

The Treatment of
Partnership Income and
Expenditure in South
African Income Tax law

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I hereby declare that I have read and understood the regulations governing the submission of the Postgraduate Diploma in Income Tax Law dissertations, including those relating to length and plagiarism, as contained in the rules of this University, and that this dissertation conforms to those regulations.

Table Of Contents

1. Introduction
2. Structure of a partnership
3. Types of partnerships
4. Partnerships in relation to Income Tax
 - i. Accrual
 - ii. Source
 - iii. Ownership of Partnership Property
 - iv. Deductions
 - v. Sale of the Right to Partnership Profits
 - vi. Sale of Goodwill
 - vii. Dissolution
 - viii. Insolvency of a partner or partnership
 - ix. New developments
5. Conclusion

1. Introduction

Partnerships are a popular structure used to carry on a trade. They provide several benefits such as the ability to raise increased capital through the contributions of a number of partners, the sharing of responsibilities and costs related to the enterprise, as well as an opportunity for the combination of knowledge and skills possessed by particular partners. These qualities are embodied in the fundamentals of a partnership as determined in *Joubert v Tarry & Co*¹, namely:

- Each partner must contribute to the partnership by way of money, labour or skill.
- The business must be executed for the joint benefit of all the partners.
- The objective of the partnership must be the generation of profits.
- A legitimate contract (known as the partnership agreement) must exist between the parties.

A partnership contract can be made orally, in writing or by tacit agreement². However a mere profit-sharing agreement is not enough to invoke a *bona fide* partnership,³ nor is the simple intention or agreement to enter into a partnership enough to create a partnership. It is necessary to put the actual intention/ agreement into effect. Section 82 places the burden of proving the existence of a partnership on the taxpayer; therefore it is sensible to document the partnership. This is best accomplished by creating evidence of the partnership e.g. drawing up the partnership agreement in writing⁴, opening a partnership bank account, creating separate books of account of the partnership, obtaining a trading licence and more of the like.⁵

¹ *Joubert v Tarry & Co* 1915 TPD 277

² Williams, 1996, pg.386

³ *ITC 1085* 1967 *Taxpayer* 55, 28 SATC 187.

⁴ De Koker, 1995, pg. 11 – 20

⁵ *ITC 248* 6 SATC 382; *Hoheisen v CIR* 5 SATC 207; *Naik v COT* 1959 (1) SA 724 (FC), 1959 *Taxpayer* 68, 22 SATC 97

2. Structure of a Partnership

“Partnership must be distinguished from an association or body of persons which in law constitutes a separate entity with perpetual succession and with no individual liability of the members in respect of its debts.”⁶

A partnership is not a separate legal entity⁷ and therefore all partners of an ordinary partnership are jointly and severally liable for the debts of the partnership. It is also for this reason that the individual partners are taxed separately from the partnership, each on their share of partnership profits or losses.⁸

Due to the fact that a partnership is not a separate legal entity, it would seem that no legal relationship can exist between a partner and the partnership (a person cannot sue himself). It has however been suggested, “that because the partnership consists of a body of persons acting in each other’s interests, that when a partner contracts with a partnership, he is not contracting with himself, but he is in fact contracting, to an extent, with his partners.”⁹ It is the Commissioner’s practice to treat a partnership like a separate entity, where partners receive salaries or let premises to the partnership or the like. The Commissioner taxes the partner on his receipts from the business and allows the partnership to claim those expense amounts as deductions. The true legal basis regards the underlying transaction as merely being a predetermined sharing of the partnership’s profits or losses.¹⁰

Each partner acts as an agent of the partnership, but his relationship with the partnership is made more complex by the fact that he is simultaneously also a principal

⁶ Meyerowitz, 2003-2004, pg. 16 – 26; *ITC 227 6 SATC 234*

⁷ *R v Levy* 1929 AD 312; *Muller en Andere v Pienaar* 1968 (3) SA 195 (A).

⁸ Huxham & Haupt, 2005, pg.176

⁹ Huxham & Haupt, 2005, pg. 177

¹⁰ Meyerowitz, 2003-2004, pg.16 – 30f

of the partnership. As a principal, a partner loses the ability to be an employee of the partnership.¹¹

Partnerships generally contain between two and twenty partners.¹² Twenty being the maximum number of partners permitted due to the limitation set out in s30 of the Companies Act No.61 of 1974.

A partnership does not have unlimited continuity. It will continue to exist only until it is dissolved due to the expiry of the agreed period of existence (if such agreement exists), the retirement of a partner, the partners' agreement, or a partner's death or insolvency.¹³

¹¹ Huxham & Haupt, 2005, pg.177

¹² Bamford, 1982, pg.3

¹³ Meyerowitz, 2003-2004, pg.16 – 25

3. Types of Partnerships

There are two different types of partnerships legally recognized, namely an ordinary partnership and then also an extraordinary partnership or limited partnership. Extraordinary partnerships can then be separated into anonymous partnerships and *en commandite* partnerships.

Ordinary partnerships are the most common form of partnership, wherein all the partners are held jointly and severally liable for any obligation arising from the actions of any partner acting within his capacity as an agent of the partnership.¹⁴

Limited partnerships offer a degree of protection to limited partners, by placing a limit on the extent of their liability. Section 24H(1) defines a 'limited partner' as 'any member of a partnership *en commandite*, an anonymous partnership or any similar partnership, if such member's liability towards a creditor of the partnership is limited to the amount which he has contributed or undertaken to contribute to the partnership or is in any other way limited'. The crux of s24H lies in subsection 3, which constrains allowances and deductions claimable by a limited partner. Limited partners can only claim amounts up to the sum of the amount they are liable for or their contribution and any income received or accrued by them from the partnership.¹⁵ Any allowance disallowed under the above mentioned section may be carried forward for deduction in the next year of assessment, per s24H(4).

