether a partnership exists?

Where taxpayers receive income jointly, this is clearly a partnership for *tax* purposes.

EXAMPLE – Clear partnership

Bob and Jackie own a rental property in joint names, from which they receive income. It is clear a partnership exists because:

- income is derived from the property; and
- the title deed clearly shows the property is in joint names.

However, whether a general law partnership exists (i.e., the parties are carrying on business together) is more difficult to show, as it is a question of fact. The existence or absence of a partnership agreement is not conclusive evidence of an intention (or a lack of intention) to act as partners. However, a partnership agreement normally provides good evidence that the parties intend to be in partnership (although this may not be enough).

Some of the factors the ATO takes into account in determining whether a general law partnership exists are:

1. **The mutual assent and intention of the parties** – a written partnership agreement, although not essential, is a strong indicator that a genuine partnership exists;
2. **Joint ownership of business assets** – the ATO also looks to see that the partners are jointly liable for the debts of the business;
3. **Registration of business name** – the business name should be registered in the names of all the partners;

4. **Joint business account and the power to operate it** – the bank should be aware that the account holders are acting in partnership. If the partnership consists of a husband and wife then they should both have the power to operate the account. It should be an account that is separate from their personal accounts.
5. **Extent to which the parties are involved in the conduct of the business** – if the parties are actively involved in the conduct of the business, the ATO is more likely to agree a partnership exists.
6. **Extent of capital contribution** – the contribution of capital should be made jointly where possible;
7. **Entitlement to share of net profits** – profits should be distributed in accordance with the terms of the partnership agreement, if there is one, or equally if there is no partnership agreement.
8. **Business records** – separate partnership records such as books of account, minutes of partnership meetings and so on should be kept. These records should be different from the parties' personal and other business records.
9. **Trading in joint names and public recognition of the partnership** – the parties should promote themselves to the world at large that they are acting in partnership. This is particularly important where one partner may do a large amount of work, for example, where only one partner is qualified tradesperson. When conducting work for customers, a tradesperson should make it clear that the customer is dealing with a partnership and not simply the individual. All the invoices, business letters, tenders and advertising should be in the partnership name.

The above factors are all factors that the ATO takes into account, but if one or two are missing it does not mean a partnership does not exist. Other factors may also be important.

WARNING – Partnership between family members

It gets considerably more difficult to prove that a partnership exists in an ordinary family situation, as there is often a lack of formal agreements and there is difficulty in distinguishing between family and business responsibilities.

A joint venture can often be a partnership

Often, people say they are going into a “joint venture” together with no real thought as to what they mean. Yet the distinction is very important – if they are in partnership they must share income jointly, whereas in a joint venture the income and deductions are accounted for separately by each of the venture partners.

Importantly, if the parties are not in partnership, they may not be jointly and severally liable for the partnership debts and liabilities (refer below under “Disadvantages of a partnership”).

There is no settled meaning of “joint venture”. A useful starting point is that a joint venture is normally an agreement to share output, rather than income.

EXAMPLE – Joint Venture

ABC Pty Ltd and XYZ Pty Ltd enter into a joint venture for the subdivision, development and sale of 10 units. ABC Pty Ltd and XYZ Pty Ltd are entitled to units 1 to 6 and 7 to 10 respectively.

As ABC Pty Ltd and XYZ Pty Ltd have agreed to share output, this is a joint venture and not a partnership.

If ABC Pty Ltd and XYZ Pty Ltd instead agreed they would sell the units and split the proceeds, this would be a partnership.

Partners may be individuals or other entities

It should be noted that the partners of a partnership do not have to be individuals – they may instead be companies or trusts (or a combination of one or more individuals, companies and/or trusts). Our partnership deed allows for partners that are either individuals or “entity partners” such as trusts or companies.

Partnership of discretionary trusts

It is quite common for some (or even all) of the partners of a partnership to be discretionary trusts (or rather, for some or all of the partners to be the trustee of their respective discretionary trusts).

A partnership of discretionary trusts may provide additional advantages as compared to a partnership of individuals, including in particular:

- (a) **asset protection** – as each partner is a discretionary trust, the personal assets of the individuals (i.e., the beneficiaries of each discretionary trust) are generally protected; and
- (b) **flexibility of distributions** – the trustee of each discretionary trust can distribute the trust's share of partnership income among the trust's beneficiaries in any way it wishes. Thus, tax can be minimised by distributing income to those beneficiaries on the lowest tax rates, including any corporate beneficiaries.

However, operating a partnership of discretionary trusts is very complex, and advice should be sought from your accountant in relation to the above possible advantages and other issues.

Operating a partnership

There are a number of important issues to consider when operating a partnership.

Open a bank account

After the partnership agreement has been signed, a partnership bank account should be opened. This will be a joint bank account. Banks will normally provide a list of the things they will require to open up the bank account.

