A CRITICAL EVALUATION OF THE VAT TREATMENT OF TRANSACTIONS COMMONLY UNDERTAKEN BY A PARTNERSHIP

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A CRITICAL EVALUATION OF THE VAT TREATMENT OF TRANSACTIONS COMMONLY UNDERTAKEN BY A PARTNERSHIP

I declare that the above thesis is my own work and that all the sources I have used or quoted have been indicated and acknowledged by means of complete references.

_____ _____

SIGNATURE **DATE**

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LIST OF ABBREVIATIONS

ATO:	Australian Taxation Office
Australian GST Act:	A New Tax System (Goods and Services Tax) Act 55 of 1999
BBC:	British Broadcasting Corporation
CRA:	Canadian Revenue Agency
Council Directive:	Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax OJ L347 of 11 December 2006
ECJ:	Court of Justice of the European Communities
EU:	European Union
Canada's ETA:	Excise Tax Act (RSC 1985 c E-15)
EM:	Explanatory Memorandum
GST:	Goods and Services Tax
HMRC:	Her Majesty's Revenue and Customs
IT Act:	Income Tax Act 58 of 1962
New Zealand GST Act:	New Zealand Goods and Services Tax Act 1985 No 141
NZIR:	New Zealand Inland Revenue
Republic:	Republic of South Africa
SARS:	South African Revenue Service
TRA:	Taxation Review Authority
Sixth Directive:	Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes – Common system of value added tax: Uniform basis of assessment OJ 1977 L 145
UK:	United Kingdom
VAT:	Value-added tax
VAT Act:	Value-Added Tax Act 89 of 1991

UK VAT Act:	Value Added Tax Act, 1994
VATCOM:	Value-added Tax Committee

SUMMMARY

In this dissertation, I critically evaluate the VAT treatment of common partnership transactions that are encountered during the life of a partnership. Of great significance, is that at common law a partnership is not regarded as a person, but for VAT purposes it is treated as a separate person. This creates a strong dichotomy between the general legal nature, and the VAT character of a partnership transaction. The partnership and the VAT law dichotomy, is an important theme that runs through most of the thesis. Only once I have established the nature of the transaction for VAT purposes – whether in keeping with or differing from the common law – do I apply the relevant provisions of the VAT Act to determine the VAT implications of the transaction. An important general principle is that what is supplied or acquired by the body of persons who make up the partnership, within the course and scope of its common purpose, is for VAT purposes, supplied or acquired by the partnership as a separate person.

I conclude that there are difficulties and uncertainties regarding the application of the provisions of the VAT Act to various partnership transactions. For the sake of certainty and simplicity, I propose amendments to the current provisions that are relevant to partnership transactions, and also propose additional provisions. The proposed amendments seek to align with the purpose of the VAT Act and the principles upon which it is based, and also to adhere to internationally accepted principles for a sound VAT system. I also pinpoint those aspects of the VAT Act that can be clarified by the SARS in an interpretation statement.

I further identify issues that require more research, eg issues arising from a partnership's participation in cross-border trade.

KEY TERMS:

acquisition, agent, barter, capital contribution, consideration, contract, dissolution of a partnership, distribution, enterprise, expense, formation of a partnership, going concern, input tax, joint ownership, liquidation, tax neutrality, obligation, output tax, ownership, partner, partner's share, partnership, partnership law, partnership profits, partnership property, payment, person, principal, reciprocal connection, reorganisation relief, transaction, set off, tax simplicity, supply, taxable activity, unincorporated body of persons, VAT, vendor.

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CHAPTER 1

INTRODUCTION

1.1 Introduction

Partnerships are difficult to tax.[1] In terms of the common law, a partnership is not a legal entity separate and distinct from its partners.[2] The rights of a partnership are accordingly vested in, and the liabilities are binding on, the individual partners.[3] As a result, when a partnership makes a supply or an acquisition, each member of the partnership makes that supply or acquisition, resulting in a potential output tax liability and an input tax credit for each member. In my view, this is problematic for the application of VAT, as it is of course more difficult to assess each individual partner for the partnership's VAT liability, as opposed to assessing the partnership as a single entity. The assessment of an individual partner is even more difficult if he[4] is a member of multiple partnerships.[5]

Furthermore, any change in membership terminates the partnership. If the remaining partners agree to continue the business of the partnership, a new partnership is created.[6] This characteristic, particularly for partnerships which experience frequent membership changes, coupled with the fact that partners are individually liable, have the effect that when the composition of a partnership changes, the VAT liability of each individual partner must be recalculated before and after the change.[7] In addition, even if the VAT is assessed at partnership level, instead of assessing the individual partners, considerable administrative time would be spent registering, deregistering, and re-registering changing partnerships.[8]

It is clear that the application of VAT to partnerships could be administratively onerous, especially in the absence of special provisions intended to facilitate the process. It is, therefore, not surprising that special provisions were inserted in the VAT Act[9] to make the application of VAT to partnership

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[1] See Tait *Value Added Tax* 366.
[2] Ramdhin et al "Partnership" in Kühne M (ed) *Law of South Africa vol 19* para 281; Williams *Concise Corporate and Partnership Law* 15; Du Bois *Wille's Principles* 1007.
[3] *Muller en 'n Ander v Pienaar* [1968] 3 All SA 290 (A) 295 (hereafter *Muller 1968*); Ramdhin et al ibid at para281; Williams ibid.
[4] The terms 'he' and 'his' are used as gender neutral terms and do not exclude any other gender.
[5] Tait *Value Added Tax* 366.
[6] See paras 4.2 and 4.3 below.
[7] Tait *Value Added Tax* 366; ATO Goods and Services Tax Ruling: GSTR 2003/13 "Goods and services tax: General law partnerships" available at https://www.ato.gov.au/law/view/document?DocID=GST/GSTR200313/NAT/ATO/00001&PiT=99991231235958 (date of use: 31 December 2018) (hereafter GSTR 2003/13) para 163.
[8] Ibid.
[9] All subsequent references to legislative provisions are to provisions in the VAT Act unless otherwise indicated.

transactions less problematic. A partnership is, for example, importantly deemed to be a person for VAT purposes.[10] 'Person' is defined in the VAT Act[11] as including, inter alia, an unincorporated body of persons. A partnership is an unincorporated body of persons.[12] Moreover, section 51 contains certain deeming provisions, and sets out specific rules applicable to partnerships that carry on an enterprise.

Although these provisions are clearly aimed at simplifying the application of VAT to partnerships, they do not come without interpretation difficulties. This is illustrated by the many diverse views and uncertainties internationally on the application of similar deeming provisions to common partnership transactions as evidenced by the discussion below. Moreover, that these provisions are deeming provisions, in my view, presents an inherent difficulty because the appropriate effect of a deeming rule which creates a legal fiction is generally problematic.[13]

When applying the provisions of the VAT Act to a partnership transaction, it is important to consider whether the VAT character of the transaction differs from its common-law character. Much of the discussion, therefore, centres round the interrelationship between the 'common-law character' and the 'VAT character' of a particular partnership transaction arising from the deeming provisions.[14]

In Chapter Two I discuss the nature and the formation of a partnership. I consider whether supplies and acquisitions are made between a partnership and its members (ie, the partners), and if so, what the VAT implications of these transactions are. Each partner receives a partner's share when concluding the partnership agreement.[15] A question arising is whether the partners' shares are 'supplied' to the partners, so generating a possible output tax liability.

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[10] Henning *Perspectives on the Law of Partnership* para 7.3.10; Botes *Juta's Value Added Tax* 1 person-2.

[11] Section 1(1).

[12] In *Commissioner for Inland Revenue v Epstein* [1954] 4 All SA 7 (A) 13, for example, the court assumed that the respondent's 'association' with a certain Hendrickse and Company was a partnership. According to Williams, and Ramdhin et al, a partnership is an 'association of persons'. See Williams *Concise Corporate and Partnership Law* 15; Ramdhin et al "Partnership" para 281. See also Bamford *Law of Partnership* 1. An 'association' is defined as "an unincorporated society; a body of persons united and acting together without a charter, but upon the methods and forms used by incorporated bodies for the prosecution of some common enterprise". See *The Law Dictionary Featuring Black's Law Dictionary Free Online Legal Dictionary* 2 ed available at https://thelawdictionary.org/operation-of-law/ (date of use: 13 April 2018). Claassen defines an 'association' as "an organised body of persons who have joined together under some contract, statute, regulations or rules, for the purpose of carrying out some common object." See Claassen *Dictionary of Legal Words* 21. Based on the above, I argue that an 'association of persons' is the same as an 'unincorporated body of persons' as envisaged in the definition of 'person'. As a partnership is an 'association of persons', it is an 'unincorporated body of persons'.

[13] Kandev & Lennard 2012 *Canadian Tax Journal* 287.

[14] See Arsenault M & Kreklewetz R "Partnerships" 50.

[15] See paras 2.6.4 and 2.8 below.

One of the *essentialia* of a partnership agreement is that each partner must make some contribution to the partnership.[16] Partner contributions give rise to numerous VAT issues, for example, whether partners can make supplies to the partnership, and if so, whether such contributions could, potentially, be subject to VAT. Furthermore, I argue that in contributing labour to the partnership, the partner acts as agent on behalf of the partnership.[17] This begs the question of how a partner's power as an agent impacts on the partners' and the partnership's position for VAT purposes.

I also consider whether the VAT on costs incurred by a partnership or an individual partner upon the establishment of a partnership, is deductible as input tax.

In Chapter Three I consider transactions related to the operation of a partnership. The partnership concludes diverse transactions in the course of its operations with its partners and third parties, including with a partner acting as a third-party supplier. I deal with the potential difficulty in, and the importance of, distinguishing between a payment made by the partnership as consideration for a partner's supply, a distributive share of profits, and the VAT implications of these payments.

I argue that, in light of its status as a person,[18] a partnership can make supplies and acquisitions, and I consider the nature of the property that can be the subject of such a supply and acquisition. I also examine the different capacities in which a partner may make acquisitions for the partnership business, and the mechanisms available to a partnership, including section 18(4)(*b*), to claim a related tax deduction. The determination of the purpose of a partnership is important as a partnership is entitled to an input-tax deduction if the goods or services are acquired for the 'purpose' of making taxable supplies.[19] Despite a partnership not being a natural person, I explore how a partnership's purpose can be established.

I further discuss the VAT implications of partnership distributions to partners, whether in cash or *in specie*, and from different sources of partnership property, including profits and contributed capital. Instead of transferring the ownership of property, the partnership may permit a partner to use partnership property for private purposes, which can result in VAT abuse considering that the partnership may have deducted input tax for that property.

In Chapter Four I consider the dissolution of a partnership, where the dissolved partnership's enterprise is continued by a new partnership. This can lead to a fair number of VAT consequences, especially with

[16] See para 2.3 below.
[17] See para 2.6.2 below.
[18] See para 2.3 below.
[19] See 'input tax' as defined in s 1(1).

regard to the transfer of the partnership property to the new partnership, and the sale and acquisition of partners' shares. I consider what exactly is disposed of or acquired in the case of the sale or acquisition of a partner's share.

Section 51(2), which deems the dissolved and the new partnership to be a single partnership, subject to its meeting certain requirements, impacts significantly on the VAT and transfer duty implications of the transfer of partnership property, especially immovable property, from the dissolved to the new partnership. I also examine the application of section 11(1)(*e*), in terms of which the supply of the partnership enterprise from the dissolved to the new partnership can be zero rated where section 51(2) does not apply.

The partnership would, in all likelihood, incur costs in its transition from the dissolved to the new partnership, which raises the issue of the deductibility of the VAT on those costs.

Section 8(25) provides specific relief to vendors who qualify for the group-relief measures under the IT Act. In the 2015 Budget Tax Proposals, it was proposed that this relief not only apply to groups of companies, but that it be extended to unincorporated entities.[20] In my discussion of section 8(25) I consider, inter alia, the wisdom of extending this provision to partnerships.

In Chapter Five, I deal with the dissolution of a partnership and the VAT treatment of the changes during this phase – eg, the cessation of the partners' agency powers after dissolution, the partners' loss of their partners' shares, and the partners' acquisition of certain rights post-dissolution. I also consider the impact of a partnership's dissolution on a partnership and a partner's indebtedness.

I examine the VAT implications of the death of a partner, which are unclear without specific provisions regulating such an occurrence.

After dissolution the partnership is liquidated, its creditors are paid, and its remaining assets are distributed to the partners.[21] I reflect on the VAT on these, and other related transactions that typically occur during this phase.

In Chapter Six I consider different options to, inter alia, create greater certainty and simplicity in the VAT treatment of common partnership transactions, including legislative changes and interpretation statements by the SARS dealing with the more complex issues.

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[20] National Treasury Republic of South Africa *Budget Review 2015* 25 February 2015 Annexure C: Additional Tax Amendments 148.

[21] See para 5.3.1 below.

1.2 Research approach

I address the various issues by interpreting the relevant provisions of the VAT Act, applying the principal approaches to the interpretation of statutes and contracts in South Africa. I also examine important aspects of the South African partnership and agency law, which are crucial to the discussion.

Relevant case law and academic commentary, both local and foreign, as well as publications of the SARS and of foreign revenue authorities, are considered. I also consult the case law and writings of comparable and leading VAT/GST jurisdictions, especially those of Australia, Canada, New Zealand, and the UK.[22] The aim is not to undertake a comprehensive comparative survey of another country's law on the topic, but rather to extract valuable lessons for the correct interpretation of the VAT Act as regards common partnership transactions, and to propose appropriate legislative amendments.

[22] Note that I discuss European VAT law in various places. It must be noted that the EU VAT model is not a modern VAT. Modern VAT systems include Australia, Canada, New Zealand, Singapore and South Africa.

