



QUESTION WE'VE BEEN ASKED

QB 17/09

Is there a full or partial disposal when an asset is contributed to a partnership as a capital contribution?

This QWBA is about whether there is a full or partial disposal of an asset where a person contributes an asset to a general or limited partnership as a capital contribution. Where the asset disposed of is, for example, depreciable property or revenue account property the disposal may result in income or loss for the person who disposed of the asset. Whether there is a full or partial disposal is relevant to the amount of income or loss the person may have from contributing the asset to the partnership.

Key provision

Section HG 2 of the Income Tax Act 2007.

Question

1. Where a person owns an asset and contributes that asset to a partnership as a capital contribution, does the person dispose of:
 - the entire asset (**full disposal**); or
 - only part of the asset, because the person, in their capacity as a partner of the partnership, has an interest in the asset, under s HG 2, proportionate to the **person's partnership share (partial disposal)**?

Answer

2. There is a full disposal of the asset.
3. In summary, this is because:
 - Neither s HG 2 nor any other provision in the Act specifies or determines whether there is a full or partial disposal where a person contributes an asset to a partnership as a capital contribution. In the absence of any applicable provision in the Act, the answer is determined under partnership law and the general law.
 - Where a person contributes an asset to a general partnership, the legal ownership **of the asset and the person's interest in the asset fundamentally change**. Before disposal, the person is the sole owner of the asset. Following disposal, the asset **ceases to be the person's property**. The asset belongs to the partners of the partnership as joint owners and is partnership property. The person and their co-partners each have a beneficial interest in the whole of the asset, and the asset, as partnership property, must be used exclusively for the purposes of the partnership. There has been a disposal of the asset by its sole owner to joint owners.
 - Where a person contributes an asset to a limited partnership, the person has fully disposed of the asset to a separate legal person who has not held any previous interest in the asset.
4. This means, for example, that where the asset disposed of is either depreciable property or revenue account property (which includes trading stock) for the person, the person may have an amount of depreciation recovery income or depreciation loss, or income or loss, calculated on the basis that the person has fully disposed of the asset.

Explanation

5. Uncertainty exists about whether there is a full or partial disposal where a person contributes an asset, which is owned by the person, to a partnership as a capital contribution. The Commissioner has been asked to clarify her position on this question.
6. This item focuses on the income tax consequences for the person disposing of the asset to a partnership as a capital contribution.

Meaning of “partnership”

7. For the purposes of the Act, the term “partnership” is defined in s YA 1 to mean:
 - the relationship that subsists between a group of 2 or more persons who carry on a business in common with a view to profit (a general partnership);
 - a limited partnership registered under the Limited Partnerships Act 2008 (limited partnership);
 - a joint venture, if the venturers all choose to be treated as a partnership for the purposes of the Act and the Tax Administration Act 1994;
 - co-owners of property if the co-owners all choose to be treated as a partnership for the purposes of the Act and the Tax Administration Act 1994, provided the co-owners are not co-owners only because they are shareholders of the same company, or settlors, trustees, or beneficiaries of the same trust.
8. A listed limited partnership, which is an entity or group of persons that is listed on a recognised exchange, is a company, and not a partnership, for the purposes of the Act: s YA 1 definitions of “company” and “listed limited partnership”.
9. This item considers whether there has been a full or partial disposal where a person contributes an asset to a general partnership or limited partnership as a capital contribution. It is outside the scope of this item to consider the full or partial disposal question in relation to either joint venturers or the co-owners of property.

Taxation of partnerships under the Act

10. Sections HG 2 to HG 12 of the Act contain rules concerning the taxation of partnerships.
11. Section HG 2(1) provides that a partnership is transparent **and is “looked through” in accordance with a partner’s partnership share** – that is, for a particular right, obligation, or other property, status or thing, the share that a partner has in the partnership: s YA 1 definition of “partnership share”.
12. More specifically, s HG 2(1) provides that for the purposes of a partner’s liabilities and obligations under the Act, in their capacity as partner of a partnership, the partner is treated, unless the context requires otherwise, as:
 - carrying on an activity carried on by the partnership and having a status, intention and purpose of the partnership, and the partnership is treated as not carrying on the activity or having the status, intention, or purpose (s HG 2(1)(a)); and
 - holding property that a partnership holds, as being party to an arrangement to which the partnership is a party, and as doing a thing and being entitled to a thing **that the partnership does or is entitled to in proportion to the partner’s partnership share**, and the partnership is treated as not holding the property, being a party to the arrangement, and not doing the thing or being entitled to the thing (s HG 2(1)(b)–(d)).
13. It has been suggested that s HG 2(1) has the effect that where a person, in their non-partner capacity, disposes of an asset to a partnership as a capital contribution, the