An **anonymous partnership** allows for a partner to share in the profits and losses of the enterprise without him disclosing his identity and actively participating in the business.¹⁶

¹⁴Huxham & Haupt, 2005,pg.176

¹⁵ Section24H(3)

¹⁶ Huxham & Haupt, 2005, pg.176

“The anonymous partner is liable to the disclosed partners for his full share of the partnership debts incurred by them”.¹⁷

***En Commandite* partnerships** are similar to anonymous partnerships, since both options have undisclosed partners with limited liability. The sleeping partner in an *en commandite* partnership contributes a fixed sum to the partnership in order to receive a share of the profits. His liability is limited to the amount of his capital contribution.¹⁸

Another form of partnership, albeit in a different sense, is the **family partnership**. “Business ventures carried on by members of a family are frequently in the form of a partnership”.¹⁹ Where the partnership is between parent and child or between spouses, certain income tax advantages may arise through the ability to split their income.²⁰ It was accepted in ITC 551²¹ and ITC 642²² that a parent and a minor child may legally be in partnership together²³. Section 7(3), which may deem a minor child’s income to be that of its parent, does not apply in a bona fide partnership between parent and child. Where the partnership is between spouses, s7(2) is precluded from deeming income of one spouse to be that of the other spouse, provided the profit share is not excessive. Where the split leaves one spouse with an unreasonably large share, the superfluous amount may be taxed in the hands of the second spouse.²⁴

¹⁷ Meyerowitz, 2003-2004, pg. 16 – 28

¹⁸ Meyerowitz, 2003-2004, pg.16 - 28

¹⁹ Huxham & Haupt, 2005, pg.178

²⁰ Williams, 1996, pg.398

²¹ ITC 551 13 SATC 204

²² ITC 642 15 SATC 238

²³ Meyerowitz, 2003-2004, pg.16 – 25

²⁴ Huxham & Haupt, 2005, pg .178

4. Partnerships in relation to Income Tax

The Income Tax Act defines a ‘taxpayer’ as “any person chargeable with any tax leviable under this Act and includes every person required by this Act to furnish any return.” A partnership does not fall into this definition, nor is it specifically included by the Act’s definition of a ‘person’. It is also not a distinct legal *persona*²⁵, therefore each partner is individually liable for tax;²⁶ the partnership itself (not being a taxable entity) is not held liable. Due to the above-mentioned characteristics, a partnership can be perceived as a conduit through which each partner’s income flows to him. As a conduit, the partnership does not affect the type of income that flows through it. Amounts received as interest, dividends, etc will retain their characteristics and therefore receive any distinctive treatment as a result of their being interest, dividend, etc income.²⁷

While partnerships are not included in the definition of a ‘person’ in terms of the Income Tax Act, they are however incorporated in the VAT Act’s definition of ‘person’. They are however given vendor-status (separate from the partners), regardless of the fact that they do not have a separate legal *persona*. This ensures that the partnership is left unaffected in terms of its vendor-status, should there be a change in the constitution of the partners that make up the enterprise.²⁸

Section 66(15) demands the partnership produce a joint return in respect of the partnership business, as well as any other information that may occasionally be required by Revenue, and holds each partner “separately and individually liable for the rendering of the joint return.” It is however the South African Revenue Services’ practice to accept

²⁵ Williams, 1996, pg.386

²⁶ Section 77(7)

²⁷ Williams, 1996, pg.387

²⁸ Huxham & Haupt, 2005, pg.181

a copy of the financial statements showing the partnership's total income for the tax year in place of a joint return.²⁹

Where a partner joins an existing business and is to share in the profits made prior to the conclusion of the partnership agreement, the original owner continues to be liable for tax on the full amount up to the date that the partnership agreement is concluded.³⁰ Even though a partnership agreement can be entered into retrospectively³¹, this will not however affect the above stated precedent. In order for the original owner to escape sole tax liability, he would have to prove that a partnership existed at the time the profits were made and that the conclusion of the partnership agreement merely confirmed that fact.³²

When calculating the partners' taxable income, it is the Commissioner's practice to first establish the partnership's taxable income, treating it as if it had a separate legal identity, and then to apportion that amount between the partners according to their agreed profit-sharing ratio. Each partner then pays tax on his share of the partnership income in addition to any additional income earned from other sources, less any rebates or deductions available to him. If the partnership is exposed as having made an assessed loss, each partner can set-off any income arising from another source against his portion (as settled in the partnership agreement) of the loss.³³

“Partners are taxed on their profits, irrespective of their drawings”.³⁴

Another practice of the Commissioner is treating each partner as a third party in any transactions he may have with the partnership, as set out in the partnership agreement.

²⁹De Koker, 1995, pg. 11 – 2

³⁰De Koker, 1995, pg. 11 – 6; ITC 536 (1942) 13 SATC 100

³¹Williams, 1996, pg. 386

³²ITC 551 (1943) 13 SATC 204

³³De Koker, 1995, pg. 11 – 3

³⁴Huxham & Haupt, 2005, pg. 180

An example may be partners receiving salaries, rental income or interest on loans from the business. These amounts will be deductible in the calculation of the partnership's taxable income, but will be included in the receiving partner's separate income calculation.³⁵ In *COT v Newfield*³⁶, a Rhodesian case, the court held that where a partnership paid a partner a salary as compensation for services rendered to the partnership in terms of the partnership agreement, this was not a capital receipt in the form of a loan on capital account, but was instead a receipt representing gross income in the hands of the partner. The Commissioner's treatment therefore clashes with the general principle of law that a partnership is not a separate legal entity.³⁷

As a result of the Commissioner's occasional, calculated oversight of the fact that a partnership is not (in law) a separate legal entity, confusion arises in some court cases dealing with partnerships. *ITC 1583*³⁸ is a perfect example of such an occasion. The facts of the case that the taxpayer, a partner in a law firm, had a credit in his capital account at the partnership, while his wife owed a sum of money on the family home. The taxpayer used his credit at the partnership to pay off his wife's home loan. Prior to this transaction taking place, the wife had already applied for a similar amount in credit from the bank. This amount was later used to replace the amount taken from the capital account in the partnership. The taxpayer claimed to have lent the amount from his wife in order to make a loan to the partnership. The Commissioner refused to allow a deduction for the interest paid by the taxpayer on the re-advance to the business. Conradie J agreed with the Commissioner's assessment, reasoning that the rearrangement of finances did not have any effect on the "*partnership's* income earning capacity".[Own emphasis] It has been suggested that Conradie J identified the wrong party as the income producer. The income producer should have been the taxpayer. Booysen J³⁹ said that he had trouble agreeing with the Conradie J's conclusion in *ITC 1583*. He was of the opinion that replacing the old capital taken with new borrowed

³⁵ De Koker, 1995, pg. 11 – 2

³⁶ *COT v Newfield* 1970 (3) SA 422 (RAD), 32 SATC 157

³⁷ De Koker, 1995, 11 – 2

³⁸ *ITC 1583* 57 SATC 58, 1997 *Taxpayer* 11

³⁹ *CIR v Smith* 60 SATC 397

capital did have an impact on the partnership's income earning capacity, as else the partnership would have had to find capital elsewhere.⁴⁰

A similar case, to the one above, is *ITC 1603*⁴¹. One major difference between the cases is that the partnership agreement in *ITC 1603* stated that the capital amount contributed would not be permanently fixed within the partnership and would be repaid if and when the means to do it was available. The time came that the partnership was able to repay the partners' capital amounts, even though it was foreseeable that the same amount would again be required by the partnership in the near future. The taxpayer, a partner, therefore withdrew his capital and used it to repay his bond. Within days the taxpayer organized a loan from the bank, for essentially the same amount as he had just withdrawn, which he paid over to the partnership, which credited his capital account. Galgut J came to a different conclusion from that of Conradie J in *ITC 1583*, remarking that, "where a taxpayer requires capital to finance his income earning operations, it is entirely up to him to choose the source from which he derives such capital." Although there are differences in the facts of the case, the real difference seems to be of a judicial nature. *ITC 1603* was confirmed on appeal in *CIR v Smith*.⁴²