CHAPTER 2

NATURE AND FORMATION OF A PARTNERSHIP

2.1 Introduction

In this chapter I discuss the two theories on the nature of partnership, and the effect of applying each theory in South African law. Importantly, the nature of a partnership in terms of the common law, differs from its nature for VAT purposes. In light of this difference, I consider what the approach should be when determining the nature of any partnership transaction for VAT purposes and applying the relevant provisions of the VAT Act to the transaction.[23]

Furthermore, I explain whether supplies and acquisitions are made between a partnership and its members on formation of the partnership, and if so, what the VAT implications are of these transactions. Relevant considerations include: the transactions and activities normally associated with the establishment of a partnership; the practical significance of a partnership's status as a person for VAT purposes; and the impact of section 51, which sets out specific rules applicable to partnerships which carry on an enterprise.

2.2 The legal nature of a partnership

A partnership is established by an agreement between prospective partners.[24] The court in *Pezzutto v Dreyer*,[25] confirming the *essentialia* of a contract of partnership, stated the following:

Our courts have accepted Pothier's formulation of such essentials as a correct statement of the law. (Joubert v Tarry & Co 1915 TPD 277 at 280/1; Bester v Van Niekerk 1960 (2) SA 779 (A) at 783H-784A; Purdon v Muller

[23] The interaction between common law, legislation and court judgments is important. The courts apply both common law and statutory law. Statutes must, as far as possible, be interpreted in accordance with common law. (Van Heerden & Crosby *Interpretation of Statutes* 2) As a result, no hierarchy exits between the common law and legislation so that the one is superior to the other. The only exception is the Constitution of the Republic of South Africa (No. 108 of 1996), which is the highest law in the land and all law is, consequently, subject to it (Botha *Statutory Interpretation* 13 para 2.2.2.) Common law can, therefore, not per se overrule the provisions in the VAT Act, and vice versa. The VAT Act, however, has specific provisions, which I discuss, which regulate the application of VAT to certain partnership transactions. These partnerships transactions are, at the same time, also governed by the common law. I am of the view that both the relevant VAT provisions and the partnership common law must be considered when drafting VAT legislative rules to avoid "bad drafting". Yet, it has to be acknowledged that VAT is a modern tax that is not always compatible with the ancient legal principles of the common law. Accordingly, VAT legislation may, for VAT purposes, alter the way a transaction is traditionally treated in terms of the common law by means of deeming provisions or legal fictions.

[24] Ramdhin et al "Partnership" para 261; Bamford *Law of Partnership* 1; Benade et al *Ondernemingsreg* para 3.01; Mongalo, Lumina & Kader *Forms of Business Enterprise* para 2.3.2; Williams *Concise Corporate and Partnership Law* 7.

[25] [1992] 2 All SA 81 (A) (the *Pezzutto* case).

1961 (2) SA 211 at 218B-D). The three essentials are (1) that each of the partners bring something into the partnership, whether it be money, labour or skill; (2) that the business should be carried on for the joint benefit of the parties; and (3) that the object be to make a profit (Pothier: A Treatise on the Contract of Partnership (Tudor's translation) 1.3.8). A fourth requirement mentioned by Pothier is that the contract should be a legitimate one.[26]

2.2.1 Two theories on the nature of partnership

There are two theories on the nature of partnership: the entity theory; and aggregate theory. In terms of the entity theory, a partnership is a body or entity separate from, and with rights and obligations distinct from, its members. Furthermore, a partnership can own property and carry on business. Many civil law jurisdictions apply the entity theory.[27]

In terms of the aggregate theory, a partnership is not recognised as a separate entity, but is regarded as merely an aggregate or collection of individuals. Consequently, the partners, rather than the partnership, are the owners of partnership property. Any change in its membership terminates the identity of the partnership. As a person cannot contract with himself, a partner may be the debtor/creditor of his[28] partners, but he cannot be the debtor/ creditor of his partnership, or be employed by it. English law, and so most other common-law jurisdictions, apply the aggregate theory of partnership.[29]

In order to achieve desired results, courts and legislators in both entity and aggregate jurisdictions, do not always adhere strictly to a specific theory of partnership. A partnership may, for example, be treated as a separate entity for certain purposes in an aggregate jurisdiction. Conversely, in an entity jurisdiction, the separate identity of a partnership may be disregarded in exceptional circumstances.[30]

2.2.2 Application of two theories causing confusion and uncertainty

As in English law, South African common law applies the aggregate theory. The basic principle or general rule, in terms of the common law, is that a partnership is not a legal entity and, therefore, does not have legal personality.[31] It does not have an existence separate from its partners. This means, as

[26] Ibid at 91.
[27] Ramdhin et al "Partnership" para 279. See also Benade et al *Ondernemingsreg* para 2.20; Williams *Concise Corporate and Partnership Law* 16.
[28] The terms 'his' and 'he' are used as gender neutral terms and do not exclude any other gender.
[29] Ramdhin et al "Partnership" para 279. See also Benade et al *Ondernemingsreg* para 2.20; Scamell & I'anson Banks *Lindley on the Law of Partnerships* 5.
[30] Ramdhin et al ibid. According to Benade et al ibid at para 2.21, none of these theories is followed dogmatically. They claim that although a country's legal system normally subscribes to one of the theories, the other theory is used at times when practical considerations or fairness so require. See also Williams *Concise Corporate and Partnership Law* 16.
[31] See para 1.1.

stated above,[32] that the rights of a partnership vest in, and the liabilities bind, the individual partners. Consequently, a partnership cannot have assets and liabilities. If two or more individuals, in their capacities as partners, enter into a contract, the identity of the partnership is always synonymous with the identity of the contracting partners.[33]

The legislator, however, has created exceptions in terms of which a partnership is treated as a separate person in particular instances.[34] A partnership is deemed to be a person for VAT purposes.[35]

The law of insolvency creates another exception where a partnership is considered to be a separate entity.[36] The court held in *Michalow NO v Premier Milling Co Ltd*,[37] for instance, that as far as section 29 of the Insolvency Act[38] is concerned, the estates of the individual partners must be treated as distinct from the partnership estate where both the partnership and the private estates are ultimately sequestrated.[39]

According to Ramdhin et al, the application of two distinct concepts of partnership in a single legal system may, and has, caused some confusion and uncertainty as to the precise legal nature of a partnership in particular circumstances.[40] In *Michalow*,[41] the court acknowledged that to treat a partnership as a debtor, and consequently as having an estate separate and distinct from the personal estates of the partners, is in direct conflict with the common law. The court referred to *Johannesburg Municipality v Cohen's Trustees* where Solomon J approved the following rule of interpretation adopted by the English courts:[42]

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[32] Ibid.

[33] *Muller 1968* at 295; Ramdhin et al "Partnership" para 281. See Williams *Concise Corporate and Partnership Law* 15, 41.

[34] Ramdhin A et al "Partnership" in Kühne M (ed) *Law of South Africa vol 19* 2 ed (LexisNexis 2016) paras 281 and 282; Williams *Concise Corporate and Partnership Law* 17-18; Benade et al *Ondernemingsreg* paras 2.22 and 2.23.

[35] See para 1.1.

[36] *Michalow NO v Premier Milling Co Ltd* [1960] 1 All SA 551 (W) 556 (hereafter *Michalow)*; *Muller 1968* at 294; *Strydom v Protea Eiendomsagente* [1979] 3 All SA 454 (T) 456; Ramdhin et al "Partnership" paras 281 and 287; Henning *Perspectives on the Law of Partnership* para 734; Benade et al *Ondernemingsreg* paras 2.26 to 2.31; Williams *Concise Corporate and Partnership Law* 18.

[37] *Michalow* ibid.

[38] Act 24 of 1936; s 29 provides as follows:

> Every disposition of his property made by a debtor not more than six months before the sequestration of his estate, which has had the effect of preferring one of his creditors above another, may be set aside by the Court if immediately after the making of such disposition the liabilities of the debtor exceeded the value of his assets, unless the person in whose favour the disposition was made proves that the disposition was made in the ordinary course of business and that it was not intended thereby to prefer one creditor above another ….

[39] *Michalow* at 556.

[40] Ramdhin et al "Partnership" para 279.

[41] *Michalow* at 554.

[42] Laid down in *Reg v Morris* 1 CCR 95.

> [I]t is a sound rule to construe a statute in conformity with the common law rather than against it, except where and so far as the statute is plainly intended to alter the course of the common law.[43]

This rule of interpretation, which has been applied in innumerable South African cases, embodies the presumption that the legislature does not intend to alter the existing law more than is necessary.[44]

The court in *Michalow* explained that to justify such a drastic departure from the common law, one would have to adopt the hypothesis that those who deal with and grant credit to a partnership, do so solely in reliance on the partnership assets, and that they must regard the partnership as a separate entity. That being so, the court held that the Insolvency Act "plainly intended to alter the course of the common law" and to treat a partnership as having a separate estate and as being in the same position as any other debtor.[45] To hold otherwise would deprive partnership creditors of a safeguard against preferences which is extended to all other types of creditor.[46]

It is clear from *Michalow*, that a departure from the common-law principle that a partnership is merely a collection of individuals, rather than a separate entity, is only justified in any particular circumstance if this was plainly intended based on relevant considerations. It is further evident from the judgment that the problem of the nature of a partnership in a legal system which applies two distinct concepts of partnership, can be complex and requires very careful consideration.

2.2.3 The common law versus the VAT nature of partnership

The deeming of a partnership to be a person or separate entity by VAT/GST legislation against the backdrop of general law that applies an aggregate theory of partnership, also raises difficulties of interpretation. The difficulty with the use of a deeming rule, is that it imbues a person or a thing with features or qualities that he or it does not have,[47] without the legislature defining its scope or clarifying exactly what its effect is.[48]In terms of Canadian common law, for example, a partnership is not

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[43] 1909 TS 811 at 823. See also *Seluka v Suskin and Salkow* 1912 TPD 258 at 265 where the court stated: "It is true that it is a canon of construction that an Act must not be presumed to alter the common law, but directly it is clear from the language of the statute that the very object of the Act is to alter the common law, then full effect must be given to this object."

[44] Devenish *Interpretation of Statutes* 159; Botha *Statutory Interpretation* 45 para 4.6.1.

[45] *Michalow* at 556.

[46] Ibid.

[47] See *CSARS v Marshall NO* (816/2015) [2016] ZASCA 158 (3 October 2016) para 25.

[48] In *Chotabhai v Union Government (Minister of Justice) and Registrar of Asiatics* 1911 AD 13 (*Chotabhai*) the court, explaining the nature of the difficulty to which a deeming rule can give rise, stated at 33:

> The use of the word 'deemed' was perhaps not a happy one, because that term may be employed to denote merely that the person or things to which it relates are to be considered to be what they really are not, without in any way curtailing the operation of a Statute in respect of other persons or things falling within the ordinary meaning of the language used. If the word were so employed, the result would be artificially to extend the scope of the expression referred to, without attempting to define it.' Para 33 *Chotabhai* was quoted in *CSARS v Marshall NO* 816/2015) [2016] ZASCA 158 (3 October 2016) para 25.

considered a separate entity,[49] but for GST purposes, it is deemed to be a separate person distinct from its partners.[50] Arsenault and Kreklewetz, commenting on the application of Canada's ETA to partnerships, submit that the fact that a partnership is not a legal entity probably results in some of the most complex GST issues.[51] Likewise, in Australia, New Zealand, and England a partnership is not a legal entity in terms of general law, but is treated as a separate person for GST/VAT purposes.[52]

The question which arises is, given that a partnership is deemed a separate person for VAT purposes, to what extent does the VAT character of a partnership transaction differ from its common-law character?[53] This question is relevant to all partnership transactions.

In my view, the correct VAT treatment of a partnership transaction requires a proper understanding of the transaction, that is either in keeping with the common law, or differs from the common law, but only to the extent that the specific provision(s) of the VAT Act plainly intended to alter the course of the common law.

2.3 The effect of deeming a partnership to be a person

The term 'person' is of fundamental importance in the application of the VAT Act. A 'vendor' is defined[54] as meaning a person who is, or is required to be, registered for VAT, and it is a vendor who may levy VAT on supplies[55] and deduct the VAT on acquisitions as input tax.[56] Moreover, a vendor is a person who is compelled to register, or may voluntarily register for VAT, provided that he carries on an

[49] Chabot et al *EY's Complete Guide to GST/HST* para 10,010; Houghton "Partnerships and Unincorporated Business Organisations" available at https://www.lawsonlundell.com/media/news/136_PartnershipsandUnincorporatedBusinessOrganizations.pdf (date of use: 16 August 2018).
[50] Section 123(1) of Canada's ETA; Chabot et al ibid; CRA "Partnership" available at https://www.canada.ca/en/revenue-agency/services/tax/businesses/small-businesses-self-employed-income/setting-your-business/partnership.html (date of use: 15 September 2018).
[51] Arsenault & Kreklewetz "Partnerships" 14.
[52] Higgins *Law of Partnership* 14; Taxpayers Australia Inc *Taxpayers Guide 2014-2015* para 24.323; Williams *Corporations and Partnerships in New Zealand* para 775; GSTR 2003/13 paras 21 and 22. GSTR 2003/13 deals with general law partnerships. According to the ATO, a 'general law partnership' is the relation which subsists between persons carrying on a business in common with a view to making a profit, whereas a 'tax law partnership' is an association of persons in receipt of ordinary income or statutory income jointly (GSTR 2003/13, paras 10 and 11). In my opinion, a 'general law partnership' is similar to a 'partnership' under South African common law. See too Cross *New Zealand Master Tax Guide* 973 para 23-110; s 57 of the New Zealand GST Act; Scamell & I'anson Banks *Lindley on the Law of Partnerships* 5; Hemmingsley & Rudling *Tolley's Value Added Tax* para 50.1. In Scotland a partnership is a legal person distinct from its partners. See Hemmingsley & Rudling ibid.
[53] See Arsenault & Kreklewetz "Partnerships" 6.
[54] In s 1(1).
[55] Section 7(1)(*a*) levies VAT, at the standard rate of fifteen per cent, on the supply by a vendor of goods or services in the course or furtherance of an enterprise he carries on.
[56] See 'input tax' as defined in s 1(1).

enterprise and the relevant turnover thresholds are exceeded.[57] Therefore, before VAT registration can take place, there must be a person, and that person must carry on an enterprise. In my view, the deeming of a partnership to be a person implies that, for VAT purposes, it is capable of doing what the VAT Act empowers a person to do, including, make supplies and acquisitions, carry on an enterprise, and register for VAT. I argue, further, that as a partnership is a person, it may register for VAT as a single person, rather than registering its members individually, provided that it carries on an enterprise.