person disposes of only part of the asset because following the disposal, the person, in their capacity as partner, is treated as holding the asset in proportion to their partnership share.

14. **The Commissioner's** view is that s HG 2(1) is not directly relevant to whether there is a full or partial disposal because:
- The rules in s HG 2(1) apply for the purposes of determining a partner's liabilities and obligations under the Act in their capacity as partner of a partnership.
 - The income tax consequences for a person disposing of an asset to a partnership as a capital contribution arise in the person's non-partner capacity (as transferor of the asset) and do not arise in the person's capacity as a partner of the partnership.
 - Any income tax consequences on the disposal cannot give rise to partnership income or loss because the partnership is acquiring, and not disposing of, the asset.
15. The Commissioner is aware that it has been suggested that the full disposal approach ignores the wording of s HG 2(1) and that the section can be interpreted as a broader statement of transparency that applies to a person in their non-partner capacity. The Commissioner considers:
- These views disregard the literal wording of s HG 2(1), which explicitly states that **the rules in s HG 2(1) apply to a partner "in their capacity of partner of a partnership"**. These words are unambiguous and explicitly provide that a person who is a partner of a partnership may have liabilities and obligations under the Act in both their partner and non-partner capacities.
 - The literal wording of s HG 2(1) does not state that there is no disposal of that part of the asset that is treated as being held by the partner that contributed the asset. And nor does it state that the part of the asset that is treated as being held **by the partner is to be disregarded in determining the partner's liabilities and obligations**, in their non-partner capacity, in relation to their disposal of the asset.
16. The Commissioner also notes s HG 2(1)(b) provides that the **"partner is treated as holding property that a partnership holds, in proportion to the partner's partnership share"**. The Commissioner considers that this look-through proportional holding of property rule applies only to **"partnership property"**, which requires at law (and logically) a transfer of all of the beneficial and / or legal interests in the property to the partnership. Under the partial disposal approach, however, it is said that only part of the asset is disposed of by the person contributing the asset to the partnership. In the **Commissioner's view**:
- It is not possible for 100% of an asset to be partnership property and subject to s HG 2(1)(b) if only part of the asset has been disposed of to the partnership.
 - The underlying logic of the partial disposal approach appears to be as follows:
 - there is a full disposal of the asset so that s HG 2(1)(b) applies to the entire asset, with the consequence that the partners are treated as holding the asset in proportion to their partnership shares; and
 - the view that s HG 2(1)(b) then has the effect of recharacterising the full disposal as a partial disposal (in that there is no disposal to the extent of the **contributor's partnership share** in the asset).
 - Section HG 2(1)(b), on its plain and ordinary meaning, does not have the effect of recharacterising a full disposal as a partial disposal.

17. The Commissioner considers that ss HG 3 to HG 12 are also not relevant to the question considered in this item. This is because ss HG 3 to HG 10 concern the disposal of a **partner's interest in a partnership and the disposal of property that a partner is treated as holding** and ss HG 11 and HG 12 contain rules that limit deductions by partners of limited partnerships.
18. Further, no provision in any other part of the Act specifically deals with whether there is a full or partial disposal where a person contributes an asset to a partnership as a **capital contribution. Although the word "dispose" is defined in s YA 1 of the Act for the purposes of specific sections, none of these sections are relevant to the full or partial disposal question. In the absence of any applicable provision or definition in the Act, it is the Commissioner's view that the answer must be determined under partnership law and general law.**