More recently there was another case⁴³ where the taxpayer used money from his capital account to repay his bond and then promptly took out another loan, against his bond account, for the same amount as he had just repaid and deposited it into his capital account. In this case the court found that in substance there had been no withdrawal of capital and then also no repayment thereof. Similarly in substance the bond account was still financing the partner's home. This decision differs from both of the above decisions and does not even hint at an answer to the question in the above cases, as to whether or

⁴⁰ Emslie, Davis, Hutton & Olivier, 2001, pg. 500

⁴¹ *ITC 1603* 58 SATC 212, 1997 *Taxpayer 13*

⁴² Emslie, Davis, Hutton & Olivier, 2001, pg.501

⁴³ Case 10448, Judgement of the Transvaal Income Tax Special Court delivered by Van Dijkhorst J, President, on 22 July 1999

not the interest payable on the bond is in the production of income, as required for a s11(a) deduction.⁴⁴

4(i). Accrual

Gross income is taxed at the earlier of receipt or accrual of the amount.⁴⁵ It was held in the *People Stores*⁴⁶ case that an amount accrues to the taxpayer when he becomes entitled to that amount.⁴⁷ Later, in *Mooi v SIR*⁴⁸, the “entitled to principle” was expanded, requiring the taxpayer to be *unconditionally* entitled to the amount. The value of an accrual shall be the face value of the amount to be received. The taxpayer is therefore not permitted to discount the amount to its present value.⁴⁹

In the case of a partnership, accrual becomes slightly more complex as a result of a partnership not being a separate legal entity. This was evidenced in the case of *Sacks v CIR*⁵⁰, the facts of which involved a change in the partnership agreement prior to dissolution, which provided for the payment of a lump sum to any outgoing partner in respect of his portion of the profits earned by the partnership during the period of assessment until the date of dissolution. The arrangement was made for administrative reasons, such as escaping the need to prepare a balance sheet and doing a stocktake. Had the accounts been prepared as at the date of the partner’s retirement, the outgoing partner’s profit share would have been considerably larger than the amount of the lump sum he received. The court held that any amount that accrued to the partnership (i.e. the partners in common) only accrued to the individual partners in their profit-sharing ratio at the end of the period established in the partnership agreement, when account of the profits would be taken. This view contrasted Revenue’s claim that each partner became

⁴⁴ Davis, 2002, pg.228f

⁴⁵ Huxham & Haupt, 2005, pg.12

⁴⁶ *CIR v People Stores (Walvis Bay) (Pty) Ltd* 1990 (2) SA 353 (A), 52 SATC 9, 1990 *Taxpayer* 70

⁴⁷ Emslie, Davis, Hutton & Olivier, 2001, pg.30

⁴⁸ *Mooi v SIR* (1972 AD), 34 SATC 1

⁴⁹ Huxham & Haupt, 2005, pg.13f

⁵⁰ *Sacks v CIR* 1946 AD 31, 13 SATC 343

entitled to his share of any partnership accrual on the day that it accrued to the partnership⁵¹. Years later, in *ITC 751*⁵², the court did not refer to the *Sack's* case and the judgment sided with the Commissioner. Still later in another tax court decision⁵³, the court followed the precedent set in the *Sack's* case and decided against the Commissioner.⁵⁴

Legislature finally ended the confusion by including s24H in the Income Tax Act.⁵⁵ Section 24H(5) is particularly relevant to the accrual concept in relation to partnerships.

Section 24H(5)(a) provides that where any income was received by or accrued to the partners in common, a portion (determined with respect to the profit- or loss-sharing ratio arranged by the partners) of that income will generally be deemed to be received by or have accrued to each partner individually on the date it was received by or accrued to the partnership. By virtue of s24H(5)(b) each partner will be allowed to claim a proportionate share of any deductions related to expenditure incurred by the partnership or any allowances as a result of carrying on a trade⁵⁶. All partners even limited partners, of a partnership that is carrying on a trade or business, are deemed to be carrying on that trade or business by s24H(2).

The implementation of section 24H(5) is also a preventative measure against partnerships being used as tax avoidance mechanisms. Under the *Sacks* principle partners had the possibility of postponing income from accruing to them⁵⁷ as well as the freedom to manipulate their profit-share percentages, provided all partners agree, before the end of the period of account.⁵⁸

⁵¹ Meyerowitz, 2003-2004, pg.16 – 27

⁵² *ITC 751* (1952) 18 SATC 416

⁵³ *ITC 1042* (1964) 26 SATC 189

⁵⁴ De Koker, 1995, pg.11 – 7f

⁵⁵ De Koker, 1995, pg.11 – 8

⁵⁶ Meyerowitz, 2003-2004, pg. 16 – 27

⁵⁷ Williams, 1996, pg.389

⁵⁸ De Koker, 1995, pg.11 – 6

Previously SARS permitted partnerships or professionals, whose business had an accounting period that differed from the tax period of an individuals, to submit their business income reports at a date other than the end of February in terms of section 66(13)*ter*. Section 66(13)*ter* was recently replaced by section 66(13A), which now merely allows a “partnership of individuals” to apply to the Commissioner for consent to draw up the financial accounts for a period ending on a day other than the last day of February. Interpretation note 19 of 5 August 2003 contains the circumstances under which the Commissioner will grant permission to the partners to prepare the partnership financial statements to any day other than the last day of February.⁵⁹

4(ii) Source

South Africa has moved from using source only as a tax basis (prior to 2001) to its current position of applying a combination of residency and source as a tax basis (post 2001). Source remains important, particularly in respect of the determination of non-residents taxable income and in the application of double tax treaties.⁶⁰

Although ‘source’ is not a defined term in the Income Tax Act, it is held to be the origin whence the income came from. Despite the bounty of case law dealing with ‘source’, it is often still difficult to determine, as each case differs and the principles are not always easy to apply to a given situation. Watermeyer CJ expressed, what was to become the key test of source, in the *Lever Brothers*⁶¹ case:

“...the source of receipts, received as income, is not the quarter whence they come, but the originating cause of their being received as income...”