Section 51(1)(*a*) provides that where a body of persons, and by implication also a partnership, carries on an enterprise, it is deemed to carry on that enterprise independently of its members. It is evident from this provision that, according to the legislature, a partnership is capable of carrying on an enterprise.

Section 16(3)(*a*) provides that the tax payable by a vendor is calculated by deducting the amounts of input tax from the sum of output tax. 'Output tax', in relation to a vendor, is defined[58] as meaning the tax charged under section 7(1)(*a*) in respect of the supply of goods and services by a vendor. 'Input tax', in relation to a vendor, is defined[59] as meaning the tax charged under section 7 and payable by a supplier on the supply of goods or services acquired by the vendor for the purpose of making taxable supplies. Accordingly, a vendor's VAT liability – including that of a partnership which carries on an enterprise – is generally determined on the basis of its supplies and acquisitions of goods or services. These provisions add to the argument that deeming a partnership to be a 'person' suggests that, for VAT purposes, a partnership is perfectly capable of making and acquiring supplies of goods or services. This is notwithstanding that, in terms of common law, a partnership is not the bearer of rights and duties.

The meaning of the word 'person' is also useful for a better understanding of the implications of deeming a partnership a 'person'. In *De Beers Industrial Diamond Division (Pty) Ltd v Ishizuka*,[60] the court stated that when interpreting a word in a statute, the dictionary meaning of the word can be used as a guide. But where the word has more than one meaning, the context in which the word is used is important.[61] The definition of 'person' in the VAT Act is not exhaustive in that it is defined as 'including' certain entities. The ordinary meaning of 'person', therefore, falls to be considered. 'Person' is defined as meaning, inter alia, "an individual (also natural person) or a group of individuals as a corporation (also

[57] In terms of s 23(1) a person is required to register for VAT where the total value of his taxable supplies exceeds R1 million over a twelve-month period. In terms of s 23(3)(*b*) and (*c*) a person may voluntarily register for VAT where the total value of his taxable supplies exceeds R50,000 over a twelve-month period.
[58] In s 1(1).
[59] Ibid.
[60] [1980] 3 All SA 447 (T) 452.
[61] Botha *Statutory Interpretation* 86 para 7.3.4.

artificial person), regarded as having rights and duties recognised by the law."[62] By deeming a partnership to be a person for VAT purposes, the legislature plainly intended to alter the course of the common law, in that being a 'person' implies that the partnership has the capacity to acquire rights and incur obligations.

In New Zealand, the TRA held in *Case N27*, that the effect of a partnership being registered for GST, is that it is capable of carrying on a taxable activity in making and receiving supplies distinct from supplies by or to a member.[63] In the case of Australia, the ATO is of the view that as an entity, a general-law partnership may register for GST, is liable for taxable supplies that it makes, and is entitled to input tax credits for its creditable acquisitions.[64] According to Chabot et al, in Canada activities (eg, supplying, acquiring, consuming, using, etc) performed by members of a partnership in their capacity as partners, are considered activities of the partnership rather than activities of the individual partners.[65] In the UK, a partnership is treated as a 'taxable person',[66] which is required to charge VAT on taxable supplies[67] and may deduct input tax in relation to acquisitions.[68]

In terms of the EU Council Directive, a partnership can, for VAT purposes, be 'any person', even though it may be considered non-existent for corporate income tax purposes.[69] Commenting on a partnership's VAT treatment under the Council Directive, van Doesum submits that if a partnership is to be considered a 'person', it can, from a VAT perspective, be a recipient or supplier of a supply of goods or services.[70]

One of the *essentialia* of a partnership agreement is that each partner must make a contribution to the partnership, or he must make a binding undertaking that he will make a contribution.[71] The question

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[62] *Shorter Oxford English Dictionary*.
[63] (1991) 13 NZTC 3,229 at 11. See McKenzie *GST: A Practical Guide* [E-book] Location 146.
[64] GSTR 2003/13 para 27; Taxpayers Australia Inc *Taxpayers Guide* para 24.323. See also McCouat *Australian Master GST Guide* [E-book] Locations 65, 126.
[65] Chabot et al *EY's Complete Guide to GST/HST* para 10,010. Murray agrees that under the normal workings of Canada's ETA, taxable activities performed by a partner for a partnership would be subject to GST for the partnership. See Murray BF 'Partner Contributions: Deeming Away any Supply to the Partnership' available at http://www.cch.ca/newsletters/TaxAccounting/july2010/Article2.htm (date of use: 4 September 2014); Cherniak CT 'Partners/Partnerships Are Tricky With GST/HST' available at http://tradelawyersblog.com/ (date of use: 17 August 2018).
[66] Hemmingsley & Rudling *Tolley's Value Added Tax* para 50.1; HMRC "VAT Registration" available at https://www.gov.uk/vat-registration/how-to-register (date of use: 16 August 2018).
[67] Hemmingsley & Rudling ibid at para 47.1.
[68] Ibid at para 34.1.
[69] Van Doesum 2010-6 *EC Tax Review* 259-71 at 260.
[70] Ibid.
[71] The *Pezzutto* case at 91; Benade et al *Ondernemingsreg* para 3.23; Williams *Concise Corporate and Partnership Law* at 5. See also Ramdhin et al "Partnership" para 263. The contributions are risked in the business and are made for the purpose of commencement of the partnership or the carrying on of its business. See Ramdhin et al ibid at para 286; *Schlemmer v Viljoen* [1958] 2 All SA 309 (T) 315.

arising is whether a partner can make a supply to the partnership as, being a member of the partnership, he would, in effect, be making a supply to himself.

Regarding the position under general law, in *Shingadia Bros v Shingadia*[72] the court accepted the validity of a lease between a partner and a partnership.[73] The court, however, referred to *Whitaker v Whitaker & Rowe*,[74] where such a lease was described by the court as embodying a somewhat anomalous relationship. Isaacs, referring to the situation where a partner owns property used by the partnership for its business, or where the partnership owns property used by an individual partner, submits that it is doubtful whether such contracts can be called true leases. In the one case, he explains, the landlord is also one of the tenants, and in the other one of the landlords is the tenant.[75] The court in *Shingadia Bros* attempted to clarify the nature of a contract by which a partnership leases partnership property to a partner. According to the court, such a contract is arguably a contract by which the other partners allow the partner who leases the property, to use their interests in the partnership property in consideration of his undertaking to pay the rent into the partnership funds.[76] The court's analysis is correct because a partnership, not having legal personality, cannot be a party to a contract. As the partnership is not a party to the contract, the anomalous result of a partner in effect contracting with himself as a member of the partnership, is avoided.

The question arising is whether the status of a partnership as a person for VAT purposes, adequately addresses the concern that a partner who makes supplies to the partnership is effectively making supplies to himself.

In the New Zealand High Court case of *Taupo Ika Nui Body Corporate v Commissioner of Inland Revenue*,[77] a developer built a timeshare resort consisting of units. One of the issues was whether the appellant was obliged to charge GST on the administration and maintenance levies it imposed on the proprietors of the units. The court held that the determination of this point depended on whether the appellant could be seen as an entity separate from the proprietors of the land. If it could, then there were supplies between that entity and the proprietors. If it was not, there were no such supplies in that the proprietors were merely acting on their own behalf.[78] According to the court, once a body is recognised as a separate person supplies can be made between that body and its members.

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[72] *Shingadia Bros v Shingadia* [1958] 2 All SA 107 (FC) 107.
[73] Ibid at 108.
[74] 1931 EDL 122 at 125.
[75] Isaacs I "The law of landlord and tenant" 1960 *Acta Juridica* 93.
[76] *Shingadia Bros v Shingadia* [1958] 2 All SA 107 (FC) 111. See also Henning *Perspectives on the Law of Partnership* para 7.3.8.
[77] (1997) 18 NZTC 13,147 (hereafter, the *Taupo Ika Nui* case).
[78] Ibid at 13,148.

In the New Zealand High Court case of *Nelson v Commissioner of Inland Revenue*,[79] the appellant and a family trust farmed property in a partnership registered as a person under the New Zealand GST Act. The appellant and the family trust owned the farm as 'tenants in common' in unequal shares. The disputed point was whether in making his share of the farm available to the partnership, the appellant was carrying on a taxable activity.[80] The court held that for the purpose of determining whether there has been a taxable activity, the critical issue is whether the appellant supplied goods to the partnership. When the issue is seen from this perspective, the court explained, the legal implications of the appellant's role as both co-owner and partner are of incidental interest.[81]

Therefore, the fact that a partnership is a person and an entity for VAT purposes, makes it irrelevant that the supplier of the use of the land to the partnership is also a member of that same partnership. That the partnership is a person, answers the question of whether a supply can be made to that partnership even if a member of that partnership is the supplier. The issue is whether there is a supply, not whether there can be a supply to the partnership in the circumstances.

De Koker and Kruger base their view that a partner can make taxable supplies to the partnership, on a different argument. In terms of section 51(1)(*b*), a partnership's VAT registration must be effected separately from any registration of a member in respect of a different enterprise carried on by that member. Consequently, a partnership and a partner, who carry on separate enterprises, must be registered separately for VAT. Their submission that the parties' separate VAT registration implies that taxable supplies are possible between them, is in my view correct.[82]

The ECJ held in the *Heerma* case[83] that a partner who leases immovable property to the partnership of which he is a member and which is itself a taxable person, acts independently within the meaning of article 4(1) of the Sixth Directive. In terms of article 4(1), a 'taxable person' is a person who carries on an economic activity independently.[84] The court held that in letting the property to the partnership, the partner acts in his own name, on his own behalf, and under his own responsibility, even if he is at the same time manager of the lessee partnership.[85]

[79] (2001) 20 NZTC 17,220 (hereafter the *Nelson* case).
[80] Ibid at 17,223 para 10.
[81] Ibid at 17,226 para 26.
[82] De Koker & Kruger *Value-Added Tax* para 12.6. This point is reiterated below in the discussion on the impact of s 51.
[83] *Staatssecretaris van Financiën and Heerma* Case C-23/98 27 January 2000 para 17.
[84] See the full text of articles 4(1) and 4(2) of the Sixth Directive in para 2.6.3 below.
[85] *Staatssecretaris van Financiën and Heerma* Case C-23/98 27 January 2000 para 18.

Van Doesum submits, on the basis of the *Heerma* case, that as for VAT purposes and under European VAT law a partnership is distinguished as an entity distinct from its partners, it is possible for a partner to make taxable supplies to its own partnership, and vice versa.[86] He argues that where a partner makes a contribution in kind to the partnership, for example, by performing work for the partnership, he would not be performing a service for the other partners, as would be the position in terms of general law, but would rather, for European VAT law purposes, be performing a service to the partnership.[87] In my view, this statement also reflects the different ways of viewing a partner's contribution to the partnership under South African common law, and in terms of the VAT Act, respectively.

Chabot et al come to the same conclusion, that as a partnership is deemed by Canada's ETA to be a person distinct from its partners, a supply from a partner to the partnership should, for GST purposes, be treated as a supply from one person to another person.[88] According to Hemmingsley and Rudling, in the UK where a partner's contribution to the partnership is not cash, making the partnership contribution may have VAT consequences.[89] The consensus in Australia is that taxable supplies can be made between a partnership and a partner, for example, on formation of the partnership.[90]

I argue, therefore, that in terms the VAT Act, a partner can make supplies to the partnership and vice versa.

The question then arising is when can it be said that a supply is made by or to a partnership? The word partnership means, inter alia, a specific form of association of persons.[91] It is, therefore, an association or body of persons deemed to be a person for VAT purposes. An association is "a body of people organized for a common purpose."[92] I am of the view that what is supplied or acquired by this body of

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[86] Van Doesum "Contractual Cooperative Arrangements in European VAT" available at http://nl.linkedin.com /in/advandoesum 697-8 (date of use: 12 December 2016).
[87] Ibid at 699.
[88] Chabot et al *EY's Complete Guide to GST/HST* para 10,010. Cherniak confirms that in terms of the Canadian GST partners and partnerships are different legal entities for GST purposes, and that partners are required to charge GST in respect of supplies of property or a service to the partnership otherwise than in the course of the partnership's activities. See Cherniak CT "Partners/Partnerships Are Tricky With GST/HST" available at http://tradelawyersblog.com/ (date of use: 17 August 2018).in
[89] Hemmingsley & Rudling *Tolley's Value Added Tax* para 50.7, a view supported by HMRC. See HMRC "Consideration: Partnership Contributions" available at https://www.gov.uk/hmrc-internal-manuals/vat-supply-and-consideration/ vatsc68000 (date of use: 17 August 2018).
[90] GSTR 2003/13 paras 32, 65-67. According to Taxpayers Australia Inc, as a partnership is an entity for GST purposes, the GST Act applies to partnership transactions, in particular dealings between partners and the partnership in a manner that does not reflect the general law treatment of those transactions. See Taxpayers Australia Inc *Taxpayers Guide* para 24.323. McCouat holds the view that in terms of the Australian GST an 'in kind' capital contribution made by a partner on entering into a general law partnership is a supply by the partner, and may be taxable if made as part of carrying on or closing down a separate business run by the partner. See McCouat *Australian Master GST Guide* [E-book] Location 66.
[91] Ramdhin et al "Partnership" para 254; *Commissioner for Inland Revenue v Epstein* [1954] 4 All SA 7 (A) at 13. See also Bamford *Law of Partnership* 1 and Mongalo, Lumina & Kader *Forms of Business Enterprise* para 2.3.2.1.
[92] *Shorter Oxford English Dictionary*.

persons, who make up the partnership, within the course and scope of its common purpose, is, for VAT purposes, supplied or acquired by the partnership as a separate person.