General partnerships

19. The Partnership Act 1908 applies to general partnerships.
20. A general partnership is an unincorporated body of persons. It has no separate legal personality of its own: *R v Holden* [1912] 1 KB 483; *Meyer & Co v Faber (No 2)* [1923] 2 Ch 421; and *Laws of New Zealand Partnership and Joint Ventures* (online ed) at [6]. Persons who have entered into partnership with one another are called collectively a **"firm"**: s 7 of the Partnership Act 1908. Every partner of a firm is liable jointly with the other partners of the firm for all debts and obligations of the partnership incurred while a partner: s 12 of the Partnership Act 1908.
21. Section 23 of the Partnership Act 1908 provides that **"partnership property" includes all property and rights and interests in property originally brought into the partnership stock or acquired on account of the partnership or for the purposes and in the course of the partnership business. This section provides further that partnership property must be held and applied by the partners exclusively for the purposes of the partnership and in accordance with the partnership agreement.**
22. Under partnership law, the following principles apply to partnership property:
 - A partner does not have title to specific partnership property but has a beneficial interest in the entirety of the partnership assets and in each and every particular asset of the partnership: *Hadlee v CIR* [1991] 3 NZLR 517 (CA) at 528; *Hadlee v CIR* [1993] 2 NZLR 385 (PC) at 388; and Lindley and Banks on Partnership (19th ed, Sweet & Maxwell, UK, 2010) at 19-08.
 - Subject to any express or implied agreement by the partners, all the partners of a general partnership have identical and equal interests in the partnership property: Lindley and Banks on Partnership (19th ed, Sweet & Maxwell, UK, 2010) at 19-04.
 - Legal title to partnership property may be held by one of the partners, some of the partners, or all of the partners. If the legal title to partnership property is vested in only some of the partners, they hold the relevant property as trustees for all of the partners: Lindley and Banks on Partnership (19th ed, Sweet & Maxwell, UK, 2010) at 19-07.
 - During the continuance of a partnership, the beneficial interest of a partner is in the nature of a future interest taking effect in possession on (and not before) the determination of the partnership (whether by a change in the membership or by general dissolution). This is because each partner is entitled to require the partnership property to be applied for the purposes of the partnership and no partner is entitled to use or enjoy their share of those assets to the exclusion of their co-partners: Lindley and Banks on Partnership (19th ed, Sweet & Maxwell, UK, 2010) at 19-08.

Limited partnerships

23. A limited partnership is a limited partnership registered under the Limited Partnerships Act 2008: s 6 of the Limited Partnerships Act 2008.
24. A limited partnership is a separate legal person: s 11 of the Limited Partnerships Act 2008.
25. A limited partnership must have at least one general partner and at least one limited partner, and a person may not be both a general partner and a limited partner of the same partnership: s 8 of the Limited Partnerships Act 2008.
26. Each general partner is jointly and severally liable with both the limited partnership and the other general partners for the unpaid debts and liabilities of the limited partnership: s 28 of the Limited Partnerships Act 2008. However, unless the partnership agreement provides otherwise, a general partner is liable for any debts or liabilities of the limited partnership only to the extent that the limited partnership cannot pay those debts or liabilities: s 28 of the Limited Partnerships Act 2008.
27. A limited partner who does not take part in the management of the limited partnership is not liable for the debts and liabilities of the limited partnership: s 31 of the Limited Partnerships Act 2008.

Nature of the capital of a partnership and of a capital contribution

28. The capital of a partnership has the following three attributes:
 - The capital of a partnership is the aggregate of the sums contributed by its members for the purpose of commencing and carrying on the partnership business and intended to be risked by the members in that business.
 - The capital of a partnership is not the same as its property: the capital is a sum fixed by the agreement of the partners, while the actual assets of the partnership vary from day to day and include everything belonging to the partnership and having any monetary value.
 - Once a person has introduced an asset into a partnership as a capital **contribution with an agreed 'capital' value in the partnership's books, the asset ceases to be the person's property and thereafter belongs to the partnership** and is partnership property. The person ceases to have any beneficial interest in the asset which is qualitatively different to that of his, her, or its, co-partners.

(See *CIR v Dormer* (1997) 18 NZTC 13,446 (HC) at 13,453; *Bieber v Teathers Ltd (in liquidation)* [2012] 2 BCLC 585 (Ch) at [76]; and *Lindley and Banks on Partnership* (19th ed, Sweet & Maxwell, UK, 2010) at 17-01, 17-02 and 18-37).

