

Changes to Partnerships

It has been a year since the Government introduced the new legislation for partnerships. It clarified and amended some areas of the existing law on general partnerships and brought the new Limited Partnership Act 2008 (Act) into existence. The following is a brief discussion on the salient points of both.

General Partnerships

Prior to changes in the legislation, the tax rules governing this area were unclear, especially on the tax treatment of changes in a partnership that resulted from the exit and entry of the partners within it.

Some of the tax changes introduced include the following:

- Each partner is considered to conduct the partnership business in proportion to their share of the partnership, rather than the partnership conducting its own business at a partnership level.
- The new rules preclude the streaming of income to partners on a lower income since profit allocation is based on the partners' respective interest in the partnership.
- Partners will own their respective shares of the underlying assets and liabilities of the partnership. Previously, whenever a partner left or joined a partnership, the old partnership was deemed to be dissolved, bringing with it a myriad of tax issues to deal with such as depreciation recovery. There were varying treatments on the dissolution of a partnership because in practice, the partnership continued. With the new rule, the exiting partner now disposes of only his share in the partnership while the interests of the other partners are not affected.
- The exiting partner is required to account for any gain on disposal of his interest in partnership if he does not meet the safe-harbour threshold (see below).
- If the gain on disposal, as stated above, is less than \$50,000 then the exiting partner need not account for the income. The new partner acquiring the exiting partner's interest will be treated as assuming the exiting partner's position from the first day the exiting partner acquired his share of the partnership. Any income (or loss for that matter) is thereby excluded from the exiting partner's taxable income.
- There are certain exemptions relating to specific items (which have safe harbour thresholds) that are excluded from the calculation of the disposal of the exiting partner's interest in the partnership.

Please contact your advisor if you have specific queries.

Limited Partnership

The new Limited Partnership Act 2008 (the Act) came into force on 2 May 2008 to encourage foreign investment in New Zealand. Prior to its introduction, the law governing such investments of capital was covered by the "Special Partnership" law contained in the Partnerships Act 1908. Clearly, it was dated and therefore had shortcomings. The Act addresses those shortcomings by establishing a new regulatory and tax regime for Limited Partnerships and removing barriers to foreign investment capital in New Zealand's private equity industries.

Some of the features include the following:

- A Limited Partnership is a hybrid of a company and a partnership. It is recognised as a separate legal entity. Thus, it continues to exist indefinitely.
- It must have at least one general partner and one limited partner at all times, and they cannot be the same person. A partner can be a person, a partnership or a company. The partners can be associated, for example, a limited partner can be a shareholder of a general partner.
- A general partner is an agent for the Limited Partnership and is an active manager responsible for the day-to-day management of the partnership. The general partner is also liable for all debts and liabilities of the Limited Partnership.
- A limited partner is a passive investor who contributes capital to the Limited Partnership and is only liable to the extent of its capital contribution. The limited liability is retained only so long as the limited partner does not take part in the day-to-day management of the Limited Partnership. However, they can participate in what is referred to as the “safe harbour” activities (found in a schedule in the Act) such as key decisions on how the partnership is run.
- The administration of the Act is carried out by the Registrar of Companies which will keep a register of Limited Partnerships. All Limited Partnerships are required to register with the Companies Office at a cost of \$NZ270.00. The limited partner’s information is not available to the public and can not be searched or requested under the Official Information Act.
- There is no requirement to appoint an auditor and file accounts with the Companies Office thereby reducing compliance costs. Also, financial information is not revealed publicly.
- A Limited Partnership must have a written partnership agreement covering matters relating to distributions, assignment of interests, entry and exit of partners, etc.
- A Limited Partnership is not taxed as a whole but rather each partner is taxed individually at that partner’s personal tax rate. Gains or losses are attributed directly in accordance with pro-rata capital contributions. There is no requirement for partners to be New Zealand residents and overseas limited partners can be taxed in their own country.

Overdrawn Current Accounts

How so?

If a shareholder’s current account is overdrawn, it will attract either a fringe benefit if an employment relationship exists or a deemed dividend if a shareholding relationship exists. To avoid tax complications arising from both types, interest is often charged on overdrawn current accounts.

It has been common practice for a long while in private companies to pay salaries or dividends to the shareholder-employee at the end of the year in order to clear the shareholder’s overdrawn current account.

A shareholder salary is deemed to be paid on the first day of the income year for the purpose of calculating interest on the outstanding loan balance, if any, during the year.

Dividends, on the other hand, cannot be treated in the same manner as a shareholder salary i.e. dividend declared at the end of the year cannot be credited any earlier in order to avoid the interest charges on the shareholder loan account. Dividends will be applied on payment date and will reduce the loan balance on that date but interest will still be chargeable on the loan balance before the payment.

This issue has come to the fore with the recent changes in:

- The company tax rate from 33% to 30%, and
- The payment dates for provisional taxes.

Let’s assume that a company had cleared all its retained earnings by 31 March 2008 and had nil imputation credits as at 31 March 2008 in order to clarify the above issue. Therefore, only the provisional tax paid from 1 April 2008 is available to impute any dividends declared.

Although the company tax rate has reduced to 30%, any dividend declared by the company is subject to a further 3% RWT (Resident Withholding Tax) on actual payment of dividend. The 33% RWT rate has not changed.

This 3% RWT is required to be paid to the Inland Revenue Department on the 20th of the month following the dividend payment.

Clearly, if any payments made to the shareholders during the 2009 income year are to be treated as dividend payments, the company is required to pay the 3% RWT in the month following the dividend payments. If the RWT is not paid in time, there may be Inland Revenue Department penalties and interest.

Another factor that exacerbates the dividend issue for a standard income year is the payment date of the third provisional tax which is after 31 March. If a company has to declare all the earnings for the year as dividends to clear the shareholder’s current account, it will not be able to as it is limited to the amount of tax paid to 31 March 2009.

There are other factors to consider as well; for further details and advice, please contact your advisor.

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