2.4 The impact of section 51

Section 51(1)(*a*) provides that where a body of persons carries on an enterprise, that body is deemed to carry on the enterprise as a person distinct from the members of that body. The partners are, therefore, deemed not to be carrying on the enterprise of the partnership, even though, legally, the activities making up the enterprise are performed by the partners.[93]

A partner's contribution to the partnership cannot be subject to VAT on the ground that it is made in the course or furtherance of the partnership's enterprise, because of section 51(1)(*a*) which deems the enterprise to be carried on by the partnership, rather than by the partners.

Section 51(1)(*b*) requires that registration of the partnership as a vendor be effected separately from any registration of its members in respect of another enterprise carried on by that member.[94] The effect of section 51(1)(*b*) is that a partnership is only registered in respect of the enterprise it carries on. The partnership is not registered in respect of an enterprise carried on separately by any of its members, who should each be registered in respect of his own separate enterprise. A partner's contribution to the partnership can, therefore, potentially be subject to VAT if it is made in the course or furtherance of a separate enterprise carried on by the partner. As stated,[95] separate VAT registrations imply that there can be taxable supplies between a partner and the partnership.

In terms of section 51(1)(*c*), liability for tax in respect of supplies by the partnership must be determined and calculated in respect of the partnership's enterprise carried on independently by any of its members. In simple terms, section 51(1)(*c*) provides that the VAT liability of this separate enterprise must be separately calculated, apart from any enterprise which a member of the partnership might be carrying on. In other words, only the output tax and the input tax related to the partnership's enterprise, must be taken into account when calculating the tax payable by the partnership.[96]

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[93] Section 57(2)(*a*) of the New Zealand GST Act is similar to s 51(1)(*a*) of the VAT Act. Section 57(2)(*a*) provides that "the members of [the unincorporated] body shall not themselves be registered or liable to be registered under this Act in relation to the carrying on of that taxable activity." In *Case S84* [1996] 17 NZTC 7,526 at 9, the court held that s 57(2)(*a*) circumvents potential registration difficulties which could arise when supplies are made by individual partners on behalf of the partnership, by emphasising that only the partnership can be registered for the particular taxable activity.

[94] Section 23 regulates the registration of persons for VAT.

[95] See para 2.3 above.

[96] The tax payable by a vendor is calculated in accordance with the provisions of s 16.

In the New Zealand High Court case of *Newman & Ors*,[97] the taxpayers argued that section 57 of the New Zealand GST Act merely allows for the registration of unincorporated bodies, and its purpose is to simplify accounting for GST. Counsel for the taxpayers gave the following example:

> Rather than requiring every member of the local tennis club to register and account for GST individually, the club itself can register (even although it is not a legal entity) and account for GST on behalf of all its members.[98]

In terms of this argument, the registration liability of each member of the unincorporated body must be considered separately. Therefore, if each member, individually considered, is not liable to be registered, then the unincorporated body is not liable to be registered even if the total value of all the supplies of the body exceeds the GST registration threshold. If, however, the unincorporated body is regarded as a single person, then the total value of the supplies of the body must be taken into account when determining whether that body is liable to register for GST.

The court in the *Newman* case disagreed with the taxpayers' argument. Section 51(1)(*c*) also refutes this argument. The partnership does not account for VAT correlated to each partner's separate share in the partnership's enterprise. Instead, the partnership accounts for VAT on the partnership's entire enterprise because the partnership's liability for tax is calculated under section 51(1)(*c*) in respect of the enterprise carried on by it independently from any enterprise carried on by any one of the partners.

The Australian GST Act, Canada's ETA, the New Zealand GST Act, and the UK VAT Act also have special rules for partnerships.[99]

2.5 Date from when a partnership is liable to register for VAT

A partnership is required to register for VAT as from the date on which its taxable turnover as a person separate from its members exceeds the compulsory VAT registration threshold.[100] The question of whether a partnership exists could be a matter of dispute if the turnover of each member, considered individually, is under the compulsory registration threshold. The members might claim that there is no partnership in order to avoid VAT registration, as well as an outstanding VAT liability on past supplies. If, however, the members are found to have been conducting business as a partnership all along, then

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[97] *Newman & Ors v Commissioner of Inland Revenue; Holdsworth & Ors v Commissioner of Inland Revenue; Hair & Ors v Commissioner of Inland Revenue* (2000) 19 NZTC 15,666 (hereafter the *Newman* case).
[98] Ibid 15,685 at para 68.
[99] See s 184-5 of the Australian GST Act; s 272.1 of Canada's ETA; s 57 of the New Zealand GST Act; and s 45 of the UK VAT Act.
[100] See s 51(1) read with s 23(1).

the back-dating of the partnership's VAT registration to the date when the partnership was established could be warranted.

Whether persons constitute a 'body of persons' as envisaged in section 51(1) and should, therefore, be registered as a single person, is a question of fact that does not depend on the exercise of a discretion of the Commissioner for the SARS. This justifies the back-dating of VAT registration to the date of the establishment of the body of persons.[101]

Section 50A is an anti-avoidance provision aimed at preventing the artificial splitting of the activities of a business in order to avoid VAT registration. Section 50A, in contrast to section 51, depends on the Commissioner for the SARS exercising his discretion to direct that separate persons be registered as a single person. However, section 50A provides that liability to register as a single person is with effect from such a decision. The newly-registered single person can, therefore, not be held liable for VAT on past supplies as in the case of a section 51 registration.

In the New Zealand Court of Appeal case of *Commissioner of Inland Revenue v Chester Trustee Services Ltd*,[102] two trading trusts, the Brook Family Trust (BFT) and the G & I Family Trust (GIFT), each had a separate GST registration which accounted for GST on a payments basis, signifying that the tax became payable only when a debtor of the trust had paid its invoice. The Commissioner issued a notice of his intention to register BFT and GIFT as a single entity for GST purposes, and to assess that entity on an invoice basis for undisclosed output tax on certain sales. The Commissioner determined that the taxable activity was being carried on by both BFT and GIFT as an unincorporated body of persons within the meaning of section 57. The court, agreeing with the Commissioner, held that the business was being conducted by what, under section 57, is a different entity that did not have permission to account for GST on a payments basis. Registration must, importantly, relate back to the date on which that entity became liable to registration.[103]

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[101] Section 23(4)(*b*) provides that where a person, who is liable to be registered for VAT, has not applied to be registered, that person shall be a vendor with effect from the date on which he first became liable to be registered. In terms of the proviso to this provision, the Commissioner for the SARS is, however, given a discretion to register such person from a later date depending on the circumstances.

[102] [2002] NZCA 258, [2003] 1 NZLR 395, (2002) 20 NZTC 17,925, (2002) 9 NZCLC 263,016 (14 October 2002) CA111/02.

[103] Ibid at para 29. In Australia and Canada a partnership is liable to register for GST if it makes taxable supplies. See GSTR 2003/13 para 27; McCouat *Australian Master GST Guide* [E-book] Location 46; Chabot et al *EY's Complete Guide to GST/HST* para 10,010; CRA "Partnership" available at https://www.canada.ca/en/revenue-agency/services/tax/businesses/small-businesses-self-employed-income/setting-your-business/partnership.html (date of use: 15 September 2018). In the UK, VAT registration of persons carrying on business in partnership 'may be' in the name of the firm. See s 45(1) of the UK VAT Act; Hemmingsley & Rudling *Tolley's Value Added Tax* para 50.2.

It is an *essentialia* of a partnership agreement that the business of the partnership be carried on in common.[104] I agree with Ramdhin et al's argument that as in South African law a partnership is established by means of an agreement to carry on business, the partnership need not actually commence business before it is established.[105] In terms of section 23(1), a person may be liable to register for VAT provided that he 'carries on any enterprise'. In my opinion, seeing that a partnership may only start to conduct its business from a date after it has been established, the partnership may only become liable to register from a date subsequent to its establishment.

2.6 The VAT consequences of a contribution to a partnership

The VAT treatment of a partner's contribution to the partnership will be considered from the perspective both of the partner and of the partnership. From the partner's perspective, the question is whether the contribution is subject to VAT. From the partnership's perspective, the question is whether the contribution is consideration for a supply.[106] The VAT Act does not deal specifically with the VAT implications of a partner's contributions to the partnership.

A partner may contribute either money, food, skill, or labour or its equivalent, to the partnership.[107] Movable or immovable property can be contributed either in the form of ownership of the property, or merely its use.[108] The contributions need not be of the same character, equal value, or the same quantity.[109] As a rule, no limitations are placed on the nature of the contributions that may be made, provided that the contributions have a commercial value.[110]

'Goods' include corporeal movable things and fixed property, but exclude money.[111] 'Services' are defined as anything done – including granting or surrendering a right, or making of a facility or advantage available – but exclude a supply of goods or money.[112] Considering the nature of a partner's

[104] Ramdhin et al "Partnership" para 263; Williams *Concise Corporate and Partnership Law* 6. See also Mongalo, Lumina & Kader *Forms of Business Enterprise* para. 2.3.3.3; and Benade et al *Ondernemingsreg* para 3.22.
[105] Ramdhin et al ibid at para 263.
[106] See Van Doesum 2010-6 *EC Tax Review* 263.
[107] *Uys v Le Roux* 1906 TS 429 at 433; Ramdhin et al "Partnership" para 263; Benade et al *Ondernemingsreg* para 3.23; Mongalo, Lumina & Kader *Forms of Business Enterprise* para 2.3.3.1; Williams *Concise Corporate and Partnership Law* 5.
[108] *Whiteaway's Estate v Commissioner for Inland Revenue* 1938 TPD 482 at 485; *Fortune v Versluis* [1962] 1 All SA 414 (A) at 427; Ramdhin et al ibid.
[109] Ramdhin et al ibid; Benade et al *Ondernemingsreg* para 3.25; Williams *Concise Corporate and Partnership Law* 5.
[110] Benade et al ibid at para 3.24; Ramdhin et al ibid. The court stated the following in the *Pezzutto* case at 91, ' … each partner must contribute something 'appreciable', i.e. something of commercial value, although such contribution need not be capable of exact pecuniary assessment as, e.g., where a partner contributes his labour or skill …'.
[111] See the definition of 'goods' in s 1(1). Section 8(11) provides that a supply of the use or right to use any goods under a rental agreement, or any other agreement under which such use is granted, is deemed to be a supply of goods.
[112] See the definition of 'services' in s 1(1).

contribution, and the definitions of 'goods' and 'services', a contribution in kind would most likely constitute either goods or services.

A contribution of money is not a supply of goods or services and is, therefore, not subject to VAT as money is specifically excluded from the definitions of both terms.[113] A contribution of the use of money,[114] however, could be exempt under section 12(*a*), read with section 2(1)(*f*).[115] However, it must be noted that a partner is not entitled to interest on his capital contributions to the partnership unless payment of interest has been agreed upon.[116]

2.6.1 The making of the contribution in the course or furtherance of an enterprise

A partner's contribution will be subject to VAT, under section 7(1)(*a*), if it is made in the course or furtherance of an enterprise he conducts. 'Enterprise' means, in the case of a vendor, any enterprise or activity which is carried on continuously or regularly by a person in the Republic,[117] and in the course or furtherance of which goods or services are supplied to another person for a consideration.[118] An activity which involves the making of exempt supplies is deemed not to be the carrying on of an enterprise.[119]

If the contributing partner is a vendor carrying on an enterprise distinct from the partnership enterprise, a contribution of goods or services made in the course or furtherance of that enterprise may be either taxable or exempt. Whether the contribution is subject to VAT will also depend on whether the partner receives a consideration in return.[120] This aspect is discussed below.[121]

The New Zealand *Case K55*[122] was decided on an application of section 8(1) of the New Zealand GST Act, which provides that GST is charged on the supply of goods and services by a registered person in

[113] See the definitions of 'goods' and 'services' in s 1(1).
[114] In other words, the lending of money.
[115] Section 12(*a*) exempts the supply of 'financial services', which is defined in section 2(1)(*f*) as meaning the provision of credit by which money is provided in return for a sum exceeding the amount of such money.
[116] Bamford *Law of Partnership* 38; Williams *Concise Corporate and Partnership Law* 37; Ramdhin et al "Partnership" para 294. In *Jameson v Irvin's Executors* (1887) 5 SC 222 at 251, the court confirmed that in the law of partnership, profits must ordinarily be regarded as sufficient compensation for the use of capital or labour, and not interest on capital or salary for services rendered.
[117] Or partly in the Republic.
[118] See the definition of 'enterprise' in s 1(1).
[119] Proviso (v) to the definition of 'enterprise'. 'Exempt supply' is defined in s 1(1) to mean a supply that is exempt from tax under s 12. 'Taxable supply' is defined in s 1(1) as meaning any supply of goods or services which is chargeable with tax under the provisions of s 7(1)(*a*), including tax chargeable at the rate of zero per cent under s 11. A 'taxable supply' does not include an exempt supply.
[120] See s 7(1)(*a*) read with 'enterprise' as defined in s 1(1).
[121] See para 2.6.4.
[122] (1988) 10 NZTC 453.

the course or furtherance of a taxable activity carried on by that person. 'Taxable activity' is defined in section 6(1)(a) of the New Zealand GST Act to mean any activity carried on continuously or regularly by a person which involves the supply of goods and services to another person for a consideration. The TRA held that if capital assets are used in conducting a taxable activity, the sale of those assets can readily be in the course or furtherance of that activity.[123] In this case, a clear nexus was held to exist between the objector's farming activities, and the sale of his car which was used principally for those activities.[124]

The definition of 'taxable activity' and section 8(1) of the New Zealand GST Act, are worded similarly to the definition of 'enterprise'[125] and section 7(1)(*a*) of the VAT Act. I agree with the view that a contribution by a partner of a capital asset in his own enterprise, would likewise be made in the course or furtherance of the partner's enterprise.[126]

The GST/VAT legislation in Australia, Canada, New Zealand, and the UK – as in South Africa – does not specifically set out the VAT treatment of a partner's contribution to the partnership.