29. When an asset is contributed to a partnership as a capital contribution, its legal ownership and juristic character changes. Where the asset is contributed to a general partnership, the asset becomes property of the partnership and the partners become the joint legal owners of the whole asset.
30. This was explained by the English High Court in *Bieber v Teathers Ltd* in the context of contributions to general partnerships. Teathers was the promoter and managing partner of the Take 3 TV partnerships, which were commercially unsuccessful. Teathers had invited subscriptions from investors in an information memorandum and used the subscriptions to establish the partnerships. Investors claimed there had been a breach of trust by Teathers because it had not applied the subscriptions in accordance with criteria in the memorandum. The Court held there was a trust obligation, but the obligation had ended when the subscriptions were paid from a settlement account to the relevant partnership account. This was because the partnership deeds stated that the subscriptions were capital of the partnerships and on payment to the relevant

partnership account the subscriptions became capital of the partnership. The Court said at [76]:

Of course, real money moved. It moved from the HSBC settlement account to the relevant Barclays partnership account. When that happened the legal ownership and juristic character of the money changed. It ceased to belong to Teathers and became the property of the partners. As is stated in *Lindley & Banks on Partnership* (19th edn) at 17-02:

“... once a partner has brought in the asset and been credited with its agreed “capital” value in the firm’s books, the asset as such will cease to be his property and will thereafter belong to the firm ...”

It belonged to the firm not in the sense that each partner individually owned that little bit of the Barclays partnership account which represented his payment, but in the sense that they were joint owners of the whole (just as they were jointly and severally liable on the account). By “joint owners” I do not mean that they were beneficial joint tenants or tenants in common. **I mean that the partners together were joint legal owners and that each partner was entitled in equity to that floating and unascertainable share of the partnership property that would be determined only at dissolution.** The money ceased to be money held by Teathers under an irrevocable offer ... [and] became a partnership asset to be dealt with under the terms of the partnership deed and s 20 of the Partnership Act 1890 [a provision materially the same as s 23 of the Partnership Act 1908 (New Zealand)]. [Emphasis added]

31. In dismissing an appeal by Teathers, the English Court of Appeal agreed with the High Court that once the subscriptions had been paid into the relevant partnership account, the subscriptions belonged to the partnership and vested in the general partners as **joint legal owners**. Consequently, each investor’s beneficial ownership of his or her individual subscription ceased and was replaced with a right to participate in the profits of the partnership and in its net assets on dissolution: *Bieber v Teathers Ltd (in liquidation)* [2013] 1 BCLC 248 (CA) at [59].

Capital contributions to limited partnerships

32. The term “capital contribution” is defined in s 37 of the Limited Partnerships Act 2008. The definition provides that the capital contribution of a partner is the share of the assets contributed, or agreed to be contributed, by a partner to the limited partnership or assigned to a partner by another partner and may take any form and may be made on terms (if any) provided in the partnership agreement.
33. Section 38 of the Limited Partnerships Act 2008 provides that the partnership interest **of a partner is the partner’s share of the assets of the limited partnership, the partner’s right to receive distributions from the limited partnership, and the partner’s right to any other benefit conferred by the partnership agreement and includes any liability or other burden of the partner in relation to the limited partnership.** Since a limited partnership **is a separate legal person, a partner’s share** of the assets of a limited partnership is only a notional share because the assets are owned by the limited partnership: *Laws of New Zealand Limited Partnerships* (online ed) at [17].
34. **It is the Commissioner’s view that the answer to the question as to whether** there is a full or partial disposal where a person contributes an asset to a limited partnership as a capital contribution is that there is a full disposal of the asset. This is because the person contributing the asset and the limited partnership are each a separate legal person. Further, there is no continuity of interest because the limited partnership has not owned any previous interest in the asset.
35. The Commissioner considers that the decision of the Court of Appeal for British Columbia in *Edenvale Restoration Specialists Ltd v British Columbia* 2013 BCCA 85 supports her view. The issue in *Edenvale* concerned the amount of tax payable under the Social Service Tax Act, RSBC, 1996, on the purchase of property by a limited

