## QUESTION WE'VE BEEN ASKED QB 14/03

## GST – TRANSFER OF INTEREST IN A PARTNERSHIP

All legislative references are to the Goods and Services Tax Act 1985 unless otherwise stated.

This question we've been asked is about ss 2, 3, 5, 6, 8, 14, 51 and 57.

This item updates and replaces Question 108 published in *Public Information Bulletin* No 158, p 26 (November 1986) and an item entitled "GST Treatment of the Sale of an Interest in a Taxable Activity" published in *Public Information Bulletin* No 164, p 31 (August 1987). Both items deal with the GST treatment of the sale of an interest in a partnership. The current relevance of this information was identified during a review of content published in *Public Information Bulletins* and *Tax Information Bulletins* before 1996. The Public Information Bulletin review has now been completed, see "Update on Public Information Bulletin review" *Tax Information Bulletin* Vol 25, No 10 (November 2013).

This item covers the situation where an interest in a partnership is transferred from one partner to another, either new or existing, partner. It does not cover the situation where a new partner receives a partnership interest in return for a contribution to the partnership capital.

This item does not cover the GST consequences of a final dissolution of a partnership (including where a partnership is dissolved as the result of a partner acquiring all the interests of other partners).

### Question

1. Is a transfer of an interest in a partnership subject to GST?

### Answer

2. Most transfers of partnership interests will not be subject to GST as the supply will not be made by a registered person or, if the transferor is registered, will not be a supply made in the course or furtherance of a taxable activity carried on by the transferor.

3. A transfer will be subject to GST if the transferor is registered for GST and the transfer is a supply made in the course or furtherance of a taxable activity carried on by the transferor. In addition, the interest in the partnership must not be a "participatory security" or an "equity security". A transfer will be an exempt supply and, therefore, not subject to GST if the partnership interest is a "participatory security" or an "equity security".

4. Generally, a partnership interest will be a "participatory security" where entry into the partnership involves an investment of money (or money's worth), and where the partnership has more than five partners (or a manager (or person associated with the manager) who also manages another such arrangement).

5. A partnership interest will be an "equity security" where the partnership is a body corporate (for example, a limited partnership registered under s 51 of the Limited Partnerships Act 2008).

## Explanation

6. Section 8(1) imposes GST on supplies of goods and services made in New Zealand. "Supply" includes all forms of supply (s 5(1)) and "services" are defined as "anything which is not goods or money" (s 2).

7. To be subject to GST a supply must be made by a registered person in the course or furtherance of a taxable activity carried on by that person. A person is a "registered person" if they are registered, or liable to be registered, under the Act (s 2). A person's liability to be registered turns on the value of supplies they make, or expect to make, in New Zealand in a 12-month period (s 51).

8. A "taxable activity" is an activity carried on continuously or regularly by a person and which involves, or is intended to involve, the supply of goods or services (s 6(1)). An activity is not a taxable activity to the extent it involves making exempt supplies (s 6(3)(d)).

9. A partnership (which is not a limited partnership) is the "relation which subsists between persons carrying on a business in common with a view to profit" (s 4 of the Partnership Act 1908). That relationship gives rise to an unincorporated body of persons that does not have a legal personality separate from its members. For GST purposes, an "unincorporated body" in s 2 means "an unincorporated body of persons, including a partnership". An "unincorporated body of persons" is also a separate "person" for the purposes of the Act. Therefore, a partnership is a separate "person" for GST purposes.

10. A supply is not subject to GST if it is an exempt supply (s 8(1)). "Exempt supplies" include supplies of financial services (s 14(1)(a)). "Financial services" include the "issue, allotment or transfer of ownership of an equity security or a participatory security" (s 3(1)(d)).

### *Application of s 57*

11. Section 57(2) sets out some specific rules that apply when an unincorporated body carries on a taxable activity and is registered. Subsection (2)(e) says:

> Subject to subsections 3 to 3B, any change of members of that body shall have no effect for the purposes of this Act.

12. It has been suggested that this wording means that a supply of an interest in a partnership has no GST effect. That is not the Commissioner's view. The subsection refers to a change of members of a body. It is possible to have a transfer of a partnership interest without having a change of members. That will be the case when an existing partner transfers some, but not all, of their interest in a partnership to one or more of the other partners. In that case, the partnership interests have changed but the members of the partnership have not changed.

13. In the Commissioner's view, the reference to a change of members, rather than to changes of membership interests, indicates the intended scope of the provision. For GST purposes, a registered unincorporated body, including a partnership, is treated as continuing to be the same body despite a change of members. For example, if a partnership has 25 partners and two retire and one new partner joins, the change of members does not create a new unincorporated body for GST purposes. The partnership is treated as being the same registered person before and after the change of members. It is noted that a partnership that reduces to one partner (and, therefore, is no longer a partnership at general law) will also no longer be an "unincorporated body of persons" or a partnership for GST purposes.