In the case of Australia, the ATO and McCouat agree that where a registered partner makes an in-kind capital contribution in the course or furtherance of his own enterprise, the in-kind capital contribution is a supply that may be taxable.[127] The consensus in Canada is that a partner's contribution of property to the partnership is a potentially taxable transaction.[128]

In the case of New Zealand, it is clear from the *Nelson* case,[129] and from the New Zealand Court of Appeal case *Commissioner of Inland Revenue v Bayly*[130] which is discussed below,[131] that a partner's contribution to the partnership can be subject to GST. In both these cases the court found that in making the use of land which they owned available to the partnership, the partners were carrying on a taxable activity.

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[123] *Case K55* at 4. See also GSTR 2003/13 para 75.
[124] *Case K55* at 5.
[125] See the definition of 'enterprise' in s 1(1).
[126] See GSTR 2003/13 para 75.
[127] GSTR 2003/13 para 72; McCouat *Australian Master GST Guide* [E-book] Location 66. An 'enterprise' is defined in the Australian GST Act as an activity, or series of activities, done, inter alia, in the form of a business or on a regular or continuous basis in the form of a lease, for example. See s 9-20(1)(a) and (c).
[128] Arsenault & Kreklewetz "Partnerships" 26; Beam, Laiken & Barnett *Taxation in Canada* para 18,965. Canada's ETA defines 'taxable supply' as meaning a supply that is made in the course of a commercial activity. See s 123(1). 'Commercial activity of a person' means, amongst others, a business carried on by the person'. See para (a) of its definition in s 123(1).
[129] (2001) 20 NZTC 17,220.
[130] (1998) 18 NZTC 14,073 (hereafter the *Bayly* case).
[131] See para 2.6.3 below.

In the UK, according to HMRC, a contribution to a partnership comprising services or goods, from a partner's existing business, may, depending on the circumstances, be subject to VAT.[132]

2.6.2 The partner acting as agent for the partnership

Van Doesum argues that a partner's contribution to the partnership may simultaneously serve as a supply on behalf of the partnership to a third party, and by carrying out that task, as an in-kind contribution of labour to the partnership.[133] This is in my view correct, especially considering that partners have the power to act as each other's agents.[134] In view of the partners' agency powers, a question which arises is how a partner's power as an agent impacts on the partner's and the partnership's position for VAT purposes?

As the term 'agent' is not defined in the VAT Act, regard should be had to its meaning in common law.[135] According to Silke, an agent is a representative, who has the power to represent another in his legal relations with third parties, ie, he has the power, acquired contractually, to create legal rights in favour of the person represented, and to create legal obligations binding on the person represented.[136] As a

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[132] XXX Hemmingsley & Rudling *Tolley's Value Added Tax* para 50.7; HMRC "Consideration: Partnership Contributions" available at https://www.gov.uk/hmrc-internal-manuals/vat-supply-and-consideration/vatsc68000 (date of use: 17 August 2018). The UK follows the *KapHag* case of the ECJ (ie, *KapHag Renditefonds 35 Spreecenter Berlin-Hellersdorf 3. Tranche GbR and Finanzamt Charlottenburg* Case C-442/01 26 June 2003), which is discussed below (see para 2.8). On the basis of the *KapHag* case, HMRC holds the view that where the partnership contribution does consist of goods or services, neither admission into the partnership, nor any consequent share of partnership profits, constitutes consideration provided to the new partner for the goods or services that he has contributed. HMRC argues, however, that if the incoming partner is a taxable person, he will need to be treated as making a 'deemed supply' of goods or services if, inter alia, the 'deemed supply' criteria in Schedule 4 para 5 to the UK VAT Act are satisfied. See HMRC "Consideration: Partnership Contributions" ibid; Hemmingsley & Rudling ibid. Note that in the UK a transaction by a person is within the scope of VAT if, amongst others, it is made in the course or furtherance of a business carried on by that person. See Hemmingsley & Rudling ibid at para 1.6.

[133] Van Doesum 2010-6 *EC Tax Review* 263.

[134] The position of a partner acting on behalf of a partnership, was explained in *Potchefstroom Dairies and Industries Co Ltd v Standard Fresh Milk Supply Co* 1913 TPD 506. The court stated that partners are very often styled as agents of each other. The court was, however, not prepared to express a view on whether partners are in fact agents seeing that the law of agency, as currently understood, was developed much later than the law of partnership. In my view, the argument is that when the law of partnership was developed, partners could not have been envisaged as each other's agents, simply because the law of agency did not exist at the time. The court confirmed, however, that partners certainly have the powers of agents, and that the broad principles of the law applicable to agents applies to partners. The court explained further that, although partners may have the powers of agents, they are far more than agents in that the character of a partner is far more complex than merely that of agent. This is so because, in addition to being an agent, a partner has the double character of agent and principal in one and the same transaction, and that not for a share only but in each capacity for the whole. See Henning *Perspectives on the Law of Partnership* para 8.1.2; Ramdhin et al "Partnership" para 306; Mongalo, Lumina & Kader *Forms of Business Enterprise* para 2.3.6.2; Bamford *Law of Partnership* 50. See also Williams *Concise Corporate and Partnership Law* 39.

[135] This approach is based on the presumption that the legislature does not intend to alter the existing law more than is necessary. See para 2.2.2 above.

[136] Silke *Law of Agency* 2. According to De Wet JC "Agency and Representation" in Kühne M (ed) *Law of South Africa vol 1* 3 ed (LexisNexis 2014) para 125, the task to be performed by the agent is the conclusion of a juristic act on behalf of or in the name of the principal.

result, an agent transacts with third parties on behalf of his principal. Such transactions are the principal's transactions in that they are for his benefit, or render him liable, without any benefit or liability attaching to the agent.[137] Section 54(1) is in line with the common law, providing that where an agent makes a supply on behalf of a principal, that supply shall be deemed to be made by the principal and not by the agent. Therefore, where a partner makes a supply to a third party, acting as an agent on behalf of the partnership, the supply is that of the partnership and not the partner.

In *Case N27*[138] the court referred to section 57 of the New Zealand GST Act which directs, in subparagraph (1)(a), that the individual members of a partnership are not themselves liable to be registered under the Act. Seeing that the partnership is to be registered, it is the partnership, rather than the individual members, that carries on a taxable activity. As a result, the court reasoned that when a person, as a member of a registered partnership, acts in the capacity as a member of the partnership and for partnership purposes, the supply by or to that person is deemed to be a supply by or to the partnership and not to any or all of its individual members.[139]

What is key in the judgment, is the court's confirmation that, because the partnership is the registered entity, a supply is deemed to be by or to the partnership "when a person, as a member of a registered partnership, acts in the capacity as a member of the partnership, for partnership purpose".[140] I am in agreement with the court, provided that the partner acted as agent on behalf of the partnership. It would seem, however, that whenever a partner acts in his capacity as a partner and for partnership purposes, he acts as agent for the partnership.

The partnership is, likewise, deemed by section 51(1)(*a*) and (*b*) to be carrying on the partnership's enterprise, and is required to register separately for VAT in respect of that enterprise. Consequently, the supplies and acquisitions of the partner as agent for the partnership are deemed to be those of the partnership. The partnership must, therefore, account for output and input tax on the supplies and acquisitions made by the partner as agent.[141]

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[137] Du Bois et al *Wille's Principles* 986; *Blower v Van Noorden* 1909 TS 890 at 899. The court in *Blower v Noorden* also stated (at 899) that no person dealing with an agent can be held to have intended to contract with him personally, unless the terms of the contract make this clear. Silke maintains that the acts of the agent are done in the name of the principal, and are deemed to be the acts of the principal himself. See Silke ibid at 11.

[138] *Case N27* above.

[139] Ibid at 11. Similar sentiments are expressed by Chabot et al *EY's Complete Guide to GST/HST* para 10,010, namely that anything done by a partner in the partner's capacity as a member of the partnership is deemed to have been done by the partnership in the course of the partnership's activities, rather than in the course of the activities of the individual partner. This, they submit, means that certain activities of a partner are deemed to have been done by the partnership.

[140] Ibid.

[141] See Botes *Juta's Value Added Tax* 51-2.

In *Databank Systems Ltd v Commissioner of Inland Revenue,*[142] the New Zealand Court of Appeal held that where a principal employs an agent to supply services to a customer on behalf of the principal, there will be two contractual relationships. The agent, the court reasoned, will be supplying his services as agent to his principal under the contract between them, whilst the principal will be the receiver of those services. At the same time the principal is the supplier, through the agent, of services to the customer under the contract between the principal and the customer.[143]

In the UK, HMRC holds the same view, arguing that agents act both in their own right making a supply of their services to their principal, and on behalf of the principal in fulfilling their agency function.[144] Commenting on the position in Canada, Chabot et al submit that the principal is required to account for tax on the supply made through the agent, and the agent is required to collect tax on the commission charged to the principal.[145]

In the case of Australia, the ATO and McCouat are likewise of the opinion that if sales are made through an agent, the principal is the one liable for GST, not the agent. Commission paid to the agent, however, is treated as consideration for a supply of agency services.[146]

I argue, therefore, that whilst the partnership is deemed to make the supply made by the partner as agent and must account for output tax on the partner's supply, the partner may be required to account for output tax on his contribution of labour to the partnership, depending on whether all the requirements of section 7(1)(*a*) have been met.

In the case of Canada, Arsenault and Kreklewetz contend that where a partner acts for the purpose of the business of the partnership, the partner acts as an agent of the partnership, making the partner's actions the partnership's actions, which are then the actions of each and every other partner.[147] Section

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[142] [1989] 1 NZLR 422 (hereafter the *Databank* case).
[143] Ibid at 426. See also McKenzie *GST A Practical Guide* [E-book] Location 77.
[144] HMRC "VATTOS8300 – Tax points for specific categories of supplier: Agents" available at http://www.hmrc.gov.uk/manuels/vattosmanual/vattos8300.htm (date of use: 21 January 2016). Further support for this view can be found in Hemmingsley & Rudling *Tolley's Value Added Tax* para 3.2, where it is stated that an agent will usually be involved in at least two separate supplies at one time – the supply of own services to the principal, and the supply made between the principal and the third-party.
[145] *EY's Complete Guide to GST/HST* para 2,130. The Canada Revenue Agency (CRA) agrees that when a registrant acts as agent in selling taxable goods or services on behalf of a principal, generally it is the principal who must charge and account for GST on the sale of the goods or services. See CRA "Agents" available at https://www.canada.ca/en/revenue-agency/services/forms-publications/publications/gi-012/agents.html (date of use: 17 August 2018).
[146] McCouat P *Australian Master GST Guide* [E-book] Location 457; ATO "GST – Agent, consignment and progressive transactions" available at https://www.ato.gov.au/Business/GST/In-detail/Rules-for-specific-transactions/ Agent,-consignment-and-progressive-transactions/GST---Agent,-consignment-and-progressive-transactions/ ?page=2 (date of use: 18 August 2018).
[147] Arsenault & Kreklewetz "Partnerships" 28.

272.1(1) of Canada's ETA provides that, "anything done by a person as a member of a partnership is deemed to have been done by the partnership in the course of the partnership's activities and not to have been done by the person." In Arsenault and Kreklewetz's opinion, section 272.1(1) encapsulates the agency principle underlying partnership.[148] It is stated in the explanatory notes to the amendments which added section 272.1(1), that the effect of this provision is that partners are not required to register separately for GST purposes.[149] The GST effect of section 272.1(1) is to deem what would otherwise have been a potentially taxable supply from partner to partnership, to be a 'nothing' for GST purposes.[150] Consequently, the position in Canada is that a partner is not required to account for GST on the supply of agency services to the partnership.

Both New Zealand and Australian partnership law consider a mutual agency relationship to exist between the partners in the sense that each partner is a principal of the business and may bind the other partners.[151] In the UK, in terms of the Partnership Act[152] every partner is an agent of the firm and of his other partners for the purpose of the business of the partnership. Moreover, the acts of every partner who performs any act while carrying on business of the kind carried on by the firm in the usual way, binds the firm and its partners.[153]

Considering that in both New Zealand and the UK an agent's supply to his principal is recognised for GST/VAT purposes,[154] in my view a partner's supply of agency services to the partnership could be subject to GST/VAT in these jurisdictions.

Section 184-5(1) of the Australian GST Act, provides that:

> For the avoidance of doubt, a supply, acquisition or importation made by or on behalf of a partner of a partnership in his or her capacity as a partner:
>
> (a) is taken to be a supply, acquisition or importation made by the partnership; and
>
> (b) is not taken to be a supply, acquisition or importation made by that partner or any other partner of the partnership.

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[148] Ibid.

[149] Department of Finance Canada *Amendments to the Excise Tax Act, the Federal-Provincial Fiscal Arrangements Act, the Income Tax Act, the Debt Servicing and Reduction Account Act and Related Acts* Explanatory Notes July 1997 at 150.

[150] Arsenault & Kreklewetz "Partnerships" 28. Murray supports this view, and argues that the practical effect of s 272.1(1) is that a partner is not considered to have made any sort of supply to the partnership when he performs duties 'as a member of a partnership'. The partner is therefore not required to account for GST in relation to the performance of such duties. In fact, Murray's article is significantly entitled "Partner Contributions: Deeming Away any Supply to the Partnership" and is available at http://www.cch.ca/ newsletters/TaxAccounting/july2010/Article2.htm (date of use: 4 September 2014).

[151] Higgins *Law of Partnership* 87; McCouat *Australian Master GST Guide* [E-book] Location 47; Williams *Corporations and Partnerships in New Zealand* para 777.

[152] 1890 Chapter 39 53 and 54 Vict.

[153] Section 5. See also Scamell & I'anson Banks *Lindley on the Law of Partnerships* 285.

[154] See the discussion above under this sub-heading.