partnership, which had paid the purchase price, in part, by issuing the vendor with units in the limited partnership representing 15% of the total units in the partnership. Under the Ontario Limited Partnership Act 1990 a limited partnership is not a separate legal person and the plaintiff contended, on the basis of *Seven Mile Dam Contractors v British Columbia* (1979) 104 DLR (3d) 274 (SC), which is discussed later in this item, that tax was payable on 85%, not 100%, of the transferred property. The Court rejected that contention and distinguished *Seven Mile*. The Court held that under the partnership agreement, and on the facts, that it was the general partner, a limited liability entity, that was the purchaser of the property. Consequently, the general partner, as purchaser, was required to pay tax on 100% of the purchase price of the property because it had not previously owned any interest in the property.

Alternative arguments

Common law principle that a person cannot dispose of property to themselves

36. Under common law, a person cannot convey or dispose of property to themselves or contract with themselves: *Rye v Rye* [1962] AC 496 (HL); *Ellis v Kerr* [1910] 1 Ch 529; *Napier v Williams* [1911] 1 Ch 361; *De Tastet v Shaw* (1818) 1 B & Ald 664.
37. It has been suggested that the general law principle that a person cannot dispose of property to themselves applies where a person contributes an asset to a general partnership, with the consequence that there is only a partial disposal of the asset to the partners who had no prior interest in the asset.
38. **It is the Commissioner's view that the potential application of this general law principle cannot arise in the context of the contribution of an asset to a limited partnership as a capital contribution.** This is because the disposal of the asset is from one separate legal person to another and, therefore, there is no disposal of property from a person to themselves.
39. **In the context of general partnerships, it is the Commissioner's view that this general law principle has no application because s 56 of the Property Law Act 2007 abrogates the general law principle that a person cannot dispose of property to themselves.** Section 56 of the Property Law Act 2007 provides that a person may dispose of an estate or interest in property to themselves, alone or jointly with some other person, and that such a disposition is enforceable in the same manner as a disposition to another person. The Property Law Act 2007 applies to property to the extent that the law of New Zealand applies to the property, unless a provision of the Property Law Act 2007 is inconsistent with a provision in another enactment, in which case the provision in the other enactment prevails: s 8(1), (2) and (4) of the Property Law Act 2007.
40. **For the purposes of the Property Law Act 2007, "disposition" includes any sale, transfer, exchange, or assignment, and includes the creation of any interest in property:** s 4 of the Property Law Act 2007. Where a person contributes an asset to a partnership as a capital contribution, the contribution is a valid and enforceable disposition. This is because there is a transfer of the asset from the person, as owner, to the partners, as joint owners and, further, because the contribution involves the creation of beneficial interests: s 56 of the Property Law Act 2007.
41. The Commissioner also notes, for completeness, that it is well-settled law that the principle that a person cannot dispose of property to themselves is in any event qualified for income tax purposes. For example, it is settled law that where a taxpayer transfers an asset from a (taxable) trading account to a (non-taxable) private account, or vice versa, the taxpayer is treated as disposing of, or acquiring, the asset for market value: *Sharkey (Inspector of Taxes) v Wernher* [1955] 3 All ER 493 (HL); *Bernard Elsey Pty Ltd v Commissioner of Taxation* (1969) 121 CLR 119 (HCA); *Case A27* (1974) 1 NZTC 60,245; and *CIR v Farmers' Trading Co Ltd* [1982] 1 NZLR 449 (CA).

The common law mutuality principle

42. The common law mutuality principle provides that a person cannot make a profit from trading with themselves. The application of the principle generally arises in the context of co-operative type associations, where both mutuality and transactions of a mutual character are present – that is, the collective dealing of the members of the association as a group and individual dealings of members with the group for their mutual benefit. **In the context of a group of persons, the essence of the principle “is an association of persons who have joined together not for trade or profit but to achieve through their mutual contributions a common end or benefit in which all members participate or are entitled to participate”.**
43. **The Commissioner’s view is that the mutuality principle has no application to the full or partial disposal question.** This is because:
- A partnership is the relation that subsists between persons carrying on business in common with a view to profit. Consequently, mutuality, which requires persons to associate not for trade or profit but for a common end or benefit, is not present in a partnership.
 - The contribution of an asset to a partnership as a capital contribution is not a mutual transaction because the contributor is not making the contribution in their capacity as a member of the partnership.

