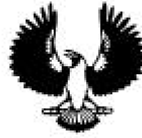
SOUTH AUSTRALIA



STATE TAXATION OFFICE

Stamp Duties **Circular No 86.**

CONVEYANCES AND TRANSACTIONS INVOLVING PARTNERSHIP INTERESTS

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BACKGROUND

Until some years ago the practice of the Stamp Duties Office had been to assess conveyances of partnership interests on a "net assets" basis. The practice in some other jurisdictions was to assess on a "gross assets" basis.

Subsequently 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 discussions have taken place between parties representing:-

- Australian Society of CPA's.
- The Institute of Chartered Accountants.
- The Law Society of South Australia.
- National Institute of Accountants.
- The Taxation Institute of Australia.
- Taxpayers Association of South Australia.
- State Taxation Office.

The following rulings reflects these discussions and representations and will be subject to re-evaluation at the end of a trial period.

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 a net basis (ie. proportionate portion of the gross assets of the partnership less the debts). Partnerships owning real property will be assessed on a gross basis. Examples 1 to 4 illustrate the techniques that will be employed.

Debts of a Partnership

The Debts of the partnership that could be deducted from the gross assets fall into two categories. First is the debts owing to the partners and the second is debts owing to outsiders. The deductibility of these debts from the gross assets depends on satisfying the following conditions.

Debts owing to the partners: Unless it can clearly be shown that any debts due to the partners are indeed bona fide debts, no allowance will be made for them. Evidence that the debt due to the partners does not form part of the capital is one of the more crucial items. Debts owing to the partners which represent undrawn accumulations of share of profit (generally the current account balances in favour of the partners) should be deducted in arriving at the net assets.

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Broadly the debts owing to the partners fall into the following four sub groups:-

a. Debts that are secured on the partnership assets at market rate interest.

b. Debts that are secured on the partnership assets at less than market rate interest.

c. Debts that are not secured but yield market rate interest.

d. Debts that are not secured and yield interest at less than the market rate.

Debts of the type described at a. above will be included in the deductible debts. Debts described in paragraphs b. and c. will require further evidence to satisfy the Commissioner that they are properly debts of the partnership and not part of the capital of the partnership. Debts of the description in paragraph d. will not be generally accepted unless the Commissioner is satisfied that they are indeed debts and again are not part of the capital.

Debts owing to outsiders: It is considered, that a debt incurred by the partnership within two years preceding the date of transfer of partnership interest, and which has been used either directly or indirectly to reduce the capital contributed by the partners will not be a deductible debt in arriving at the net assets.

Goodwill of a Partnership

Determination of the goodwill of a partnership is dealt with in the circular on "Valuations". (Circular No. 87).

Everett Type Interests

During the trial period 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 ten to twenty per cent 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

The usual changes to a partnership that are effected are:-

i) admission of a capital partner;

ii) retirement of a capital partner;

iii) change in the capital entitlements of a partner.

All dutiable instruments or statements pursuant to Section 71e should be accompanied by a balance sheet before and after the admission/retirement/change of interest and profit and loss statements and balance sheets for the three immediately preceding financial years together with partnership agreement. In the case of Everett type assignments, a balance sheet immediately prior to the assignment and balance sheets and profit and loss statements for the immediately preceding financial year should be provided.

A list of the related creditors of the partnership detailing the amount, the relationship, how the debt arose and the terms should also be provided. A copy of any partnership agreement should also be provided.

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The foregoing list of requirements is not exhaustive.

Examples

1. Profits (and the surplus/deficit in the event of dissolution) are not shared in accordance with capital contribution ratio.

The Balance sheet of a partnership just prior to a transfer of interest is as follows:-

	$		$
Capital A	5	Net Assets (Including Goodwill)	15
Capital B	10		
	15		15

The partnership agreement states that the profits and the surplus on dissolution are to be shared equally. C wishes to purchase A's interest in the partnership and become a partner under the same terms and conditions. Stamp duty will be charged on the consideration paid by C or one half of $15 whichever is greater.

If C purchases B's interest for $10, duty will be assessed on $10. [Consideration of $10 or one half of $15 whichever is greater].