⁵⁹ Huxham & Haupt, 2005,pg.179

⁶⁰ Huxham & Haupt, 2005, pg.15

⁶¹ *CIR v Lever Brothers and Unilever Ltd* (1946 AD) 14 SATC 1

There are therefore two things that must be identified regarding source. The first is the originating cause and the second is the location of the originating cause.⁶²

With respect to partnerships, some controversy arises in determining where the source of the each partners' share of income is derived. The leading case, *CIR v Epstein*,⁶³ dealing with the source of partnership income contained the following facts: The taxpayer was working as an agent in South Africa, in partnership with Argentinean dealers in the purchase and sale of asbestos. The taxpayer purchased the asbestos in South Africa on instruction of his Argentinean partners, in his own name. The dealers would subsequently have their clients open a letter of credit for the taxpayer from which he would draw the full sales amount, as quoted to the client. He then deducted the cost price and split the profit with the Argentinean dealers, sending them their share. The taxpayer therefore did not provide any services nor did he spend any money outside of South Africa.

The majority judgment held that the 'originating cause' of each partners' share of profits was the services that the partner rendered to the partnership. Centlivres CJ made his judgment based on Watermeyer CJ's findings in the *Lever Brothers* case, namely in order to determine the source of income, one must first find the 'originating cause' of the income being received. Watermeyer CJ went on to define an 'originating cause' as the work the taxpayer did in order to earn the income. As the taxpayer neither exerted himself nor employed capital outside the Union, Centlivres CJ deduced that the source of the taxpayer's income must have been from within the Union, where he did his work. The determination of source is therefore "primarily concerned with the partner and not the partnership." In the case of a limited partner, the 'originating cause' would be the employment of his capital.⁶⁴

⁶² Huxham & Haupt, 2005, pg.16

⁶³ *CIR v Epstein* 1954 (3) SA 689 (A), 19 SATC 221, 1954 *Taxpayer* 147

⁶⁴ Meyerowitz, 2003-2004, pg.7 – 17

In his dissenting judgment, Schreiner JA argued, that since a partner is an agent of the partnership, “the taxpayer’s income is not where he personally exerts himself, [...], but where the business profits are realized. Schreiner JA continued by saying: “The transactions in both countries were the transactions of both partners and the income which each received originated in the same place”.

It is submitted that section 24H(2), expressed above, seems to support the conclusion of Schreiner JA as the subsection implies that the partnership and its activities should be seen as a separate from the individual partners, who are then deemed to carry on the partnership’s business. This becomes even clearer when assuming that the partnership had been a company, as all the company’s income would be from the same source. It therefore seems strange that when the exact same business is carried on in partnership the source of the profits is split depending on the location of each partner’s activities.⁶⁵

4.(iii) Ownership of Partnership Property

Due to the fact that a partnership is not a separate legal entity, it is unable to own any property in its own capacity. Instead partners hold any property jointly as co-owners. Property given to the partnership cannot be held by the individual partners in their own capacity.⁶⁶ Capital allowances (like wear-and-tear or initial allowances) attributable to the partnership assets are apportioned between the partners in a ratio as stipulated in the partnership agreement⁶⁷. Any related recoupments are incorporated in the partners’ income in the same proportion as that of the capital allowances⁶⁸.

Where a partner purchases an asset for use in the partnership business, he has the choice not to include the item in partnership property and merely ‘borrow’ it to the

⁶⁵ Emslie, Davis, Hutton & Olivier, 2001, pg.123

⁶⁶ Huxham & Haupt, 2005,s pg.177

⁶⁷ Williams, 1996, pg.390

⁶⁸ De Koker, 1995, pg. 11 – 10

partnership therefore retaining full ownership. In this case that partner alone would be entitled to the deduction of the full capital allowance from his portion of the partnership profits.⁶⁹

Moveable property is transferred from the ownership of the individual to the partners as a whole, through an operation of law (*constitutum possessorium*) which is equivalent to a change in ownership as a consequence of a contractual change of intention evidenced by the partner offering his asset to the partnership⁷⁰. Immoveable property can only be transferred to the partnership by formally signing over and registering it in the name of the partnership. Intangible property requires the asset to be transferred through cession.⁷¹

Difficulties may arise, if a sole trader brings into his existing business a second person (forming a partnership). On entering the business the new person may purchase his share of the existing assets from the original trader and a credit of the purchased amount would be made to the current account of the original trader. It would seem there was a disposal of a portion of the property. The question now is whether there would be a recoupment for any part of the allowances the sole trader claimed in full. Similar problems would arise should an existing partnership admit a new partner on the same terms as mentioned above. The test to be applied is determining whether there is an accrual or not. If the answer is in the affirmative, then assets that previously received capital allowances shall have a recoupment.⁷²

Where the partnership property contains debts due and an incoming partner purchases a share of these debts, he will not be entitled to claim a share of the bad debts allowance (s11(i)) when any of that debt goes bad. Section 11(i) contains a proviso, necessitating any debt amount to have currently or previously been included in income, prior to the

⁶⁹ De Koker, 1995, pg. 11 – 10

⁷⁰ *Berman v Brest and Another* 1934 WLD 135

⁷¹ Huxham & Haupt, 2005, pg. 177

⁷² De Koker, 1995, 11 – 11

bad debts allowance becoming claimable. As a result, none of the debt purchased would previously have been included in the buyer's income. The remaining partners will also not be at liberty to claim the full allowance, as the full debt was not due to them either. The same problem would arise if the remaining partners chose to purchase the outgoing partner's interest.⁷³

4.(iv) Deductions

Once 'income' has been determined, the following step is to subtract all amounts claimable under the Act in the form of tax deductions. There are two forms of deductions claimable. Firstly amounts falling within the realm of section 11(a), the general deduction formula, read with section 23; and secondly any specific deductions, which are largely located in sections 11 through to section 19.⁷⁴

As previously mentioned, deductions accrue in the same manner as income does, as both are guided by section 24H(5). Therefore as revenue accrues to each partner in his given proportion as it accrues to the partnership, so does any deduction or allowance established by the Act become available to each taxpayer in their profit-share percentage. The "expenditure-incurring rule" differs from its opposite equivalent, the "revenue-accrual rule", in that it does not specifically "apply notwithstanding anything to the contrary in law or in the partnership agreement"⁷⁵. Also previously indicated, limited partners are restricted in their deductions, only being able to claim a maximum amount of the sum of their contribution to the partnership or their possible liability to creditors of the partnership; and any income they receive or accrue from that business⁷⁶.