Rose, Neil, and Seven Mile

44. The Commissioner is aware of the view that *Rose v FCT* [1951] 84 CLR 118 (HCA), *Neil v Inland Revenue Commissioner (NZ)* (1967) 14 ATD 509 and *Seven Mile* support the partial disposal approach. However, the Commissioner considers, for the reasons mentioned below, that these cases are not determinative of the full or partial disposal issue in the New Zealand context.

Rose

45. In *Rose*, the High Court of Australia was concerned with ss 36(1) and 59(2) of the Australian Income Tax Assessment Act 1936–48 (ITAA 36) (which respectively applied **where a taxpayer “disposed of” trading stock and depreciable property**) and whether, for the purposes of those sections, there had been a full, a partial or no disposal of assets. The taxpayer had introduced, as a capital contribution, assets, including livestock, plant and machinery, of his existing grazing business to a general partnership, comprised of the taxpayer and his two sons. The Court at pg 123 expressed the issue as whether:
- the transmutation of the property in the assets from the sole property of the taxpayer to the co-ownership of him and his two sons as partners in equal shares involve[d] a disposal of the livestock and of the depreciable property for the purposes of [ss] 36(1) and 59(2) respectively.
46. The Court said that the resolution of the issue depended on the meaning of the **expression “disposed of” in each section. It considered that each section was directed at the disposal of the “entirety of ownership in the assets and not the conversion of single ownership into collective ownership” or the creation or transfer of an undivided share or fractional interest in the assets: *Rose* at 124.** The Court held that the investing of the property in the assets in the three partners did not involve a disposition of the assets within the meaning of ss 36(1) and 59(2) of the ITAA 36. This was because the taxpayer, as partner, retained an interest in the assets. Therefore, the taxpayer had not disposed of the entirety of the property in the assets.
47. **It is the Commissioner’s view that *Rose* does not assist in answering the question considered in this item.** This is because *Rose* is limited to its specific statutory context

and stands as authority only for the meaning of the words “disposed of” in ss 36(1) and 59(2) of the ITAA 36. Further, *Rose* contains no detailed analysis on the nature of the capital of a partnership or on how the ownership, juristic character, and a person’s interest in an asset will fundamentally change when a person introduces an asset to a partnership as a capital contribution.

Neil

48. The reasoning of *Rose* was applied in New Zealand in *Neil*, a case in which the taxpayer and his brother owned, in equal shares, livestock used in a farming business and where the taxpayer sold his half interest to his brother. The issue was whether the taxpayer had assessable income from the sale of his half-interest in the livestock under s 98(7) of the Land and Income Tax Act 1954, a section materially similar in wording to s 36(1) of the ITAA 36.
49. The Court considered that the reasoning in *Rose* applied because of the similarity of the material words in s 36(1) of the ITAA 36 and s 98(7) of the Land and Income Tax Act 1954, despite the fact that *Rose* concerned a disposal from single ownership into collective ownership and *Neil* concerned a disposal in the opposite direction. The Court held that s 98(7) of the Land and Income Tax Act 1954 did not apply because that **section applied to the disposal of only “trading stock” and not to a disposal of a share or an interest in trading stock.** The Court also considered that the amendment in 1966 of s 98(7) of the Land and Income Tax Act 1954 so that it applied to the disposal of a share or an interest in trading stock indicated that the section, as it stood at the time of **the taxpayer’s sale of his half-interest**, did not apply to a sale of a fractional share in trading stock.
50. The Commissioner considers that *Neil* does not assist in answering the full or partial disposal question considered in this item. This is because, firstly, since the taxpayer disposed of a half interest, the issue of whether there had been a full or partial disposal of the asset was not (and, on the facts, could not be) in issue. Secondly, like *Rose*, *Neil* is limited to its specific statutory context, which the Court held required a disposal of the whole asset for the provision in issue to apply. Thirdly, also like *Rose*, *Neil* contains no detailed analysis on the nature of the capital of a partnership or on how the ownership, juristic character, and a person’s interest in an asset all fundamentally change when a person introduces an asset to a partnership as a capital contribution. Fourthly, it did not involve the disposal of an asset to a partnership as a capital contribution.
51. For completeness, the Commissioner notes that it is her view that neither s EB 24 (the provision in the Act that corresponds to s 98(7) of the Land and Income Tax Act 1954 as amended) or s EE 2 of the Act are relevant to the question considered in this item. Although these provisions provide that the trading stock and depreciation rules apply to the disposal of a share or interest in trading stock or depreciable property that is co-owned, these sections do not answer or inform the question of whether there has been a full or partial disposal where an asset is contributed by a person to a partnership as a capital contribution.