Partnership capital

Often, when a partnership starts, the partners inject their own capital into the partnership to get it going.

EXAMPLE – Initial capital

Bill and Ben are starting their flowerpot business and will operate as a partnership. Bill and Ben are each putting in \$10,000 to start the business. This money (known as partnership capital) will be used to pay start-up costs.

The partnership agreement (if there is one) should set out how the partnership capital should be treated and accounted for throughout the life of the partnership.

Splitting profits (or losses)

The basis of splitting profits is generally set out in the partnership agreement.

WARNING

Generally speaking, only general law partnerships (i.e., business partnerships) deriving income are able to split profits in *different* proportions to the partner's underlying interest in the partnership. This means that rental property owners and people who jointly invest in shares or interest bearing deposits (i.e., those in tax law partnerships) must pay tax on their share of the profits or losses based on their underlying ownership interest in the jointly owned asset(s), and cannot agree on another way of splitting the income and expenses for tax purposes.

Consider registration for the tax system

Even though a partnership is not legally a separate entity, there are a number of taxes that the partnership may have to register for, including GST, PAYG withholding and so on. In this regard, advice should be obtained from your accountant.

Advantages of a partnership

The main advantage of a partnership is simplicity. Other advantages are:

- Less costly to establish than a company or a trust;
- Inexpensive to run;
- Easy to understand (especially if it is a partnership of individuals);
- Can provide some flexibility in the partnership agreement; and
- Income splitting between partners.

Also refer above to advantages for a partnership of discretionary trusts.

Disadvantages of a partnership

The main disadvantages of a partnership are:

- The partners are jointly and severally liable (i.e., each partner is liable not only for their share of the partnership debts but also for those of the other partners. At worst, one partner can be liable for the entire partnership's debts);
- Generally no asset protection (especially where the partners are individuals); and
- Some tax disadvantages.

Entry and retirement of partners

When a new partner is admitted to a partnership or a partner retires from a partnership, the current partnership ceases and generally a new partnership is created.

EXAMPLE – Retirement of partner

Josie, Jackie and Jocelyn are all partners in the Music Club Partnership. Josie is retiring, leaving Jackie and Jocelyn to run the business. At the time Josie leaves, the old partnership (of Josie, Jackie and Jocelyn) ceases, and a new partnership (of Jackie and Jocelyn) begins.

The ATO's requirements regarding a change in partners are set out in the instructions for partnership tax returns, available at www.ato.gov.au (regarding "reconstituted partnerships"). The ATO generally requires the 'new' partnership to obtain a new tax file number and ABN and the 'old' partnership to lodge a tax return for the period from the beginning of the tax year to the date the partnership was reconstituted (i.e., the date the membership of the partnership changed). The new partnership (or possibly a sole trader, if there is only one 'partner' remaining)

will need to lodge a tax return for the period from the date of the reconstitution to the end of the tax year.

TIP – Administrative concession if there is a “technical dissolution”

If the change in the composition of the partnership amounts only to a “technical dissolution” of the partnership, the partnership may be able to continue as a “reconstituted continuing entity”. In that case, the ATO does not require the new partnership to obtain a new tax file number (although application must be made to the ATO for continued use of the partnership’s TFN) or for two tax returns to be lodged in the one year.

Refer to the link below for further information (including as to the meaning of “reconstituted continuing entity” and “technical dissolution”).

[/www.ato.gov.au/Individuals/Deceased-estates/In-detail/Partnerships/Changing-the-makeup-of-a-partnership/](http://www.ato.gov.au/Individuals/Deceased-estates/In-detail/Partnerships/Changing-the-makeup-of-a-partnership/)

Only one tax return need to be lodged for a “reconstituted continuing entity” for the whole year but, when it is lodged, it must contain the following information:

- the distributions made to every person who was a partner at any time during the financial year, including those who left the partnership during the year;
- the date of dissolution of the old partnership;
- the date the new partnership came into existence;
- the names of the new, continuing and outgoing partners;
- the TFN or address and date of birth of all new partners; and
- details of the changes, if the persons authorised to act on behalf of the partnership have changed.

Advice should be sought from your accountant as required in relation to the above.

On the entry and retirement of partners, there are a number of important tax issues including those relating to (this list is not exhaustive):

- Stamp duty;
- Trading stock;
- Plant and equipment;
- Work-in-progress;
- GST; and
- Capital gains tax (CGT).

Use of an agent/manager

A company agent/manager is sometimes used to act on behalf of the partnership (especially where it is a partnership of trusts). This is done predominantly for administrative ease. Although not absolutely necessary, each of the partners would generally have a proportionate number of shares in the company acting as agent and appoint a director to the agent’s board.

