SOUTH AUSTRALIA

STATE TAXATION OFFICE

Stamp Duties

Circular No. 165
(replaces Circular No. 86)

CONVEYANCES AND TRANSACTIONS INVOLVING PARTNERSHIP INTERESTS

Circular No. 86 was issued by this Office in October 1993 and outlined the methods used when assessing stamp duty payable on conveyances of interests in partnerships.

This Circular restates those methodologies and seeks to clarify situations which were not covered by Circular No. 86.

BACKGROUND

It has been a practice of the State Taxation Office to assess conveyances of partnership interests on a "net assets" basis. The practice in some other jurisdictions is to assess on a "gross assets" basis. Under the net basis, the interest of a partner in a partnership is determined by his/her interest in the partnership funds or partnership capital. This is called the "entity" approach. In essence the partnership funds or partnership capital is equivalent to the net assets of a partnership, that is the sum of all assets of the partnership less its liabilities. The gross basis looks at the underlying assets of the partnership and the interests of partners in those assets. Under this approach every partner is deemed to have a proportional interest in each asset of the partnership.

In 1993 it was considered appropriate to change to a gross basis and a number of assessments were made on that basis. However, representations were made to the Commissioner by various groups as to the appropriateness of the use of a gross basis.

In the meantime, the decision in Commissioner of Stamps v Reynolds [17 ATR 987; 86 ATC 4528] came under scrutiny. This suggests that in an Everett [Federal Commissioner of Taxes v Everett, 80 ATC 4076; (1980) 143 CLR 440] type assignment the proper basis of assessment is one that employs discounting techniques.

Considerable consultation took place between parties representing:

- Australian Society of CPA's
- The Institute of Chartered Accountants in Australia
- The Law Society of South Australia

- National Institute of Accountants
- The Taxation Institute of Australia
- Taxpayers Association of South Australia

Circular No. 86 was issued in 1993 with the intention that it would be reviewed after a trial period. The following ruling reflects re-evaluation at the end of the trial period. This Office proposes to continue with the net basis (or partnership funds approach) on an ongoing basis, subject to periodic review.

RULING

Conveyances of partnership interests or changes in the ownership of a partnership interest will be assessed, **with the exception of partnerships owning real property**, on the change of a partner's interest in the partnership funds. The partnership funds are generally the sum total of all assets of a partnership less liabilities.

Partnerships owning real property will be assessed on a different basis and are described elsewhere in this Circular.

DETERMINING THE ASSETS OF A PARTNERSHIP

Debts of a Partnership

The debts of a partnership which can be deducted from the gross assets fall into two categories. If a debt cannot be deducted it will, in effect, form part of the partnership funds or capital. These are the debts owing to the partners and debts owing to outsiders. The deductibility of these debts from the gross assets depends on satisfying the following conditions.

1 Debts owing to the partners

Unless it can clearly be shown that debts due to partners are genuine debts, no allowance will be made for them. Debts owing to the partners which represent undrawn accumulations of a share of profits (generally the current account balances in favour of the partners) should be deducted in calculating the net assets.

2 Debts owing to outsiders

It is considered that a debt incurred by the partnership within six months preceding the date of transfer of partnership interest, and which has been used either directly or indirectly to reduce the capital contributed by partners, will not be a deductible debt in calculating the net assets.

Other Assets of a Partnership

The partnership funds, at the time of change of ownership of partnership interests, should reflect the market value of all assets of the partnership. Therefore, in ascertaining the quantum of partnership interest transferred, the market values of all assets, both tangible and intangible should be determined and those values should be used in the calculation of that quantum.

Goodwill of a Partnership

Determination of the goodwill of a partnership is dealt with in Circular No. 166 on "Valuations". It has been this Office's experience that goodwill is generally not shown in the balance sheet of a partnership. This reflects the practice suggested in the Australian Accounting Standard No 18 titled "Accounting for Goodwill". However, goodwill should be determined and its value aggregated with the values of other assets of the partnership for the determination of interest conveyed.