Seven Mile

52. In *Seven Mile*, the Supreme Court of British Columbia held that there was a partial disposal, for the purposes of the Social Services Tax Act, RSBC, 1960, where a vendor general partnership had sold assets to a purchaser general partnership in which the vendor partnership held a 50% partnership share. On appeal, the Court of Appeal for British Columbia affirmed the decision of the Supreme Court: ***Seven Mile Dam Contractors v British Columbia*** (1980) 116 DLR (3d) 398.
53. The Commissioner acknowledges that *Seven Mile* could possibly be viewed as providing some support for the partial disposal view where an asset is contributed to a general

partnership. However, it is the Commissioner's view that *Seven Mile* provides no real assistance to resolving the full or partial disposal issue in a New Zealand context. This is because *Seven Mile*, like *Rose* and *Neil*, contains no detailed analysis on the nature of the capital of a partnership or on how the ownership, juristic character, and a person's interest in an asset all fundamentally change when a person introduces an asset to a partnership as a capital contribution.

Other considerations

54. It is the Commissioner's view that the full disposal approach produces outcomes that are sensible and workable, which is in contrast to the logical challenges and compliance issues that arise under the partial disposal approach.
55. The Commissioner observes that the partial disposal approach appears to give rise to an inherent inconsistency since, under this approach, only part of an asset is disposed of, but, nonetheless, the whole of the asset is treated as partnership property. It is difficult to understand how, on the one hand, the partners hold, as joint owners, 100% of the whole asset as partnership property when, on the other hand, the person has disposed of only part of the asset. If the person has not disposed of part of the asset (in the sense of creating beneficial interests in the asset), it would appear that the partners can have no joint beneficial ownership interest in that part of the asset that the person has not disposed of. The Commissioner notes that this inconsistency does not arise under the full disposal approach. Furthermore, the Commissioner notes that the partial disposal view is inconsistent with how partnerships actually, in practice, treat assets that have been contributed as capital contributions – that is to say, as having been fully disposed of to the partnership with the effect that the entire asset is treated as partnership property. This can lead to schematic issues in relation to how the rules in subpart HG in the Act are intended to work. For example, where the asset that is 'partially' contributed is revenue account property for the contributor and is held by the partnership on capital account and the partnership treats the entire asset as partnership property.
56. The Commissioner is also aware that the partial disposal approach can, in practice, give rise to non-compliance. This occurs where the contributor of the asset overlooks the obligation to account for tax on the part of the asset they have treated, for tax purposes, as being retained by them when the asset is subsequently disposed of by the partnership.

Conclusion – there is full disposal when an asset is contributed to a partnership as a capital contribution

57. It is the Commissioner's view that where a person owns an asset and contributes that asset to a general partnership or to a limited partnership as a capital contribution, there is a full disposal of the asset by the person to the partnership under partnership law and general law.
58. Where the asset is contributed to a general partnership, this is because:
- Neither s HG 2 nor any other provision in the Act applies to determine whether there is a full or partial disposal, so partnership law and the general law apply to determine the issue.
 - The legal ownership of the asset, its juristic character, and the person's interest in the asset, all fundamentally change.
 - Before disposal, the person is the owner of the asset.
 - Once the person has introduced an asset into a partnership as a capital contribution, the asset ceases to be the person's property. It belongs to the partners of the partnership and becomes partnership property.

- The asset belongs to the partnership - not in the sense that each partner individually owns a separately identifiable part of the asset, but in the sense that the partners are the joint owners of the whole asset.
- Following disposal, the person ceases to have any beneficial interest in the asset **that is qualitatively different to that of the person's co-partners**, and the asset must be used by the partners exclusively for the purposes of the partnership.
- A disposal of property by a person to themselves, alone or jointly, is valid and enforceable.
- There has been a disposal of the whole asset by its sole owner to joint owners.