GST and ABN issues

A partnership may make supplies and acquisitions of goods and/or services. This will either be done by the partnership itself or, if it has an agent acting for it, through the agent.

If there is no agent, the partnership should obtain an ABN and, if it is necessary (i.e., its turnover is above the threshold) or it chooses to do so, register for GST.

However, if there is an agent, the question will arise as to who should account for GST and how should it be done.

The GST Act provides two ways that a partnership acting through an agent can account for GST:

- **Option 1:** By treating the agent as a separate person in all of the transactions made by the partnership, so that:
 - the partnership would make all of its supplies to the agent (and issue a tax invoice to the agent), which would then on-supply these to the partnership's customers (with the agent issuing its own tax invoice); and
 - all acquisitions of the partnership would be made first by the agent (which would claim an input tax credit), and the agent would then on-supply those acquisitions to the partnership (with the agent paying GST on the supply and the partnership claiming an input tax credit).

This is an artificial option provided by Division 153-B of the GST Act (since this is not how agency transactions are legally treated) and can be more complicated than the next option; or

- **Option 2:** By treating all supplies and acquisitions that the agent makes as being made by the partnership itself (Division 153-A of the GST Act). This is actually how the supplies and acquisitions are treated at law, and is the more common way of accounting for GST.

Option 1

If your partnership chooses to use the first option for accounting for GST, the registration question is quite simple: both the partnership and agent will need to obtain ABNs and register for GST (if necessary), and will each issue (and receive) their own tax invoices. The partnership and agent will be considered to make supplies to and from each other.

Option 2

If your partnership chooses to use the second option, even though the partnership may act through an agent, it is the partnership, and not the agent, that is liable for all GST and which can claim input tax credits. A Goods and Services Tax Ruling issued by the ATO, GSTR 2013/1 (which supercedes previous GST rulings, including GSTR 2000/17, which has been withdrawn), states (at paragraph 95):

".....when an agent uses his or her authority to act for a principal, then any act done on behalf of that principal is an act of the principal. An entity therefore makes a supply or acquisition if their agent makes it on their behalf."

Therefore, the partnership needs to have an ABN and be registered for GST.

The partnership can issue tax invoices and receive tax invoices in its own name, for GST and input tax credits purposes.

However, if the partnership wants the agent to be, to all intents and purposes, the face of the business and able to issue (or receive) tax invoices in its own name, the agent will need to, at the least, obtain an ABN. Under GSTR 2000/37, a principal can rely on tax invoices issued or received by an agent with the agent's name and ABN. If the agent does not make any supplies or acquisitions in its own name – i.e., it only acts as agent for the partnership and does not do anything else – it will not need to register for GST, subject to one concern.

The concern is that, although any tax invoice issued by that agent (with the agent's own ABN) should be valid, if someone dealing with the agent receives such a tax invoice and then checks the online ABN register to confirm that the ABN is valid, it will see that the agent is not registered for GST. Therefore, they may think that they are not able to claim an input tax credit (despite the fact that they should be able to, as the taxable supply is actually being made by the partnership, which is registered, via the agent).

This problem can be avoided if the agent also registers for GST. However, this does mean that there is the added administrative hassle of the agent needing to lodge business activity statements (BASs). If the agent does not do anything else except act as agent for the partnership, it should have no supplies and no acquisitions and should simply need to lodge nil statements each period (unless the agent is paid for its services as agent or otherwise uses the first option above).

Therefore, in summary:

- The partnership will always need to register for GST (if its turnover is higher than \$75,000 a year (\$150,000 for non-profit organisations) or otherwise if it voluntarily opts in) and should lodge all BAS statements for the business.
- The agent will need an ABN if the partnership wishes to issue and receive tax invoices through the agent.
- If the agent does not register for GST, there may be problems with purchasers who think they cannot claim an input tax credit, but it will not have to lodge BAS statements.
- If the agent does register for GST, purchasers should have no reason to question the validity of tax invoices, but it will have the added hassle of lodging BAS statements (but these are likely to be nil statements).
- In any event, the agent will need to register for GST if it has its own enterprise, if it is paid by the partnership for its services as agent or if the partnership and agent use Division 153-B in accounting for GST (provided in all cases that it meets the turnover threshold, or chooses to voluntarily register if not), and will lodge BAS statements taking any relevant supplies or acquisitions into account accordingly.

This is a complex area and we recommend you obtain professional advice if you are at all unsure about operating in this area.

Features of NTAA Corporate's Partnership Agreement

NTAA Corporate's partnership agreement is designed for a partnership of both individuals and non-individuals (i.e., trusts and companies). It is therefore a more complex agreement than a standard partnership agreement for individual partners.

The following are some of the features of NTAA Corporate's Partnership Agreement. However, the agreement should be read in full to fully ascertain the relationship between the partners.