2. Admission of a partner who contributes no capital.

The balance sheet of a partnership just prior to the admission of a partner is as follows:

	$		$
Capital A	10	Net Assets (Including Goodwill)	30
Capital B	10		
Capital C	10		
	30		30

The partnership agreement states that the profits and the surplus on dissolution are to be shared equally. D, (C's son/daughter) is admitted as a partner and contributes a nominal capital of $1. Thereafter he/she is entitled to 25 per cent of future profits and 25 percent of surplus on dissolution. The value of interest transferred will be $6.50 [one fourth of $30].

In certain instances the partnership agreement may provide that the ownership of the assets (or of certain assets) of the partnership remain vested on the original partners after the admission of a new partner.

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If the entire assets remain vested in the original partners it is considered that there is no conveyance of an interest in the business to the new partner. If only certain assets remain vested, the interest in the business conveyed will be limited to the residual assets. The value of interest transferred will be based on a proportion (residual assets/gross assets) of the net assets.

The dilution of goodwill (which is not reflected in the financial statements) of a business will be taken to be a conveyance of property. [Refer to example 4].

3. Treatment of overdrawn capital balances of a partner.

The financial statement at the relevant time is as follows:-

	$		$
Capital A	10	Net Assets (Including Goodwill)	10
Capital B	10		
Capital C	-10		
	10		10

C wishes to transfer his/her interest to D or to the existing partners. Presently he/she is entitled to one third share of profits and one third of the surplus on dissolution. C owes the partnership $10. Therefore the net assets of the partnership are $20.

Duty will be assessed on the consideration paid or one third of $20 whichever is higher.

4. Admission of a new partner who brings in his/her capital.

The financial position just prior to admission is as follows:

	$		$
Capital A	10	Net Assets (Without Goodwill)	30
Capital B	10		
Capital C	10		
	30		30

The partnership business between A, B and C has Goodwill of $20 and it is not reflected in the financial statements. It is proposed to admit a new partner D who will make a capital contribution of $10 and a further contribution of $5 for his/her share of Goodwill.

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The total assets of the partnership including Goodwill is $50. The admission of a new partner results in the conveyance of one forth of the assets to the incoming partner. Duty will be assessed on $15. [The greater of $15 or one fourth of $50].

If the partner contributes only $10, duty will be assessed on $12.50 [one fourth of $50 or $10]

5. Treatment of changes in profit sharing and surplus/deficit sharing ratios.

The financial statement of a partnership just prior to a contemplated change is as follows:

Capital A	$10	Net Assets (excluding goodwill)	$20
Capital B	$10		
	$20		$20

A and B are in a partnership business sharing profits and losses equally. They have also agreed to share this surplus/deficit equally. B wishes to work less hours and they agree to alter sharing ratios (both) to 60/40.

The change in the profit sharing ratio will not affect B's entitlement to the assets of the partnership business. Therefore it is considered that such a change will not result in the conveyance of interest in a partnership.

However the alteration of surplus/sharing ratio will result in the conveyance of business interest, namely the proportional part of the goodwill (which is not reflected in the financial statements) that changed hands.

6. Treatment of the retirement of a partner

A, B and C have traded in partnership for some years sharing profits and losses equally. They have also agreed to share the surplus/deficit on dissolution equally. B wishes to retire and agrees that he/she be paid $10 (the equivalent of his capital contribution). The financial position just prior to the retirement of B is as follows.

Capital A	$10		
Capital B	$10	Net Asset (excluding Goodwill)	$30
Capital C	$10		
	$30		$30

Under the gross approach, the withdrawal of cash will amount to conveyance of property of value of $6.66. However under the net basis approach the value of property conveyed will be nil.

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If the partnership had goodwill on the day of retirement and had it not been reflected in the accounts, B by accepting $10 only would have conveyed a third of the goodwill to A and C. A third of the goodwill will be assessed for stamp duty.

If the outgoing partner is to be compensated by a series of cash payments over a period, discounting techniques should be employed to quantify the present value of the compensation.

12 October, 1993

COMMISSIONER OF STAMPS

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