⁷³ De Koker, 1995, pg. 11 – 12

⁷⁴ Huxham & Haupt, 2005, pg.63

⁷⁵ De Koker, 1995, pg. 11 – 9

⁷⁶ Meyerowitz, 2003-2004, pg.16 – 28f

Only partnership expenses which are covered by the Act in respect of deductions may be claimed by a partner. This means that where a partner does not pay his part of the losses and another partner is obligated to pay that amount to the creditors, as partners are jointly liable, the partner forced to pay out is unable to claim any deduction on the additional amount paid out, as that is considered to be a capital and not a revenue loss. It is considered capital, because the extra amount paid is as a result of partnership law and not the production of income.⁷⁷ It is much the same in the case of a partner overdrawing funds from the partnership and then defaulting on the repayment of the amount. The remaining partners will not be allowed to deduct the irrecoverable amount.⁷⁸

There are several deductions in the Income Tax Act that relate specifically to partnerships:

Section 11(i) has been previously referred to under 4(iii), Ownership of Property. It states that where any debt due to the taxpayer goes bad in the year of assessment, the amount can only be deducted if it was previously included as income in the taxpayer's current or in any previous year of assessment. This section becomes particularly relevant in terms of a partnership, where a first or new partner joins the business and purchases a portion of the debt. Should the debt then go bad, he will be unable to make use of the s11(i) deduction, as the amount was never (previously or currently) included in the taxpayer's income. Similarly when a partner leaves the partnership, the remaining partners will be unable to claim a deduction under s11(i) for the full amount of the bad debt, as a portion of the debt was never due to them.⁷⁹

Annuities paid to former partners or their dependants are deductible under **section 11(m)(ii)** and **section 11(m)(iii)** respectively.

⁷⁷ Meyerowitz, 2003-2004, pg.16 – 32; *ITC 328 8 SATC 258*

⁷⁸ Meyerowitz, 2003-2004, pg.16 – 32; *ITC 371 9 SATC 315*

⁷⁹ De Koker, 1995, pg. 11 – 12

Section 11(m)(ii) allows a former partner's annuity to be claimed, provided that partner was a partner for a minimum of five years, his retirement was due to "old age, ill health or infirmity" and that the amount of the annuity is reasonable when considering the services provided by that partner and the profits achieved by the partnership prior to his retirement. The section expressly forbids the deduction, where the amount is due in respect of the partner's interest in the partnership. Where all these conditions are met, the Act does not limit the deduction⁸⁰.

A deduction of the annuity paid to dependants of a former partner is allowed under section 11(m)(iii) where the person is dependant on a former partner for his maintenance or was dependant on a former partner directly prior to the former partner's death. This section does however impose a maximum limit on the amount of the annuity of R2500 per former partner in each year of assessment, regardless of the number of dependants.⁸¹

While **section 11(w)** only refers to an allowance being given in respect of premiums paid on life assurance policies taken out on the lives of employees or company director, it is the Commissioner's custom to give the partnership a deduction, if it pays the premiums on the partner's individual life policies, which are for the benefit of the partners themselves. The amount deducted from the partnership income will however be included in the taxable income of the partner⁸². Partners cannot be employees at the same time as they are partners⁸³. Where partners take out a joint life policy that is expected to provide liquid funds on the death of a partner, this is generally done to allow for the payment of goodwill to the estate of the deceased partner. The amount paid is capital and therefore not deductible.⁸⁴

⁸⁰ Williams, 1996, pg.388

⁸¹ Williams, 1996, pg.388

⁸² Huxham & Haupt, 2005, pg. 181

⁸³ Huxham & Haupt, 2005, pg. 177

⁸⁴ De Koker, 1995, pg.11 – 4

If an employee of a partnership, who is a member of a pension fund and becomes a partner, is allowed to maintain his pension fund membership on becoming a partner as per the proviso to **paragraph (c)(ii)(ee) of section 1**'s definition of 'pension fund', provided his contributions to the fund are limited to 7.5% of the salary he received during the 12 months prior to him becoming a partner. He is therefore able to claim under s11(k) an amount equal to his pension fund contributions as do not exceed the greater of R1750 or 7.5% of his salary for the 12 months before to he became a partner. In the case of an employee becoming a partner and retaining his membership to a pension fund, 'retirement-funding employment' is limited to his portion of the partnership profits that do not exceed his pensionable income in the 12 month period preceding his becoming a partner.⁸⁵

Section 11(I) allows deductions to be made of any amount an employer contributes for the benefit of his employees to a pension, provident and/or benefit fund, provided: Where a lumpsum is paid, the Commissioner can choose to allow the deduction in annual installments or where the contribution per employee is greater than 10% of that employee's approved remuneration, the Commissioner can deem the amount to be excessive and limit the deduction to 10% of the employee's approved remuneration for the year. What is significant to a partnership, is that s11(I)(iv) deems the partnership to be the employer (i.e. treats it as a separate legal entity). Effectively the subsection ensures that only one deduction is allowed per partnership, as without the provision each partner would be an employer, in law, and that the deduction is then split among the partners in their profit-sharing ratio.⁸⁶

⁸⁵ Huxham & Haupt, 2005, pg.181

⁸⁶ Huxham & Haupt, 2005, pg.104f

4(v). Sale of the Right to Partnership Profits

A partner, who sells his right to profits earned by the partnership, will still be subject to taxation where it becomes evident that from the sales agreement, that he was merely disposing of his income after it had accrued to him⁸⁷. Since income accrues to the partner in his capacity as a partner, as the it is earned by the partnership (provided by s24H(5)), he will generally be liable for tax on his portion of the partnership income accrued, despite the fact that he is contractually obligated to pass that income on to the purchaser of the right⁸⁸. The purchaser will probably also be taxed on the amount, as it would be considered income (earned from a capital asset: the right). The effect would therefore be that the same amount is taxed twice, but each time by a different person. “The seller of the right is liable to tax on the basis that he is receiving the income in the capacity of a partner in the firm. The recipient of the right is liable to the tax on the income by virtue of his contractual rights under the cession.”⁸⁹

In *FCT v Everett*⁹⁰, a case decided by the High Court of Australia, a partner assigned his wife a certain portion of his partnership income. The court allowed this and determined that only the wife was liable for tax on her share of the income (i.e. the partner was not taxed twice). This has “income- splitting stratagem” has not yet been tried in a South African court. It is generally accepted that income received for services rendered accrues to the assignor before it can be assigned to another. Only income derived from property can be assigned before accruing to the assignor. Therefore it can be argued that a partner’s share of partnership income is a result of his right as a partner (derived from property) and is not compensation for his labour.⁹¹ In my opinion, attempting the same strategy in South Africa would require a degree of caution, as the

⁸⁷ Williams, 1996, pg. 391; *ITC 350* (1936) 9 SATC 69

⁸⁸ De Koker, 1995, pg. 11 – 12; *ITC 350* (1936) 9 SATC 69

⁸⁹ De Koker, 1995, pg. 11 – 12

⁹⁰ Williams, 1996, pg. 391; *FCT v Everett* (1980) 10 ATR 608

⁹¹ Williams, 1996, pg. 391

Commissioner could possibly invoke the anti-avoidance paragraph, section 103(1), depending on the facts.