It is not clear whether section 184-5(1) has the same effect as section 272.1(1) of Canada's ETA in eliminating the need for partners to account for VAT on agency services supplied to the partnership. I have referred to McCouat's[155] view that in terms of the Australian GST an 'in-kind' capital contribution made by a partner on entering into a general law partnership, is a supply by the partner and may be taxable if made as part of carrying on a separate business run by the partner.[156] I argue that if the supply of agency services to the partnership is made by the partner as part of the carrying on of a separate enterprise, the partner could be liable for GST on such services. Section 184-5(1) deems the partner's supply that of the partnership in the same way that an agent's supply is deemed that of his principal. This, however, does not mean that the partner's supply of agency services to the partnership should be ignored for GST purposes in that it is a separate transaction.[157] It is possible, however, that the Australian legislature could have intended section 184-5(1) to have the same effect as section 272.1(1).

2.6.3 Partner making his contribution 'continuously or regularly'

A partner's contribution will be made in the course or furtherance of an enterprise if the activities that culminate in making the contribution are sufficiently continuous or regular to constitute an enterprise.[158]

The *Bayly* case supports the argument that a partner's contribution to a partnership can constitute an enterprise. The question raised in this appeal was whether the trustees in each case were liable under the New Zealand GST Act for output tax on the sale of their interests in farmland plus, in the case of three trusts, livestock. The farming partnerships in which the trusts were members operated farming enterprises. In terms of the Deeds of Partnership, each of the partners placed the interest in land and the livestock at the use of the partnership, without transferring ownership to the partnership.

The Commissioner of Inland Revenue contended that in providing the farmland (plus the livestock) to the respective partnerships, each trust had carried on a taxable activity.[159] The court agreed with the Commissioner and emphasised that it is the activity itself – ie, the trusts' on-going and recurring rights and responsibilities – which must be continuous or regular so as to constitute a taxable activity as envisaged in section 6 of the New Zealand GST Act.[160]

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[155] In para 2.3 above.
[156] McCouat *Australian Master GST Guide* [E-book] Location 66.
[157] See the reasoning applied in the New Zealand *Databank* case above and under this sub-heading.
[158] In the New Zealand High Court case of *Allen Yacht Charters Limited v CIR* (1994) 16 NZTC 11,270 at 5, it was held that the words 'continuously or regularly' as contemplated in the definition of 'taxable activity' in s 6 of the New Zealand GST Act, indicate that "the activity must either be carried on all the time, i.e., continuously, or it must be carried on at reasonably short intervals, ie regularly. An activity that is intermittent or occasional does not qualify."
[159] Ibid at 14,074.
[160] Ibid at 14,078.

As a result, a partner's contribution of goods or services may be an enterprise activity if made in the course or furtherance of a continuous or regular activity carried on by the partner. Such a contribution is, in terms of section 7(1)(*a*), subject to VAT if it meets all the requirements in this provision. Conversely, where a partner who is not a vendor, makes a one-off contribution that is not made in the course or furtherance of a continuous or regular activity – eg, the one-off contribution of the ownership of property – the supply is not made as part of an enterprise.

A question arising is whether the mere holding of a partner's share can constitute an enterprise. A partner's share has a dual nature. Firstly, a partner's share signifies a partner's right to claim a specific portion of the partnership assets, such as profits, when this portion is due. Secondly, a partner's share comprises his undivided interest in jointly-owned partnership property, including partnership profits, other than the realisation of the property as such.[161]

The South African Supreme Court of Appeal held in *Commissioner for SARS v De Beers Consolidated Mines Ltd*,[162] that unless one conducts business as an investment company, the investments one holds cannot, on their own, be regarded as constituting an enterprise.[163] I argue that this case is authority for the view that the mere holding of a partner's share does not constitute an enterprise activity – unless, for example, the partner's enterprise is buying and selling partners' shares.[164]

Under article 2(1) of the Sixth Directive, VAT is chargeable on "the supply of goods or services effected for consideration within the territory of the country by a taxable person acting as such". Article 4(1) and (2) of the Sixth Directive provides:

> 1. 'Taxable person' shall mean any person who independently carries out in any place any economic activity specified in paragraph 2, whatever the purpose or results of that activity.
> 2. The economic activities referred to in paragraph 1 shall comprise all activities of producers, traders and persons supplying services including mining and agricultural activities and activities of the professions. The exploitation of tangible or intangible property for the purpose of obtaining income therefrom on a continuing basis shall also be considered an economic activity.

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[161] Ramdhin et al "Partnership" para 289; Williams *Concise Corporate and Partnership Law* 31. Benade et al *Ondernemingsreg* paras 4.14 and 4.21, also confirm that every partner has a right to share in the profits of the partnership. This right is an *essentiale* of a partnership contract. They further explain that a partner has an undivided share in the partnership assets until the partnership dissolves and the partnership estate is liquidated. In *Sacks v Commissioner for Inland Revenue* 1946 AD 31 (hereafter the *Sachs* case), the Appellate Division stated at 40 of the judgment that during the subsistence of a partnership agreement the partnership property is owned in common and in undivided shares, but that a partner also becomes entitled to claim a share of the partnership profits at the end of an agreed period(s) and may also be entitled to an amount when the partnership agreement terminates.

[162] [2012] 3 All 367 (SCA), 74 SATC 330 (hereafter the *De Beers* case).

[163] Ibid at para 34.

[164] See, eg, NZIR "Questions We've Been Asked QB 14/03, – GST – Transfer of Interest in a Partnership" available at http://www.ird.govt.nz/resources/7/2/72537cec-da81-407d-ad4f-e490c9f2213d/qb1403.pdf at 3 para 16 (date of use: 8 December 2016), where the NZIR acknowledged that a partner could carry on a taxable activity of buying and selling partnership interests.

Both ‘economic activities’ in the Sixth Directive, and ‘enterprise’ in the VAT Act, require activities in respect of which amounts are received. The definition of ‘enterprise’ requires ‘continuous or regular’ activities in the course or furtherance of which goods or services are supplied ‘for a consideration’. ‘Economic activities’ are essentially activities conducted “for the purpose of obtaining income therefrom on a continuing basis.” The Sixth Directive was replaced by the Council Directive with effect from 1 January 2007. ‘Taxable person’ and ‘economic activity’ are similarly worded in the Council Directive.[165]

In the *Polysar Investments* case, the ECJ held that the mere acquisition of financial holdings in companies does not amount to the exploitation of property for the purpose of obtaining income therefrom on a continuing basis, as envisaged in article 4(2) of the Sixth Directive. This is because any dividend yielded by that holding is merely the result of ownership of the holding. The position is different where the holding is accompanied by direct or indirect involvement in the management of the companies in which the holding has been acquired.[166] This view was reconfirmed by the ECJ in, amongst others, the *Sofitam SA*,[167] *Wellcome Trust Ltd,*[168] and *Harnas & Helm* cases.[169]

The ECJ, in the *Floridienne* case,[170] stated that involvement in the management of subsidiaries must be regarded as an economic activity within the meaning of article 4(2) of the Sixth Directive, in so far as it entails carrying out transactions which are subject to VAT, such as the supply by the holding company of administrative, accounting, and information technology services to its subsidiaries.[171] The court held, however, that in order for the dividends to be regarded as consideration for these services, and, therefore, fall within the scope of VAT, there must be a direct link between the services and the dividends.[172] The court concluded that there was no such a direct link.[173]

Citing the *Polysar Investments* and *Harnas Helm* cases with approval, the ECJ in the *KapHag* case, held that the entry of a new partner into a partnership in consideration for a contribution in cash, does not constitute an economic activity falling within the meaning of the Sixth Directive on the part of the partner.[174]

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[165] See art 9 of the Council Directive.
[166] *Polysar Investments Netherlands BV and Inspecteur der Invoerrechten en Accijnzen (Inspector of Customs and Excise) Arnhem,* Case C-60/90 20 June 1991 paras 13 and 14.
[167] *Sofitam SA (formerly Satam SA) and Ministre chargé du Budget* Case C-333/91 22 June 1993 paras 12 and 13.
[168] *Wellcome Trust Ltd and Commissioners of Customs & Excise* Case C-155/94 20 June 1996 para 32 (hereafter the *Wellcome Trust* case).
[169] *Harnas & Helm CV and Staatssecretaris van Financiën* Case C-80/95 6 February 1997.
[170] *Floridienne SA Beinvest SA and Belgian State* 14 November 2000 Case C-142/99 (hereafter the *Floridienne* case).
[171] Ibid at para 19.
[172] Ibid at para 20.
[173] ibid at para 23.
[174] Ibid at para 39.

For reasons stated below,[175] I argue that the direct-link test does not apply when determining whether an amount is consideration for a supply in terms of the VAT Act. It is my view that because 'economic activities' and 'taxable person' in the Sixth Directive are, respectively, similarly defined as 'enterprise' and 'taxable person' in the VAT Act, the ECJ's reasoning as to when a financial holding constitutes an economic activity, can serve as guidance when considering the same issue under the VAT Act.

Whether profit distributions qualify as consideration for partners' capital contributions, is discussed below.[176] Assuming that they are not, a mere holding of a partner's share does not constitute an enterprise activity because any profit share yielded by that holding would merely be the result of ownership of such partner's share.[177] A partner's contribution is, therefore, not made in the course or furtherance of an enterprise comprising a mere holding of a partner's share. The holding of a partner's share would, however, be part of an enterprise activity where the partner makes contributions to the partnership which are subject to VAT. A partner could, for example, supply management services to the partnership in return for which he is paid a management fee.[178] As a result, a partner's contribution could be made in the course or furtherance of the holding of a partner's share, provided that such holding constitutes an enterprise activity.

2.6.4 Whether the contribution is made for a consideration

Section 7(1)(*a*) provides that in order for a supply to be subject to VAT, it must be made for a consideration. The term 'consideration' is defined,[179] in relation to the supply of goods or services to a person, as meaning any payment made, whether in money or otherwise, in respect of, in response to, or for the inducement of, the supply of goods or services, whether by that or any other person.

Each partner receives a partner's share when concluding the partnership agreement.[180] In *Sacks v Commissioner for Inland Revenue,*[181] the court referred to the decision of the Cape Provincial

[175] See para 2.6.4.3 below.
[176] See para 2.6.4 below.
[177] See para 2.6.5 below.
[178] Unless the partners agree otherwise, it is a *naturalia* of partnership that each partner can represent the partnership in transactions that fall within the ambit of the partnership business, without further permission from his co-partners. See Benade et al *Ondernemingsreg* para 3.50. One of the partners can, therefore, be entrusted with the management responsibilities of the partnership. See Ramdhin et al "Partnership" para 263.
[179] See s 1(1).
[180] Ramdhin et al "Partnership" para 289. See also Williams *Concise Corporate and Partnership Law* 31; Benade et al *Ondernemingsreg* paras 4.14 and 4.21.
[181] 1946 AD 31.

Division,[182] whose judgment was appealed, where it held that a partner's right to share in the profits of the partnership accrues at the inception of partnership.[183] The question arising is whether a partner makes his contribution to the partnership for consideration, and particularly, whether a partner's share constitutes consideration for such contribution.

This would depend on whether the partner receives a partner's share on formation of the partnership, or any other payment, "in respect of, in response to, or for the inducement of the partner's contribution to the partnership, as contemplated in the definition of 'consideration'." These phrases are, in the present context, defined as follows:

a. 'respect' means '1 Relation, connection, reference, regard … now chiefly in … *in respect of*'
b. 'in response' means 'in reply (to), by way of reaction (to)';
c. 'inducement' means '1 A thing which induces someone *to do* something; an attraction, an incentive … A ground or reason which inclines one to a belief or course of action … 2 The action of inducing; persuasion, influence'.[184]

Considering the ordinary meaning of 'in respect of, in response to, or for the inducement of', the supply and payment are required to bear some sort of a connection if the payment is to constitute consideration. The question, however, is how close must that connection be? The SARS is of the view that although the definition of consideration is very wide, there must be a sufficient *nexus* between the supply and the payment for the supply to constitute consideration.[185]

2.6.4.1 New Zealand

The definition of 'consideration' in the VAT Act is virtually a duplication of the definition of the term in the New Zealand GST Act,[186] with both definitions incorporating the phrase "in respect of, in response to or for the inducement of".[187]

[182] Note that this is an appeal against the decision of the Cape Provincial Division which appears to be unreported. The appeal is reported as *Sacks v Commissioner for Inland Revenue* 1946 AD 31.
[183] Ibid at 43.
[184] *Shorter Oxford English Dictionary.*
[185] SARS Interpretation Note 70 – 14 March 2013 "Supplies made for no consideration" para 5.1.2, In *CSARS v Marshall NO* (above) at para 33 the court stated that SARS Interpretation Notes, "though not binding on the courts or a taxpayer, constitute persuasive explanations in relation to the interpretation and application of the statutory provision in question."
[186] Section 2 of the New Zealand GST Act.
[187] 'Consideration' is defined in section 2(1) of the New Zealand GST Act as meaning, "in relation to the supply of goods and services to any person, includes any payment made or any act or forbearance, whether or not voluntary, in respect of, in response to, or for the inducement of, the supply of any goods and services, whether by that person or by any other person; but does not include any payment made by any person as an unconditional gift to any non-profit body."

In the New Zealand Court of Appeal (Income Tax – PAYE) case of *Shell New Zealand Limited*,[188] the issue was whether Shell was required to make tax deductions from particular payments made to employees. This, in turn, depended on whether the payments were made to each of the employees concerned 'in respect of or in relation to their employment'. The court stated that the words 'in respect of or in relation to' are words of the widest import.[189] According to New Zealand Inland Revenue (the NZIR) the courts have, in recent years, consistently rejected weak linkages between payments and supplies as propagated in the *Shell New Zealand* case.[190]

In the *Taupo Inka Nui* case, the New Zealand High Court held that the use of the term 'consideration'' introduces the specific meaning given to that term in a legal context. The concept of consideration as used in the law of contract has an element of reciprocity. There is no such element in a situation where a corporate body merely collects the contributions from its members and passes them on. The court held that while the term 'in respect of' is unrestricted and wide enough to encompass a meaning which includes what took place in that case, it must be interpreted in relation not only to the use of the term 'consideration', but also to the associated concepts of 'response to' or 'inducement of', both of which involve an element of reciprocity.[191]

The facts in the New Zealand Court of Appeal case of *New Zealand Refining Co Ltd*[192] were that New Zealand Refining Company Limited (NZRC) operated an oil refinery. In terms of an agreement, the Crown was to make the payments to NZRC only if and so far as the refinery remained operational. Once it closed, payments would cease and no further sums would be due unless it reopened.