CHANGES OF PARTNERSHIP INTERESTS

Everett Type Interests

Discounting techniques will be used to value assignment of interests (Everett type). The maintainable future cash flow will be determined solely on the basis of the financial statements for the most recent year ended and the discount rate will be the long term Government bond rate plus a range of 10% - 20% on the date of assignment having regard to the circumstances of the case. The discounting will be over the period specified by the assignment. The same basis will be used where the instrument liable for duty is a statement lodged pursuant to Section 71E of the *Stamp Duties Act 1923*.

Changes Affecting a Partnership

Changes to a partnership generally occur as a result of the:

a) admission of a partner;

b) admission of a partner through the conveyance of an existing partner's total or partial interest in the partnership;

c) retirement of a capital partner;

d) change in the capital entitlements of a partner; or

e) change in profit sharing entitlements of a partner.

All dutiable instruments or statements pursuant to Section 71E which are lodged for assessment as a result of changes to a partnership should be accompanied by:

a) Balance sheets showing the assets immediately before and after the admission/retirement/change of interest;

b) Profit and loss statements and balance sheets for the three immediately preceding financial years; and

c) A copy of the partnership agreement.

In the case of Everett types of assignments, the instruments or statements should be accompanied by:

a) A balance sheet immediately prior to the assignment;

b) Profit and loss statements and balance sheets for the preceding financial year; and

c) A copy of the partnership agreement.

Some Examples

The following examples, while not exhaustive, illustrate the principles involved. All examples will relate to the following hypothetical partnership. The statement of affairs of a partnership just prior to the change in partnership interest is as follows:

A, B, C & Co

Assets	$ 35	
Liabilities	$(10)	
Net Assets		$ 25
Partnership Funds		
Capital A	$ 5	
Capital B	$ 10	
Capital C	$ 10	
Total Funds		$ 25

The profits (capital and income) of A, B, C & Co are shared by A, B and C in the ratio 1:2:2.

1 Admission of a Partner Who Brings Capital to the Partnership

A new partner D is admitted to the partnership on payment of $10 as capital to the partnership. Thereafter, D will be entitled to $^{2}/_{7}$ of capital and income profits.

Scenario 1 — The partnership has no goodwill.

From the partnership funds approach, the interest of A, B and C in the partnership funds, before and after the admission of D, remains the same ($25). Therefore, although there has been a change in the legal or equitable interest in the funds of the partnership on admission of D as partner, the property conveyed (that is the interest in the partnership funds), is of zero value. There will be no stamp duty liability. Notwithstanding this, a statement pursuant to Section 71E(3) of the *Stamp Duties Act 1923* is required to be lodged with Commissioner.

Scenario 2 — The partnership has goodwill of $10 and it is not shown in the balance sheet as an asset of the partnership.

A, B and C prior to the admission of D (who contributes $10 for $^2/_7$ interest), owned the entire goodwill of $10 and after the admission of D, are entitled to $^5/_7$ of that goodwill. Therefore, the property conveyed is $2.86 ($^2/_7$ of $10) on admission of D.

Stamp duty will be levied on this amount.

Scenario 3 — The incoming partner does not contribute tangible capital.

There have been instances where the incoming partner contributes a peppercorn amount to the assets of the partnership for an entitlement of both income and capital profits. One reason is that the new incoming partner brings in his/her expertise. Another reason (mainly in family partnerships) is the incoming partner happens to be a very close relative of the existing partners.

Where D brings in expertise of $9 and consequently contributes only $1 to partnership funds, the interest of A, B and C before and after the admission of D in the partnership funds, will remain the same once the value of expertise has been accounted for in the books of the firm. Thus there will be no stamp duty liability.

If D does not bring in any expertise, but only contributes a nominal $1 for $^2/_7$ for interest in income and capital, stamp duty will be charged on $6.43. This figure is arrived at by comparing A, B and C's interest in the partnership funds before the admission of D (ie. $25) to their interest in those funds after admission (ie. $^5/_7$ of $26).

2 Admission of a Partner Through the Conveyance of Existing Partner's Total or Partial Interest in the Partnership

An incoming partner D pays $10 to B for his or her interest in the partnership.

Scenario 1— The partnership has no goodwill.

Stamp duty will be levied on $10, the value of interest conveyed. Had D paid $15 for the interest, duty will be levied on $15.