4(vi). Sale of Goodwill

In the *Cadac Engineering*⁹² case, goodwill was defined as including “whatever adds value to a business by reason of situation, name and reputation, connection, introduction to old consumers and agreed absence from competition”.⁹³

Transactions relating to the purchase and sale of goodwill are generally of a capital nature, consequently the amount paid for the goodwill is on capital account for both parties and neither will be taxed on it. The seller will not include the amount in his ‘gross income’ and the purchaser will not be allowed a s11(a) deduction of the purchase price. Both *ITC 140*⁹⁴ and *ITC 1073*⁹⁵, it was decided that goodwill was a capital asset, which is closer associated with the income-earning structure of the business than it is with the income-earning operations⁹⁶. There are however several occasions when the buying and selling of goodwill may attract tax, for example when goodwill is used as a trade good in a scheme of profit-making, when the underlying transaction is payment of a premium for the right to use an asset, when it is under a *fideicommissum* or lastly when it is sold to one of the remaining partners.⁹⁷

Even if goodwill is sold and payment is received through a series of installments, instead of a lump sum, goodwill will retain its capital quality, provided the price is a

⁹² *SIR v Cadac Engineering Works (Pty) Ltd* 1965 (2) SA 511 (A), 27 SATC 61 at 75

⁹³ De Koker, 1995, pg.11 – 13f; *SIR v Cadac Engineering Works (Pty) Ltd* 1965 (2) SA 511 (A), 27 SATC 61 at 75 confirming Lord

Lindley’s definition in *Inland Revenue Commissioners v Muller and Co’s Margerine LTD* [1901] AC 217 at 235

⁹⁴ *ITC 140* (1929) 4 SATC 215 at 218 per G J Maritz KC

⁹⁵ *ITC 1073* (1965) 27 SATC 199

⁹⁶ De Koker, 1995, pg.11 – 13f

⁹⁷ Williams, 1996, pg.392

fixed capital sum. Both the tax effect on the buyer and on the seller therefore remains unchanged, regardless of whether the purchase price is settled by lump sum or in installments. There are also no different tax consequences affecting the parties, relating to the method of calculating the installment amount, provided the purchase price is set at a fixed amount. Installments can be arrived by dividing the amount over a period of time or with reference to the entity's turnover prior to its sale.⁹⁸ Any related interest will of course be revenue in nature though.⁹⁹

If an annuity is given as payment for the goodwill, the annuity will be included in full in the seller's gross income. Annuities are included in gross income by virtue of paragraph (a) of the 'gross income' definition. This does not change the position of the buyer though, as he will still be purchasing a capital asset and therefore will not be entitled to a deduction.¹⁰⁰ It would seem that even if no fixed purchase price was determined, the buyer would not be entitled to a deduction, as the amount could be viewed as a 'recurring capital payment'¹⁰¹.

As in the above situation, a seller will be required to include all purchase payments in his gross income, when he receives a share of the partnership's profits in return for his goodwill, and the purchaser will again not be able to claim a deduction of the amounts paid.¹⁰² The seller can be compared to having exchanged his goodwill for the right to earn profits and therefore all profits received are the 'fruit' that the capital asset bears, which is revenue in nature¹⁰³.

⁹⁸ De Koker, 1995, pg.11 – 14

⁹⁹ Williams, 1996, pg.392

¹⁰⁰ De Koker, 1995, pg.11 – 14f

¹⁰¹ De Koker, 1995, pg.11 – 15; *ITC 98 (1927) 3 SATC 247*

¹⁰² Williams, 1996, pg.392

¹⁰³ De Koker, 1995, pg.11 – 16

4(vii). Dissolution

Dissolution of a partnership may occur for several reasons, such as a decision to stop trading, the death or retirement of a partner, as well as when a new partner is permitted to join the partnership¹⁰⁴ or when a partner becomes insolvent¹⁰⁵. Where a partner does not effectively retire but merely withdraws from playing an active part in the partnership, allowing the other partners to continue managing the business, it does not automatically indicate that the partnership has ceased to be¹⁰⁶.

At the time of dissolution, the partnership accounts will generally be prepared for the period up to that date. Taxable income will then be determined by taking into consideration every partner's amount of profit or loss for the period up to dissolution date.

Where the partnership agreement has provided for the remaining partners of a firm to compensate the outgoing partner for his share in the business, problems relating to accruals and allowed deductions pertaining to profits up until and after the date of dissolution often accompany these clauses¹⁰⁷. "The question arises, on the one hand whether the outgoing partner is taxable on the share that he receives, and on the other hand whether the remaining partners are taxable on the share paid to the outgoing partner."¹⁰⁸

Where dissolution is due to a partner leaving the partnership, the Commissioner will be entitled to assess the outgoing partner on the full amount of profits accruing to him prior to dissolution, regardless of how he chooses to dispose of his right to receive profits.

¹⁰⁴ Williams, 1996, pg.392

¹⁰⁵ Meyerowitz, 2003-2004, pg.16 – 36

¹⁰⁶ Williams, 1996, pg.392; *ITC 634* (1947) 15 SATC 114

¹⁰⁷ Meyerowitz, 2003-2004, pg.16 – 32

¹⁰⁸ Meyerowitz, 2003-2004pg.16 – 33

This was the foundation for the courts findings in *ITC 104*¹⁰⁹, where a partner paid a lump sum to the outgoing partner in return for that partner's share of the proceeds earned prior to dissolution and the court held that although the outgoing partner received the lump sum in lieu of his profit share, he was still liable for tax on his portion of profits earned by the partnership up to the date of dissolution.

This above position must be distinguished from the situation where an outgoing partner sells his right to share in the partnership profits up until the time of dissolution, as the amount he will then receive will generally be of a capital nature.¹¹⁰ Where the outgoing partner sells his right to share in profits, it is not guaranteed that the amount will be capital in his hands. One must look at the substance of the transaction, which may be that he has transformed his capital asset into an annuity-like right to income that is taxable.¹¹¹ The amount will be capital in nature in the hands of the remaining partners, regardless of whether it was calculated as "equivalent to a share of profits over a period" or whether it is based on "fluctuating profits of the business over a period". This is evidenced in the case, *IRC v Ledgard*¹¹², where the remaining partners paid an amount equal to half the deceased partner's share of profits for the three years post his passing away, as would have accrued to him had he still been a partner. The court felt that the amount paid was a lumpsum, payable after three years and that it was not deductible, due to its capital nature.¹¹³

The *Sacks* case, mentioned previously, set the precedent in the situation where partners agree prior to dissolution that the profit-share ratio will be changed when a partner leaves the partnership, in the sense that the outgoing partner will receive a lump sum which is not necessarily the same as the amount he would receive if he were receiving his originally agreed share of the profits. In this scenario, the court held that the outgoing partner was liable on the amount of the lumpsum and not on the amount that his profit-