14. Section 57(2) is still relevant to the transfer of an interest in a GST-registered partnership because:

- members of a partnership cannot register in relation to carrying on the taxable activity carried on by a GST-registered partnership (s 57(2)(a)),
- any supply made in the course of carrying on a partnership's taxable activity is treated as supplied by the partnership and not by the partners (s 57(2)(b)), and
- any supply made by a partner in their capacity as a partner is treated as made by the partnership and not the partner (s 57(2)(c)).

15. Accordingly, if the only taxable activity a person is involved in is that carried on by a partnership, the person cannot register for GST. If a partner carries on another taxable activity in their own right, the supplies made by the partnership cannot be counted to determine whether the partner is liable to register for GST in their own right.

16. Even where a partner in a GST registered partnership is registered for GST in their own right, because they carry on some other taxable activity, a supply by them of an interest in the partnership can be liable to GST only if the partner makes that supply in the course or furtherance of that other taxable activity (and it is not an exempt supply). That is, the partnership interest is held, and then transferred, in the course or furtherance of the taxable activity carried on by the partner. This could arise in situations where the taxpayer holds the partnership interest as part of a separate taxable activity carried on by that partner in their individual capacity. Alternatively, a partner could carry on a taxable activity of buying and selling partnership interests.

17. The supply made by the partner in such cases is of a partnership interest, which is a chose in action (and, therefore, a service). The supply is not the supply of a portion of the underlying assets held by the partnership. Consequently, the nature of the underlying assets does not affect the characterisation of the supply as exempt, standard-rated, or zero-rated. For example, the transfer of an interest in a land-owning partnership would not be zero-rated under s 11(1)(mb).

18. In summary, for a partner of a GST-registered partnership:

- the partner is not liable to register for GST for the activities of the partnership,
- any supplies made by the partnership do not count towards determining whether the partner has to register for GST in their own right, and
- if the partner is registered for GST in their own right, a transfer of an interest in a partnership will be subject to GST only if it is a supply made in the course or furtherance of a taxable activity carried on by the partner (ie, not the partnership taxable activity) and is not an exempt supply.

19. The two potentially relevant types of exempt supplies in the context of partnerships are "participatory securities" and "equity securities". These are considered below.

***Participatory security***

20. "Participatory security" is defined in s 3(2) as:

> … any interest or right to participate in any capital, assets, earnings, or other property of any person where that interest or right forms part of a contributory scheme (as defined in section

> 2 of the Securities Act 1978); … but does not include an equity security, a debt security, money, or a cheque:

21. The Commissioner's view is that an interest in a partnership is an "interest or right to participate in any capital, assets, earnings, or other property of any person".

22. A partnership interest will not be an "equity security" (unless the partnership is a body corporate, for example, a limited partnership registered under s 51 of the Limited Partnerships Act 2008). A partnership interest is not a "debt security" as it is not a right to be paid money that is, or is to be, owing by any person. Further, a partnership interest is neither "money", nor "cheques".

23. "Contributory scheme" is defined in s 2 of the Securities Act 1978 as:

> **Contributory scheme** means any scheme or arrangement that, in substance and irrespective of the form thereof, involves the investment of money in such circumstances that—
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> (a) the investor acquires or may acquire an interest in or right in respect of property; and
>
> (b) pursuant to the terms of investment that interest or right will or may be used or exercised in conjunction with any other interest in or right in respect of property acquired in like circumstances, whether at the same time or not;—
>
> but does not include such a scheme or arrangement if the number of investors therein does not exceed 5, and neither a manager of the scheme nor any associated person is a manager of any other such scheme or arrangement:

24. "Money" in s 2 of the Securities Act 1978 includes "money's worth".

25. The Commissioner's view is that a partnership interest will be a "contributory scheme" where it involves an "investment of money" and where the partnership meets the size threshold.

26. A partnership interest will involve an investment of money where partners lay out money (or money's worth) in the hope of return from the partnership (in the form of capital or income or both). The return could be in the form of cash, or in kind, such as the provision of services (see *Culverden Retirement Village v The Registrar of Companies* [1997] 1 NZLR 257 (PC)).

27. A partnership will meet the size threshold if it has greater than 5 partners or a manager of the arrangement (or an associated person) is a manager of another such arrangement.

### *Equity security*

28. An "equity security" is "any interest in or right to a share in the capital of a body corporate" (s 3(2)). Accordingly the supply of an interest in a partnership that is a body corporate is an exempt supply and not subject to GST.