The court found that while the parties may well have expected the refinery to continue operating and supplying the oil companies with product, there was no contractual requirement that NZRC had to keep the refinery open.[193] There was, therefore, no binding commitment to link the Crown's payments and the making of supplies of goods or services by NZRC.[194]

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[188] *Shell New Zealand Limited v Commissioner of Inland Revenue* (1994) 16 NZTC 11,303a, Court of Appeal CA 294/93 (the *Shell New Zealand* case).
[189] Ibid at 3.
[190] NZIR Interpretation Statement 3387 "*GST Treatment Of Court Awards And Out Of Court Settlements"* at 11 available at https://iknow.cch.co.nz/document/iknzUio797637sl29688950/is3387-d2-gst-treatment-of-court-awards-and-out-of-court-settlements-draft-interpretation-statement-is3387-d2 (date of use: 31 December 2018).
[191] Ibid at 13150.
[192] *Commissioner of Inland Revenue v New Zealand Refining Co Ltd* (1997) NZTC 13,187 Court of Appeal CA 239/95 (the *New Zealand Refining Co* case).
[193] Ibid at 13192.
[194] Ibid at 13193.

The court also stated that to constitute consideration for a supply, a payment must be made for that supply. The court explained that there is a practical necessity for a sufficient connection between the payment and the supply. The mechanics of the legislation would otherwise make it impossible to collect the GST. The court held that although the payments were intended as an inducement to NZRC to keep the refinery open for three years, they were not payments 'for' any supply.[195] Accordingly, they were not subject to GST.[196]

The word 'for', in the current context, means "introducing that with which something is (to be) exchanged: in exchange for; as the price or penalty of; in requital of. … At the cost of, to the amount of."[197] In terms of the ordinary meaning of the word 'for', an amount is consideration 'for' a supply if it is given in exchange for, or as the price of, that supply. In my view, 'for' clearly implies reciprocity.

The court in the *New Zealand Refining Co* case emphasised that the definition of 'taxable activity' in section 6, itself requires a *nexus* between a supply and consideration, as does section 10.[198] The tax itself is levied by section 8 on a supply in the course or furtherance of a taxable activity, and is "by reference to the value of that supply". Section 10 provides that the value of a supply is "to the extent of the consideration for the supply", the amount of the money involved or the non-monetary open-market value of the consideration.[199]

The definitions of 'enterprise' in sections 7(1)(*a*) and 10(2), are worded similarly to the definitions of 'taxable activity' in sections 8 and 10(2) of the New Zealand GST Act, and also require a *nexus* between a supply and a consideration. The definition of 'enterprise' requires that goods or services be supplied 'for a consideration'. Section 7(1)(*a*) also levies VAT by reference to 'the value of the supply'. In terms of section 10(2) the value to be placed on a supply of goods or services shall be the amount of the 'consideration for [the] supply'.

In the New Zealand Court of Appeal case of *Chatham Islands Enterprise Trust,*[200] the Crown (the settlor) established a charitable trust (the Trust). The Commissioner of Inland Revenue claimed GST on

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[195] Ibid.

[196] Ibid at 13194.

[197] *Shorter Oxford English Dictionary.*

[198] Section 10 of the New Zealand GST Act: Value of supply of goods and services, provides:

> …
> (2) Subject to this section, the value of a supply of goods and services shall be such amount as, with the addition of the tax charged, is equal to the aggregate of,—
> (a) To the extent that the consideration for the supply is consideration in money, the amount of the money:
> (b) To the extent that the consideration for the supply is not consideration in money, the open market value of that consideration.

[199] *New Zealand Refining Co* case at 13193.

[200] *Chatham Islands Enterprise Trust v Commissioner of Inland Revenue* (1999) 19 NZTC 15,075 Court of Appeal CA 171/98.

payments made by the Crown to the Trust. The Commissioner contended that the Trust, in carrying out its functions pursuant to the Trust deed, was making a supply of services to the Crown in the course of a taxable activity. This was done for a consideration, so it was argued, because the two payments induced the Trust to carry out its functions.

The court held that the Trust had not assumed a contractual or even a voluntary obligation to the Crown,[201] and further that the payments had not been made pursuant to reciprocal obligations by the Trust enforceable at law. The Trust was, therefore, not making a supply of anything to the settlor in exchange for, or induced by, the payments.[202] According to the court, the concept of supply of services, is not appropriate to capture the fulfilment by trustees of their duties as such – albeit that such fulfilment will necessarily, in a direct or indirect way, be of benefit to the beneficiaries and the settlor.[203] As a consequence, the trustees had not made their (assumed) supply of services in the course or furtherance of a taxable activity.[204]

In the New Zealand Court of Appeal case, *Suzuki New Zealand Limited*,[205] one of the questions was whether Suzuki New Zealand Limited (SNZ) supplied a repair service to Suzuki Motor Company Limited (SMC). The court held that while the one fault sometimes could and did stimulate repair by SNZ, both under its warranty to the customer and at SMC's behest, to cover warranty breach by SMC, the court was satisfied that the subsequent payment by SMC was only for the latter repair. It was not 'in respect of', 'in response to', or as an 'inducement for' the repair carried out for the customer.[206] There was a contractual intention of placing on one of the parties – SNZ – the obligation to perform repairs to vehicles under warranty, in return for an obligation by the other party – SMC – to pay.[207]

The NZIR agrees with the New Zealand courts, and sets out its views in policy documents, which effectively capture the essence of the courts' decisions. The NZIR argues that payment is consideration for a supply if the supply can be connected to the payment by enforceable, reciprocal obligations. It is not necessary for there to be a contract between the parties, but the payer and the supplier must have

[201] Ibid at para 18. Note that the New Zealand court requires that the supply and the payment be made in terms of an enforceable obligation, notwithstanding that 'consideration' is defined as a payment, 'whether or not voluntary'. In other words, the parties must be legally bound to render performance, whether that obligation arises from contract or is undertaken voluntarily.
[202] Ibid at para 18.
[203] Ibid at para 30.
[204] Ibid at para 33.
[205] *Commissioner of Inland Revenue v Suzuki New Zealand Limited* (2000) 19 NZTC 15,819 High Court Wellington CP 208/99.
[206] Ibid at para 63.
[207] NZIR Interpretation Statement 3387 "*GST Treatment Of Court Awards And Out Of Court Settlements"* at 10 available at https://iknow.cch.co.nz/document/iknzUio797637sl29688950/is3387-d2-gst-treatment-of-court-awards-and-out-of-court-settlements-draft-interpretation-statement-is3387-d2 (date of use: 31 December 2018).

the ability to enforce the deal.[208] Furthermore, the reciprocal-obligation requirement will generally be satisfied if it can be shown that payment has been made by one party 'for' the supply of goods or services by another party.[209]

2.6.4.2 Australia

Section 9.15(1)(a) and (b) of the Australian GST Act defines 'consideration' as including a payment 'in connection with', or 'in response to or for the inducement of' a supply. The only difference between the Australian and the South African and New Zealand definitions of 'consideration', is that whereas the South African and New Zealand definitions use the phrase 'in respect of', the Australian definition adopts the alternative phrase 'in connection with'. The three countries' definitions all use the phrases 'in response to' and 'for the inducement of'.[210]

The ATO is of the view that in order for a payment to be a consideration for a supply, there must be a sufficient *nexus* between supply and payment.[211] The ATO submits, on the strength of Australian case law, that the phrase 'in connection with' is of wide import and has been held to be broader in scope than 'for'.[212] In *Vidler v FC of T,*[213] an Administrative Appeals Tribunal, in considering whether a payment was 'in connection with' a supply of property as envisaged in section 9.15(1)(a), compared the use of 'for' versus 'in connection with' in the Australian GST Act. Sections 9-5(a) and 75-10(2) of the Australian GST Act, for example, refer to a 'supply for consideration' and to a 'consideration for the supply', respectively. The Tribunal held that the use of the broader concept 'in connection with' cannot have

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[208] NZIR Tax Information Bulletin Vol 14 No 10 (October 2002) at 27 available at https://www.ird.govt.nz/resources/1/6/1690aff4-80b6-4683-b52f-1cda0e366e52/tib-vol14-no10.pdf (date of use: 30 December 2018).

[209] NZIR Interpretation Statement IS 10/03 "GST: Time of supply – Payments of deposits, including to a stakeholder" at paras 72 and 73 available at https://iknow.cch.co.nz/document/iknzUio1674868sl247811834/is-10-03-gst-time-of-supply-payments-of-deposits-including-to-a-stakeholder-interpretation-statement-is-10-03 (date of use: 30 December 2018). The question is, whether, if the phrases 'in respect of', 'in response to', and 'for the inducement of', import the same requirement of enforceable reciprocal obligations into definition of consideration, are they in any way different? The NZIR sees a difference based on the *time* at which the consideration is paid. 'In respect of' can be characterised as a contemporaneous situation where payment is given for a supply at the time of payment. 'In response to' is seen to include cases where a supply is received and paid for later, while 'for the inducement of' includes cases where an enforceable supply or agreement for supply is tendered following an offer of payment for that supply. See NZIR Tax Information Bulletin ibid.

[210] Martin [2000] *JIATax* 20; (2000) 3/4 *Journal of Australian Taxation* 261 para 3.4.

[211] ATO Goods and Services Tax Ruling: GSTR 2001/6 "Goods and services tax: Non-monetary consideration" available at https://www.ato.gov.au/law/view/document?Docid=GST/GSTR20016/NAT/ATO/00001 (date of use: 31 December 2018) at para 68 (hereafter GSTR 2001/6); ATO Goods and Services Tax Ruling: GSTR 2012/2 "Goods and services tax: Financial assistance payments" available at https://www.ato.gov.au/law/view/pdf?DocID=GST%2FGSTR20122%2FNAT%2FATO%2F00001&filename=law/view/pdf/pbr/gstr2012-002c3.pdf&PiT=99991231235958 (date of use: 22 December 2018) (hereafter GSTR 2012/2) para 128.

[212] GSTR 2012/2 at para. 125.

[213] 2009 ATC 10-093 (Media neutral citation: [2009] AATA 395 Administrative Appeals Tribunal Sydney 2009).

been accidental. It must be assumed, the Tribunal reasoned, that the object of the legislation is to cast the net wider than would have been the case had the relationship between 'supply' and 'consideration' in section 9-5(a) been governed by the word 'for' rather than the phrase 'in connection with'.[214]

I argue, however, that given the use of the phrase 'in connection with', guidance should not be sought in Australian case law for the interpretation of 'consideration' in the VAT Act.

2.6.4.3 Canada, the UK and the EU

Canada's ETA provides that GST is imposed "on the value of the consideration for the supply."[215] In the UK, a supply for VAT purposes takes place when something is provided 'for a consideration'.[216] In terms of the Council Directive,[217] VAT is levied on the supply of goods and services 'for consideration'. The Sixth Directive similarly provides that what is subject to VAT, is the supply of goods or services 'effected for consideration'.[218] The Canadian and EU law do not elaborate on what 'for' means in this context.[219]

In the EU case of *Apple and Pear Development Council*,[220] the court applied a direct-link test to determine whether certain charges were subject to VAT. The court held that mandatory charges imposed on growers do not constitute consideration having a direct link with the benefits accruing to individual growers from the exercise of the Apple and Pear Development Council's functions. In the circumstances, the exercise of those functions, therefore, did not constitute a supply of services effected for consideration within the meaning of article 2(1) of the Sixth Directive.[221]

In the EU case of *Empire Stores*,[222] the court held that the supply of an article without extra charge, is made in consideration of the introduction of a potential customer and not in return for the purchase by that customer of goods in Empire Stores' catalogue.[223] The court held, therefore, that the link between the supply of the article without extra charge, and the introduction of a potential customer, must be regarded as direct, as, were the service not provided, no article would be due from or supplied without extra charge by Empire Stores.[224]

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[214] Ibid at para 65.
[215] Section 165(1).
[216] Section 5(2) of the UK VAT Act; Hemmingsley & Rudling *Tolley's Value Added Tax* para 64.1.
[217] Articles 2(1)(a) and 2(1)(c).
[218] Article 2(1).
[219] See GSTR 2001/6 at para 64.
[220] *Apple and Pear Development Council and Commissioners of Custom and Excise* Case 102/86 8 March 1988.
[221] Ibid at para 16.
[222] *Empire Stores Ltd and Commissioners of Custom and Excise* Case C-33/93 2 June 1994 (hereafter the *Empire Stores* case).
[223] Ibid at para 13.
[224] Ibid at para 16.

The ATO observes that while EU and Canadian authorities show the need for a link between supply and consideration if a VAT or GST liability is to arise, in New Zealand the definition of consideration itself describes the link.[225] In the New Zealand High Court decision of *New Zealand Refining*,[226] the court commented on the application of EU authorities to both the interpretation of 'consideration' in New Zealand's GST Act, and when considering the required link between a supply and a payment. The court stated that the ECJ cases demonstrate the need for a link between a payment and the relevant service, but that the court must not apply these cases as this would go beyond the specific words defining 'consideration'[227]

The EU's direct-link test should, therefore, not be applied in light of the difference in the wording of the provisions as regards the concept of 'consideration'. However, referring to the *Empire Stores* case, van Doesum submits that a link between a supply and the consideration must be regarded as direct when the supply will not be made if no consideration is paid, and when no consideration will be paid if the supply is not made.[228] This view is in line with the New Zealand courts' interpretation of reciprocal obligations.