¹⁰⁹ *ITC 104* (1927) 3 SATC 331

¹¹⁰ De Koker, 1995, pg.11 – 17

¹¹¹ Meyerowitz, 2003-2004, pg.16 – 35

¹¹² *IRC v Ledgard* [1937] 2 All ER 492, 21 TC 129

¹¹³ Meyerowitz, 2003-2004, pg.16 – 33

share would have been. The partner paying over the lumpsum would be liable on the amount of his share and the newly purchased share of profits up to the dissolution date less the amount of the lump sum. Hence this situation does differ from a partner purchasing an outgoing partner's share of the profits earned up to his date of retirement, where no arrangement therefore is made prior to dissolution. In that case, the outgoing partner would always be held liable for the amount of his profit-share and not the lumpsum.¹¹⁴ With the introduction of s24H¹¹⁵ the tax treatment of the two different circumstances would no longer differ in kind. In both cases the outgoing partner would be taxed on his profit-share amount and no variation in the profit-share ratio, as it occurred in the *Sacks* case, would affect the amounts already accrued to the outgoing partner.¹¹⁶ It is therefore clear that any agreement relating to the dissolution of a partnership, which has the effect of altering the partner's profit-share ratio from the ratio agreed upon while the business is operating and thereby entitling the outgoing partner to an amount that is less than the amount he is deemed to accrue under s24H(5)(a), does no more than provide for a disposal of income earned and hence is unable to influence the outgoing partner's tax liability. Where he is to receive a greater amount than that deemed, he will have a capital accrual and similarly where the actual receipt is smaller than the deemed amount a capital loss will arise.¹¹⁷

On the death of a partner certain complexities may arise, as affected parties try to give substance to the deceased's wishes in respect of his estate.

The facts in the case, *Van der Merwe v SBI*¹¹⁸, were that the taxpayer was a partner in an architect practice. The partnership agreement provided that on the death of a partner his widow or his nominated beneficiary in terms of his will would be entitled to continue drawing profits from the partnership, as would have accrued to the late partner. These drawings would take the form of the full share the deceased would have drawn in the

¹¹⁴De Koker, 1995, pg.11 – 18f

¹¹⁵ Section 24H(5)(a)

¹¹⁶ Williams, 1996, pg.393

¹¹⁷ Meyerowitz, 2003-2004, pg.16 – 33

¹¹⁸ *Van der Merwe v SBI* 1977 (1) SA 462 (A), 39 SATC 1, 1977 *Taxpayer* 87

first year, half thereof in the second year and in the third (and final) year, the widow or beneficiary would only receive one-third of the amount. These drawings were compensation paid by the partnership for any goodwill associated with the deceased partner's name or any uncompleted business at the time of his death. In this case, the taxpayer was one of two remaining partners after the death of a third partner. The taxpayer did not include in his income any of the profit amounts distributed to the late partner's widow. The Secretary however added half the amounts given to the widow in the taxpayer's income. The court sided with the Secretary, dismissing the taxpayers arguments that the amounts paid were not the purchase price of the late partner's share of the business but embodied the deceased's profits on liquidation or that on death of the third partner, the remaining partners received the deceased partner's share of the partnership subject to a *fideicommissum* in respect of that share of the profits, which was only received by the taxpayer in a representative capacity on behalf of the widow. In the making of the court's decision, the fact that the widow was not in terms of the partnership agreement required to participate in the sharing of any losses, as well as the fact that the profits the widow was to receive probably did include income relating to new contracts taken on and completed after the death of the partner, all counted against the arguments of the taxpayer.

The *Van der Merwe* case is therefore testament of the difficulty in the construction of a partnership agreement, where the partnership is one that is concerned with the provision of services (particularly professional partnerships where fees are not allowed to be shared for ethical reasons related to the profession), that allows the remaining partners on retirement or death of a partner to avoid taxation on the amount given in respect of the outgoing partner's share of the partnership. The only options that may help prevent taxation of the remaining partners, is the possible incorporation of the business prior to dissolution or where the partner retires, he does not withdraw from the partnership, but remains an inactive partner or where the partner dies, his estate continues to participate in the partnership.¹¹⁹

¹¹⁹ Meyerowitz, 2003-2004, pg. 16 – 35

The retirement of a partner from actively partaking in the partnership trade is not conclusive evidence of the extinction of the partnership. *ITC 634*¹²⁰ provides support for this statement, as in that case one of the partners withdrew himself from active participation in the business, leaving the other partner to manage and control the enterprise. The inactive partner then received a reduced share of the partnership's profits. The court held that without evidence of dissolution, the partnership continued to exist, regardless of the retreating partner's lesser role in the business.¹²¹ A similar case¹²², with a different outcome, entailed a senior partner retiring, but still receiving a given amount per year from the partnership. From the facts, it was obvious that the amount he received was compensation for the many years of hard work he had put into the partnership's business. The remaining partners wished to deduct the amount paid, but the court held that the expenditure was not in the production of income nor did it have a trade purpose and therefore the deduction was not allowed. The court also held that the old partnership had in actual effect ceased to exist and that the agreement was not a mere change of the profit-sharing ratio. Currently the amount would have been deductible under s11(m), mentioned above.¹²³

In *Holley v CIR*¹²⁴, the taxpayer received his share of the partnership by inheritance, when his uncle passed away. His inheritance was subject to certain conditions set out by his uncle, such as the payment of an annuity to his uncle's widow, his brother and his sister. The amount payable to the widow consisted of a fixed portion and a profit-based portion, while the annuities payable to his siblings were calculated with reference to profits, provided these were higher than a given minimum. His brother and sister would receive additional fixed amounts on the death of his uncle's widow. There was a further stipulation in the will, stating that if the taxpayer sold the immoveable property he had received, within three years of his uncle's death, the proceeds of the sale would be held

¹²⁰ *ITC 634* (1947) 15 SATC 114

¹²¹ De Koker, 1995, pg. 11 – 19f

¹²² *ITC 965* (1962) 24 SATC 713

¹²³ De Koker, 1995, pg.11 – 20

¹²⁴ *Holley v CIR* 1947 (3) SA 119 (A), 14 SATC 407

in trust, wherefrom the widow would receive her annuity and on her death the balance would be split among the taxpayer and his siblings. The Commissioner taxed the amount paid as an annuity to the widow. The court decided that the testator had actually intended to impose a *fideicommissum* in favour of his widow and that the taxpayer was acting as fiduciary and therefore not personally liable for tax on that amount.