29. A limited partnership, registered under s 51 of the Limited Partnerships Act 2008, "is a separate legal person" (ss 6 and 11 of the Limited Partnership Act 2008). A limited partnership is deemed to be a "company" for GST purposes (see s 2 of the GST Act), although it is not specifically deemed to be a body corporate. "Body corporate" is defined in *Butterworths New Zealand Law Dictionary* (LexisNexis, 2011) as "an association of persons regarded in law as a single legal person". This is also consistent with the definition of "body corporate" in the *Shorter Oxford English Dictionary* (6th ed). The Commissioner's view is, therefore, that a limited partnership is a "body corporate" for the purposes of the Act.

30. Whether an interest in a limited partnership established in a foreign jurisdiction is an "equity security" will depend on whether that limited partnership is treated under that foreign law as a body corporate.

## Examples

### Example 1 – New Partner Joins Partnership

31. Mary, Jane and Dave are equal partners in Sports Law, a GST-registered partnership. The partnership makes taxable supplies of around $500,000 per year. Jane carries on a part-time business as a personal trainer and makes supplies in that business of around $15,000 per year. Jane is not registered for GST. Dave owns a farm and is registered for GST for his farming activity. Mary is not registered for GST.

32. Bob, a senior employee of Sports Law, is invited to become an equal partner in the firm. Bob makes a cash payment to each of Mary, Jane and Dave. The effect of Bob joining the partnership is that Mary, Dave and Jane each transfer 1/4 of their interest in the partnership to Bob. That is a supply made by each of them. These supplies are not subject to GST because they are not supplies made by a registered person in the course or furtherance of a taxable activity.

33. Mary is not required to be personally registered for GST for the partnership's taxable activity. Although Jane carries on a taxable activity, as a personal trainer, the supplies she makes in that activity are under the registration threshold. The supplies made by the partnership are not taken into account in determining whether Jane has to register. Dave is registered for GST but the supply of the partnership interest is not a supply made in the course or furtherance of his taxable activity of farming.

### Example 2 – Sale of Partnership Interest and Separate Property

34. Robert, Helen and Bruce carry on practice as accountants through a GST-registered partnership. As senior partner, Robert has a 50% interest in the partnership. Robert also owns the building in which the partnership business is carried on. Robert is personally registered for GST for his taxable activity of renting out commercial buildings, including the building rented to the partnership.

35. Robert decides to retire and he agrees to sell his share in the partnership to Michelle. The sale agreement also includes the sale of the practice premises to Michelle.

36. The supply of the partnership interest from Robert to Michelle is not subject to GST. Although Robert is registered for GST, he does not make the supply of the partnership interest in the course or furtherance of his taxable activity (his rental activity). The supply of the building is subject to GST. The building is not a partnership asset. The building is Robert's separate property that he supplies to Michelle in the course of his taxable activity. As that is a supply of an interest in land, the correct GST treatment (ie, whether this supply is zero-rated) will depend on whether Michelle is registered, or liable to be registered, for GST and her intended use of the building.

### Example 3 – Partner Previously Carried on Partnership Activity

37. Simon bought a farm and registered for GST. After two years of farming Simon entered into partnership with two of his children, Fiona and Diane. The partnership registered for GST and Simon sold the farming business, including the land, to the partnership. This supply was zero-rated, as it included a supply of land. Simon did not deregister for GST because he had recently started a part-time pest control business.

38. After another two years, Simon's son Brian returned from overseas and asked to join the partnership. By this stage Simon had decided to expand his pest control business into a full-time activity and he agreed to sell his partnership interest to Brian.

39. The sale of the partnership interest by Simon to Brian is not subject to GST. It is not a supply made in the course or furtherance of a taxable activity carried on by Simon. Although Simon originally registered to carry on the taxable activity of farming the land that was subsequently farmed by the partnership, Simon is not carrying on that activity when he transfers the partnership interest to Brian. Simon carries on a taxable activity of pest control and the partnership interest is not supplied in the course or furtherance of that activity.

## References

**Subject references**
GST
Exempt supply
Partnership
Taxable activity
Taxable supply

**Legislative references**
Goods and Services Tax Act 1985, ss 2, 3, 5, 6, 8, 14, 51 and 57.
Limited Partnerships Act 2008, ss 6, 11 and 51.
Partnerships Act 1908, ss 4, 8 and 27.
Securities Act 1978, ss 2 and 2D.

**Cases**
*Braemar Lodge 2004 Limited (in receivership) v Owers* [2010] NZCA 300
*Culverden Retirement Village v The Registrar of Companies* [1997] 1 NZLR 257 (PC)
*Murray v Morel & Co Ltd* [2007] NZSC 27