Scenario 2 — The partnership has goodwill of $10 and it is not shown in the balance sheet as an asset of the partnership.

Stamp duty will be levied on $14 if D pays $10 to B for his/her interest in the partnership. This amount of $14 is the sum of the conveyance of the interest of B in the partnership fund of $10 and the conveyance of $^2/_5$ interest of B in the goodwill of the partnership.

3 Retirement of a Capital Partner

B retires by taking $10 from the partnership interest.

Scenario 1 — The partnership has no goodwill.

Since the interests of A and C (the remaining partners in the partnership fund before/after retirement of B) remain the same, the amount on which duty will be levied is zero. However, a statement pursuant to Section 71E(3) is required to be lodged.

Scenario 2 — The partnership has goodwill of $10 and it is not included the assets of the partnership.

Stamp duty in this instance will be charged on $4 being the conveyance of B's interest in the goodwill to A and C ($^2/_5$ of $10).

4 Change in the Capital Entitlements of a Partner

The partnership agreement is altered to entitle A to 25% of the assets in the event of dissolution and to 25% of profits.

Scenario 1 — The partnership has no goodwill.

The stamp duty will be levied on $1.25, being the conveyance on account of the dilution of B and C's interest in the partnership funds from $20 to $18.75 (being 75% of the partnership funds of $25).

Scenario 2 — The partnership has goodwill of $10 and it is not shown in the balance sheet as an asset of the partnership.

A further sum of $0.50 (being the difference between $^4/_5$ of $10 and $^3/_4$ of $10) will be added to the computed sum of $1.25.

5 Change in Profit Sharing Entitlements of a Partner

Scenario 1 — The partnership agreement is altered to enable A to have 25% of the future income. However, the capital profits and corpus on dissolution will be shared according to the capital accounts.

Stamp duty will be levied on the capital value of 5% of the future maintainable profits of the partnership (ie. increase in the entitlement from 20% to 25%).

PARTNERSHIPS THAT OWN REAL PROPERTY IN SOUTH AUSTRALIA

Partnerships which own real property will be treated differently. *In essence, stamp duty at conveyance or voluntary conveyance rates will be levied on the change in the registered proprietorship of land*. Consequently, unlike the net approach, there could be a stamp duty liability on the formation of partnerships.

Some Examples

a) X and Y are equal partners in a partnership; X contributes land of value of $100 as capital and Y contributes $100 cash as capital. Thereafter, the real property's title is altered to reflect X and Y. Duty on $50 will be levied on the transfer of a half interest in the land. This liability arises on the change in title only, had there been no change, no liability would arise.

The computation in relation to the admission of partners and retirement of partners to land owing partnerships will also differ. If, on the admission or retirement of a partner, the title of the real property is not varied, that property, any debt secured on it and the capital of the partner who has title to it, will be segregated from the other assets and liabilities. Calculations will be made on the remaining assets and liabilities on the basis of the principles stated.

b) The balance sheet of P, Q & R Co is as follows:

Assets			
Land (Title:P)		$ 100	
Other Assets		$ 250	
Total Assets			$350
Less Liability (secured on land)	$ 50		
Net Assets			$ 300
Partnership Funds			
Capital P		$ 100	
Capital Q		$ 100	
Capital R		$ 100	
Total			$ 300

For the purpose of determining the quantum of interests, (when the land title does not change) the balance sheet will have to be partitioned as follows;

Land Component

Land	$ 100	
less Liability secured on it	$ 50	
Net asset	$ 50	
Partnership Funds		
Capital P	$ 50	

Other Component

Other assets	$ 250	
Total Assets		$ 250

Partnership Funds

Capital P	$ 50
Capital Q	$ 100
Capital R	$ 100

Total	$ 250

Calculations for determining the quantum of interests will be made on the ‘Other Component’ balance sheet.

REAL LIFE SITUATION

This Office is aware that real life situations will be far more complex than the examples provided. For instance, after segregating land and its encumbrance the partnership funds could result in a negative amount. Such instances will be resolved on a case by case basis. This hybrid approach in relation to partnerships that own land is considered to be a fairer method both to the revenue base and the taxpayer than the ‘gross assets’ method.

FURTHER ENQUIRIES

Location

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