A *fideicommissum* can only be created in respect of income or profits that are made from a business where items are being sold. It is not legally possible to create a *fideicommissum* over profits or income received for the fiduciary's personal labour (i.e. provision of a service), as in the case of *Van der Merwe*.¹²⁵

The partnership agreement does not always make provision for the remaining partners to procure the outgoing partner's stake in the business. The partnership will therefore have to be liquidated. Any profit amounts that accrue to the dissolved partnership during its liquidation period, will still simultaneously accrue to the partners of the dissolved partnership in their usual profit-sharing ratio. During the winding up process the partnership continues as always and all partners share in any profits or losses that arise as a result of the partnership business preceding the dissolution.¹²⁶

4(viii). Insolvency of a Partner or Partnership

In the case of a partner going insolvent, it brings about the dissolution of the partnership. The related tax effects are the same as in the case of any other dissolution. The partnership may be placed under sequestration, in which all the partners' estates must be simultaneously sequestered as required by the law of partnerships.¹²⁷

¹²⁵ De Koker, 1995, pg. 11 – 19

¹²⁶ Meyerowitz, 2003-2004, pg.16 – 33

¹²⁷ Meyerowitz, 2003-2004, pg.16 – 36

The Commissioner receives a preferential claim in respect of the free residue of the partnership's assets to the extent that the insolvent partner's outstanding tax relates to his income received from the partnership up to the date of his insolvency. The taxation amount claimable by the Commissioner bears the same ratio to total tax, as his income from the partnership bears to his total taxable income.¹²⁸

4(ix). New Developments

It is a well known fact, that the law is not static. During 2005 four Amending Acts were promulgated in South Africa¹²⁹. In terms of partnerships and their tax liabilities, the developments arising out of recent court decisions are of more interest.

Chipkin (Natal) (Pty) Ltd v CSARS – Supreme Court of Appeal 2005, 67 SATC 243

The taxpayer was part of an *en commandite* partnership. As partner, the taxpayer claimed for three years his portion of the s14bis aircraft allowance, claimable against an aircraft the partnership had previously acquired. He later decided to sell a substantial fraction of his share of the partnership.

The Commissioner of the South African Revenue Services (CSARS) included a recoupment relating to the aircraft allowance in the taxpayer's income, as it felt that the disposal of the partner's share in the partnership fell within the ambit of a section 8(4)(a) recoupment. The taxpayer maintained that he had merely altered his partnership interest, as neither the aircraft was disposed of, nor was the partnership dissolved. He also argued that the amount he had received was not compensation for the sale of the aircraft and therefore the disposal of his portion of the partnership could not give rise to a recoupment of the aircraft's allowance.

¹²⁸ Meyerowitz, 2003-2004, pg.16 – 36

¹²⁹ Huxham & Haupt, 2006, pg.733

The court's decision, concurring with that of the tax court, was in favour of the Commissioner. As the partnership was not a separate legal entity and was therefore unable to own any assets, the partnership assets were jointly held by the individual partners. For this reason the substance of the transaction was, that when the partner sold his interest in the partnership, he was simultaneously also transferring ownership of the aircraft. Hence the amount received for his share of the partnership, was also for his share in the aircraft and a recoupment did occur.¹³⁰

ITC 1794 – 2005, 67 SATC 262

This case dealt with a family trust, formed by the taxpayer, uniting with another party to form a joint venture. At the same time, the taxpayer and the trust went into partnership with each other, agreeing to share profits and losses of the joint venture. The taxpayer received a 90% interest, while the trust took up the remaining 10%. The joint venture went on to make a loss, which the taxpayer then included his share of in his tax return in terms of s24H. The Commissioner disallowed the loss, arguing that the partnership in which the loss had occurred (the trust and another party) was not the same as the partnership of which the taxpayer was a party (the taxpayer and the trust). CSARS felt that the joint venture should account for the loss suffered and that the partnership was not entitled to include that loss in its tax return. The questions arising out of this court case was whether losses that were incurred within a partnership would attach to a partner.

The court decided against the Commissioner, stating that the partnership between the trust and the taxpayer was a valid one and that the taxpayer had correctly included his share of the loss in his tax return as per s24H.¹³¹

¹³⁰ Huxham & Haupt, 2006, pg.736 & 740

¹³¹ Huxham & Haupt, 2006, pg.740

5. Conclusion

Partnerships, although ages old but still commonly used, continue to provide confusion in the realm of income tax law.

The areas of grey start at the very commencement of a partnership, as there are no legal formalities required nor need the partnership agreement be explicit and in writing. A partnership can be formed orally or by tacit agreement¹³². All that is required is that the criteria set out in *Joubert v Tarry & Co* are met.

The main problem however stems from the fact that a partnership is not a separate legal entity¹³³ but is occasionally, for tax purposes, treated as one¹³⁴. *ITC 1583* was given above as evidence of the fact that the courts, themselves, occasionally also err in respect of when and when not the partnership should be treated as a separate entity and when the law of partnerships should strictly be adhered to, ignoring the partnership business and focusing on the partners as a collective.

The area of accrual was also quite controversial, before government stepped in and introduced section 24H, thereby nullifying the precedent set in the case of *Sacks v CIR*. The Sacks case was anyway ignored in *ITC 751*, a subsequent tax court decision, but was the adhered to in an even later case, *ITC 1042*.

The concept of source was also not without it obstacles. Problems arose when partners worked exclusively in different countries, as in *CIR v Epstein*. Controversy still surrounds the judgement of that case.

¹³² Williams, 1996, pg.386

¹³³ *R v Levy* 1929 AD 312; *Muller en Andere v Pienaar* 1968 (3) SA 195 (A).

¹³⁴ De Koker, 1995, pg. 11 – 3

There are difficulties in defining the relationship between the partners and the partnership. On the one hand the partners are agents of the partnership, yet on the other they are also simultaneously the principal¹³⁵. They receive salaries from the partnership, but are not employees of the partnership¹³⁶.

The partnership is unable to own property and therefore the partners must all jointly hold the property, as co-owners¹³⁷. This again brings in issues of how capital allowances are treated and when do recoupments occur. The issue of recoupments was as recently as this year an issue of discrepancy in the *Chipkins* case.

There is also much contention surrounding the sale of goodwill. Depending on the method of payment, different parties will experience different tax effects. For example,

The receipt of an annuity as payment for goodwill will still be included in income¹³⁸ as will the receipt of a share of partnership profits as payment¹³⁹, whereas a fixed amount paid in installments will not affect the general capital nature of goodwill¹⁴⁰.

Dissolution is similar to goodwill, as the sale of goodwill on dissolution is just one issue to be dealt with. Many obstacles occur particularly when a partner retires or dies and wishes to still receive some form of return from the partnership to provide for him or his dependants.¹⁴¹

¹³⁵ Huxham & Haupt, 2005, pg.177

¹³⁶ Meyerowitz , 2003-2004, pg.16 – 30f

¹³⁷ Huxham & Haupt, 2005, pg.177

¹³⁸ De Koker, 1995, pg.11 – 14f

¹³⁹ Williams, 1996, pg.392

¹⁴⁰ Williams, 1996, pg.392

¹⁴¹ *Van der Merwe v SBI* 1977 (1) SA 462 (A), 39 SATC 1, 1977 *Taxpayer* 87

Despite the many uncertainties and ambiguity surrounding the taxation of partnerships, partnership law does not remain static as proven by the two recent cases dealing with partnerships and will over time only become clearer.

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