- The agreement allows for the appointment of an agent but, if no agent is appointed or the agent ceases acting and is not replaced, the powers of the agent may be exercised by the partners acting jointly – refer subclause 4.5.
- If there is an agent, the agent will be entitled to conduct the partnership business (subject to the direction of a majority of the partners) as if it were the sole beneficial owner of the business and the assets of the business (except when it comes to selling the business or a majority of it – refer to subclause 4.4).
- The partners indemnify the agent in relation to any costs it incurs when acting as their agent – refer subclause 4.1(c).
- The agent can be removed by a resolution of partners holding together at least a 75% interest in the partnership – refer subclause 4.2. The agent can also retire by giving one month's written notice – refer subclause 4.3.
- if necessary, the partners will need to register the name of any business carried on by the partnership with the authority responsible for registering business names in the relevant State or Territory – refer subclause 2.3.
- If there is an agent, then the agent will open a bank account and be signatory to any cheques made out from that account. If there is no agent, then the partners will need to open the account and agree on how cheques should be signed (e.g., by a certain number of partners or by specific individuals) and should work this out with their bank – refer subclause 2.15.

- Each partner's initial interest in the partnership is specified as a percentage in the schedule. This will generally be calculated by reference to the capital contribution of each partner, but the interest is the same with respect to both the income and capital of the partnership. For example, if the partner has a 50% interest in the partnership, the partner is entitled to 50% of the income (or loss) of the partnership and has a 50% interest in the assets of the partnership. If a partner is entitled to a proportion of capital that does not reflect the capital the partner has contributed, that partner must pay the other partners to make up the balance (from the profits of the business or as otherwise agreed). The partners can agree in future if they wish to share income and capital in different proportions – refer subclauses 2.4 and 2.5.
- If a partner puts in extra capital after the partnership is established, that will not affect the partner's percentage share in the schedule, but will instead be treated as a debt owing by the partnership to the partner, with interest, unless otherwise agreed by the partners – refer subclauses 2.5(g) and 2.5(h).
- The partners may periodically draw money from the profits of the partnership on a quarterly basis or otherwise as and when they agree. If it is found that any drawings for the year exceed the available profit, the partner or partners who overdraw their share may be required to repay that amount to the partnership – refer subclause 2.7. The partners may also agree to pay one or more partners a 'salary' from the partnership (although this may give rise to different taxation considerations – speak to your accountant about this) – refer to subclause 2.8.
- Other amounts owing by a partner to the partnership or by the partnership to a partner may carry interest – refer subclause 2.17.
- Each partner owes certain duties to the partnership (refer subclause 2.12) and is also prohibited from doing certain things without the consent of the other partners, including transferring, or effectively transferring, their interest in the partnership (refer subclause 2.13). The partners should be careful of these duties and prohibitions, because the other partners may be able to expel any partner who breaches them or other material provisions of the agreement – refer subclause 5.5.
- A partner can resign from the partnership by giving notice to the other partners of the period specified in the schedule, and if his or her interest is not bought by the other partners, the partner can sell their interest to someone (approved by the other partners) outside the partnership – refer subclause 5.1.
- The partnership does not come to an end by reason only of a partner leaving or dying (if an individual), or another partner being added, and the remaining/continuing partners expressly agree that the partnership will continue beyond such an event, unless there is only one partner left or all the partners agree to bring the partnership to an end – refer subclause 5.10. If a partner has left the partnership for whatever reason, the other partners may buy that partner's share in the partnership – refer subclause 5.1 (but if none of them or any other approved person does, the partnership will come to an end in any event – refer to subclause 5.1(d)).
- The agreement provides for meetings between the partners and/or the agent, and a partner may appoint a representative to attend a meeting in their place – refer clause 3.2. The chair of a meeting of Partners does not have a casting vote – refer subclause 3.4(b).
- If the partners cannot agree on something or otherwise are in dispute, the dispute must generally first be referred to mediation, and then (if unsuccessful) to arbitration, before they can go to court – refer clause 6.
- No partner can sell or assign his or her interest in the partnership (except in certain specified circumstances) without the prior written consent of all of the other partners and any new partner must sign an agreement with the same effect as this agreement – refer subclauses 2.13(h) and 2.14.
- The partners can vary the agreement at any time by all signing a written variation, amendment or further agreement – refer subclause 9.10.
- Some partnership agreements include a "restraint of trade" clause. This one does not, as the terms of such restraint are often specific to the requirements of the particular partnership (and

overly restrictive ones can be struck down by the courts). If the partners desire that any partners leaving the partnership should be restrained from entering or carrying on similar businesses, they should all enter into a separate agreement to that effect.

- Depending upon the State or Territory in which the partnership carries on business, the partners may be required to notify the public when the partnership comes to an end. This requirement is reflected in the agreement – refer subclause 5.9.