59. Where the asset is contributed to a limited partnership, this is because:

- Neither s HG 2 nor any other provision in the Act applies to determine whether there is a full or partial disposal, so partnership law and the general law apply to determine the issue.
- There has been a disposal of the asset from one separate legal person, the person who owned the asset, to another separate legal person, the limited partnership.
- The limited partnership, as a separate legal person, has not held any interest in the asset before the disposal of the asset to it.

Example

The following example is included to assist in explaining the application of the law.

60. James has been carrying on business as an owner–driver for a logistics company. He purchased a truck for \$150,000, which he has been using in his business. His friend Fiona has identified a business opportunity in the logistics market, so she and James have formed a general partnership to carry on a logistics business. They have agreed that James will contribute his truck, which has a current market value of \$125,000 and a book value of \$100,000, as his capital contribution to the partnership, and Fiona will contribute \$125,000 in cash as her capital contribution to the partnership.
61. In the income tax year that James contributes his truck to the partnership, he will have depreciation recovery income of \$25,000 because he has fully disposed of his interest in the truck. James now owns the truck in partnership with Fiona, and the truck has ceased to be his property. As partnership property, the truck must be used for the business of the partnership.
62. If James and Fiona had established a limited partnership, instead of a general partnership, the same depreciation outcome would arise for James. This is because James would have fully disposed of the truck to the limited partnership, a separate legal person to James, and the limited partnership, as the new owner of the truck, would not have owned any previous interest in the truck.

References

Subject references

capital contribution of asset, partner,
partnership, limited partnership

Legislative references

Income Tax Act 2007, ss EB 24, EE 2, HG 2 – HG 12,
YA 1
Limited Partnership Act 2008, ss 6, 8, 11, 28, 31, 37,
38
Partnership Act 1908, ss 7, 8, 12, 23
Property Law Act 2008, ss 4, 8, 56

Case references

Bernard Elsey Pty Ltd v Commissioner of Taxation
(1969) 121 CLR 119 (HCA)
Bieber v Teathers Ltd (in liquidation) [2012]
2 BCLC 585 (Ch)
Bieber v Teathers Ltd (in liquidation) [2013]
1 BCLC 248 (CA)
Case A27 (1974) 1 NZTC 60,245
CIR v Farmers' Trading Co Ltd [1982] 1 NZLR 449 (CA)
CIR v Dormer (1997) 18 NZTC 13,446 (HC)
De Tastet v Shaw (1818) 1 B & Ald 664 (KB)
Edevale Restoration Specialists Ltd v British Columbia
2013 BCCA 85
Ellis v Kerr [1910] 1 Ch 529
*Federal Commissioner of Taxation v Australia Music
Traders Association* (1990) 94 ALR 407 (FCA)
Fletcher v Income Tax Commissioners [1971] 3 All ER
1185
Hadlee v CIR [1991] 3 NZLR 517 (CA)
Hadlee v CIR [1993] 2 NZLR 385 (PC)
Meyer & Co v Faber (No 2) [1923] 2 Ch 421
Napier v Williams [1911] 1 Ch 361
New Zealand Plumbers' Merchants Ltd v CIR (1986) 8
NZTC 5,136
Neil v Inland Revenue Commissioner (NZ) (1967) 14
ATD 509
R v Holden [1912] 1 KB 483
Rose v FCT [1951] 84 CLR 118 (HCA)
Rye v Rye [1962] AC 496 (HL)
Seven Mile Dam Contractors v British Columbia (1979)
104 DLR (3d) 274 (SC)
Seven Mile Dam Contractors v British Columbia (1980)
116 DLR (3d) 398 (CA)
Sharkey (Inspector of Taxes) v Wernher [1955] 3 All ER
493 (HL)

Other references

Bennion on Statutory Interpretation (6th ed, Lexis Nexis,
UK, 2013)
Burrows and Carter Statute Law in New Zealand (5th ed,
LexisNexis, New Zealand)
Laws of New Zealand Limited Partnership (online
edition)
Lindley and Banks on Partnership (19th ed, Sweet &
Maxwell, UK, 2010)