The ECJ's reasoning in *Floridienne*[229] is still useful, however, when considering whether profit distributions are consideration for partners' capital contributions, even when applying a different test under the VAT Act. In considering whether a direct link existed between services supplied by two holding companies to their subsidiaries, and the dividends declared by the subsidiaries, the court took the following features of dividends into account:

a. Dividends are paid as a result of a decision taken unilaterally by the subsidiary, and the same dividend is declared in respect of all the shares of a given class, irrespective of whether the shares are owned by the holding company. In the instant case, the holding companies received specific remuneration for the services they supplied to their subsidiaries, distinct from the dividends allocated to them.[230]
b. The existence of distributable profits is generally a prerequisite for payment of a dividend, and that payment, therefore, depends on the company's year-end results.

[225] GSTR 2001/6 at para 58. See s 2(1) of the New Zealand GST Act.
[226] *New Zealand Refining Company Limited v Commissioner of Inland Revenue* (1995) 17 NZTC 12,307 High Court Auckland M 764/90.
[227] Ibid at 7.
[228] Van Doesum 2010-6 *EC Tax Review* 268.
[229] Case C-142/99 above.
[230] Ibid at para 14.

c. The proportions in which the dividend is distributed, are determined by reference to the type of shares held, in particular by reference to classes of share, and not by reference to the identity of the owner of a particular shareholding.

d. Dividends represent, by their very nature, the return on investment in a company and are merely the result of ownership of that property.[231]

The court found that in view, specifically, of the fact that the amount of the dividend depends partly on unknown factors, and that entitlement to dividends is merely a function of shareholding, the necessary direct link between the dividend and a supply of services did not exist.[232] As a result, the dividends were not consideration for the supply of the holding companies' services.[233]

2.6.5 Whether partners' obligations are reciprocal

In my view, as the South African VAT was modelled in part on that of New Zealand,[234] the definitions of 'consideration' in the VAT Act and in the New Zealand GST Act are virtually identical, and both definitions use the phrase "in respect of, in response to or for the inducement of", the New Zealand requirement of 'enforceable reciprocal obligations' should be adopted for the VAT Act. Australian, Canadian, UK, and EU authorities should not be followed based on the difference in wording of the relevant provisions. A payment will, therefore, be consideration for a supply if it can be connected to that supply by enforceable reciprocal obligations. The question is, when are obligations reciprocal in terms of the South African law?

In *ESE Financial Services (Pty) Ltd v Cramer*,[235] the court stated that in a bilateral contract, certain obligations may be reciprocal. Contracts are only one of various sources of obligation.[236] The court in *ESE Financial Services* further explained that obligations are reciprocal in the sense that the performance of the one obligation, may be conditional upon the performance of some other obligation. This reciprocity, according to the court, may itself be bilateral in the sense that the performance of the obligations represents concurrent conditions. In other words, the obligations are required to be performed simultaneously. Alternatively, the reciprocity may be one-sided, in that the complete performance of the one party's contractual obligation may be a condition for the performance of the

[231] Ibid at para 22.
[232] Ibid at para 23.
[233] Ibid. The judgment in *Floridienne* was confirmed in *Cibo Participations SA and Directeur regional des impôts du Nord-Pas-de-Calais* Case C-16/00 27 September 2001 at para 21.
[234] Schenk, Thuronyi & Cui *Value Added Tax* 58.
[235] [1973] 3 All SA 199 (C) 203.
[236] Lubbe & Murray *Farlam & Hathaway* 1. Other sources of obligation include those based in delict, and those arising from unjustified enrichment and *negotiorum gestio* (ibid). See also Joubert *General Principles of Contract* 17.

other party's reciprocal obligation. The court held that for reciprocity to exist there must be a relationship between the obligation to be performed by the one party, and that due by the other party, which indicates that one obligation was undertaken in exchange for the performance of the other obligation.[237]

Contractual obligations are created by agreement between parties.[238] An obligation imposes duties on the one party to the agreement – the debtor – whilst it confers corresponding rights on the other party – the creditor. The creditor has a right to the performance of the duty by the debtor. Most obligations give rise to rights and duties for all parties to the agreement.[239] In contracts that create mutual rights and obligations, it is a matter of interpretation whether the parties' obligations are sufficiently closely connected for the principle of reciprocity to apply.[240]

In a reciprocal contract, one party has a right to withhold his performance until the other party has performed. A defendant enforces the right by raising the *exceptio non adimpleti contractus* defence against a plaintiff who has not yet performed.[241]

Two commentators have expressed a view on whether partners' obligations are reciprocal, albeit in terms of, respectively, Latvian and Romanian partnership law. Balodis, although describing a partnership agreement in Latvian law as a 'reciprocal contract', submits that such an agreement is not aimed at the exchange of performances. He argues that the aim of a partnership agreement is, instead, the consolidation of performances. When describing contractual obligations in a partnership agreement as reciprocal, Balodis does not mean that the one contractual obligation is performed in exchange for the other, but that any partner can request the other partners to render performance in accordance with the partnership agreement, and in particular, to make a contribution to the partnership. He further submits that as there is no mutual exchange of performances under a partnership agreement, no partner can, as a general principle, withhold performance on the ground that the other partners have failed to perform their duties.[242]

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[237] *ESE Financial Services* [1973] 3 All SA 199 (C) at 203-204.
[238] Lubbe & Murray *Farlam & Hathaway* 1; Joubert *General Principles of Contract* 21.
[239] Lubbe & Murray ibid at 4; Joubert ibid at 8-9.
[240] Lubbe & Murray ibid at 553.
[241] *BK Tooling (EDMS) BPK v Scope Precision Engineering (EDMS) BPK* [1979] 3 All SA 166 AD 187. According to Joubert, the defence of *exceptio non adimpleti contractus* can only be raised where the performances of the parties are reciprocal and the one is prerequisite for the other. If the performances are not reciprocal, meaning that the performances are unrelated in the sense that the one is not a *quid pro quo* for the other, the defence does not arise. See Joubert *General Principles of Contract* 230-1.
[242] Balodis K "Contractual aspects of formation and composition of commercial partnerships" (2005) X *Juridica International* 79-84 at. See also Seucan A "Specific aspects related to the partnership agreement" (2015) *Social Economic Debates vol 4 No 1* 32-35 at 35.

A Latvian partnership is similar to a South African partnership in that although the partnership enjoys some legal capacity, is not a legal person.[243] Other relevant features of a Latvian partnership are that a person who shares in the partnership profits but makes no contribution to the partnership, is not a member of the partnership; and that, as a general principle, the profits and losses of the partnership are divided among the members in proportion to their contribution to the partnership.[244]

Seucan discusses the features of a bilateral or reciprocal contract in the context of the law of Romania, to establish whether a Romanian partnership agreement is such a contract.[245] According to Seucan, a contract is reciprocal if it gives rise to mutual obligations between the parties – ie, a right accruing to one party to the agreement, is matched by a corresponding obligation imposed on the other party, and vice versa. Seucan argues that the obligations differ for each contracting party.[246] Furthermore, the obligations arising from a reciprocal contract are interdependent. Seucan's argument is compelling because, as she explains, the obligations differ as the aim pursued by each party differs.[247]

She argues further that because the partners share a common goal, the right of one party does not give rise to a corresponding obligation for the other contracting party. The obligations arising from the partnership agreement are the same for all the partners. As the obligations are not mutual, Seucan maintains, the parties to the partnership agreement are not called debtors and creditors, but partners.[248]

As in the case of a partnership under Latvian law, a partnership agreement is, in Romanian law, similar to a South African partnership. All three systems require the partners to contribute to the partnership in order to perform an activity aimed at sharing the benefits.[249]

For my part, I argue that the obligations in a South African partnership agreement are also not reciprocal. There are several indications of this. Firstly, a partner does not make a contribution to the partnership in exchange for, or conditional upon, the performance of another obligation – eg, of being provided with a partner's share – although both the obligation to make the contribution, and the entitlement to the partner's share originate from the same contract.[250] The obligation to make the contribution is imposed by the common law without any reference to a corresponding right falling to another party.

[243] Ibid at 84.
[244] Ibid at 82.
[245] Seucan (2015) *Social Economic Debates* 32.
[246] Ibid at 33.
[247] Ibid at 34.
[248] Ibid 34.
[249] Ibid at 33.
[250] I have stated that one of the *essentialia* of a partnership agreement is that each partner must make a contribution to the partnership, or he must make a binding undertaking that he will make a contribution. See para. 2.3.

Contracts of purchase and sale, and of letting and hiring of work, are examples of reciprocal contracts.[251] The essential terms of a contract of sale are: (a) that one person must sell and the other must buy; (b) a defined, ascertainable thing; (c) at a fixed or fixable price in money.[252] A contract of employment is concluded once the employee agrees to place his personal services at the disposal of the employer, and the latter agrees to pay the employee remuneration.[253] Considering the nature of the two parties' obligations, for example, in a contract of sale where the one party must sell, and the other party must purchase the property that is the subject of the sale, it is clear that the two obligations are undertaken in exchange for one another.

A partner's contribution and a partner's share, are not similarly set against one another; the one being transmitted in exchange for the receipt of the other. The obligation to contribute and the right to a partner's share, are distinct.

There is, admittedly, a connection between the value of a partner's contribution and the value of a partner's share. As stated above,[254] a partner's share denotes both his interest in the partnership property such as profits when they fall due, and his interest in jointly-owned partnership property. The partners agree on a profit-sharing ratio.[255] In the absence of an agreement regarding profit sharing, the profits are shared in proportion to the value of the partners' respective contributions. Where the value of the individual contributions cannot be determined, the profits are shared equally.[256]

The extent of each partner's share in the partnership assets is agreed to by the partners, usually in the partnership contract. In the absence of such an agreement, the value of the partners' shares in the partnership assets will be the same as their profit-sharing ratio, provided that the partners have agreed on how the partnership profits should be split. If the partners have not agreed on the profit-sharing ratio, then the values of the partners' contributions determine the values of their respective shares of the partnership assets.[257]

Logically, where the partners agree on the respective values of the shares, these values are likely to correspond to the value of their contributions. It stands to reason that a partner who contributed more

[251] *ESE Financial Services (Pty Ltd v Cramer* [1973] 3 All SA 199 (C) at 204.
[252] Du Bois et al *Wille's Principles* 889; Nagel et al *Commercial Law* para 13.09.
[253] Du Bois et al ibid at 926; Nagel et al ibid at para 37.04.
[254] See paras 2.6.3 and 2.6.4 above.
[255] Benade et al *Ondernemingsreg* para 3.43; See also Ramdhin et al "Partnership" para 295.
[256] Benade et al ibid at para 3.44; Ramdhin et al ibid. In *Fink v Fink* 1945 WLD 226, the court held, for example, that as it is impossible to say that one partner contributed more than the other, they were, therefore, entitled to share equally in the partnership profits.
[257] Benade et al ibid at para 3.66; Ramdhin et al ibid at para 295.

to the partnership, would wish to receive more than his co-partner who contributed less. Therefore, the nature of the connection between the contribution and the partner's share, is that while their values might correspond, they are not connected in the sense that they are given in exchange. Simply stated, the obligation to make the contribution and the award of a partner's share, are not obligations which are conditional upon mutual performance.

In the *Bayly* case,[258] for example, the partnership deed did not provide for the payment of rental or remuneration for the use of the land and livestock. The Deeds of Partnership provided for the profits and losses of the partnership business to be divided and borne by the partners in proportion to their capital holding in the partnership,[259] plus, in the case of two trusts, also in proportion to the value of the land they made available for use by the partnership; therefore in unequal shares.[260] Although the profit-sharing provision was linked to the capital contribution, the court did not find that the right to profit sharing qualified as consideration for the contribution.

Secondly, it is a *naturale* of a partnership agreement, that a partner is not entitled to compensation for his contribution.[261] There is, however, nothing preventing the partners from agreeing that one of them is to receive a salary in consideration of his taking a larger or more skilled share in the management of partnership affairs.[262] Furthermore, if a partner has performed special work beyond that performed by the others, and which was not envisaged as part of his duties under the contract, he is entitled to claim remuneration for his services.[263] Therefore, save where the partners otherwise agree, a partner is not rewarded for his contribution. In my view, this adds to the argument that the obligation to make a contribution is not subject to an obligation on another party to reward the partner, whether by conferring a partner's share or otherwise.

Thirdly, the *exceptio non adimpleti contractus* is not available to a partner who is sued by his co-partner(s) but who has himself not yet performed his obligation(s) under the partnership contract. A partner can, therefore, not withhold his contribution until another partner has performed his duties under the partnership agreement. According to Pothier, the action available to a partner against a co-partner

[258] (1998) 18 NZTC 14,073.
[259] Ibid at 14077.
[260] Ibid at 14077-8.
[261] Benade et al *Ondernemingsreg* para 3.52. See also Williams *Concise Corporate and Partnership Law* 37 and Ramdhin et al "Partnership" para 294. See *Parr v Crosbie* (1888-1887) 5 EDC 197, where the court held at 209, that the defendant was not entitled to commission as, by agreement of partnership, neither the plaintiff nor the defendant agreed to be paid for services rendered; *Liquidators of Grand Hotel and Theatre Co v Haarburger and Others, and Fichart & Daniels* 1907 ORC 25 at 31.
[262] *Liquidators of Grand Hotel* ibid. See also Williams *Concise Corporate and Partnership Law* 37.
[263] *Liquidators of Grand Hotel* ibid at 31; Ramdhin et al "Partnership" para 294; Benade et al *Ondernemingsreg* para 3.52.

to compel the latter's performance is the *pro socio*. By means of the *pro socio,* a partner can be compelled, inter alia, to contribute what he has undertaken to contribute to the partnership.[264]

Fourthly, all partners have the same obligation: to make some contribution to the partnership.[265] A partner is not required to perform one kind of obligation towards his partner(s), in exchange for his partner(s) performing a different kind of obligation towards him. In fact, the meaning of 'contribution'[266] in this context, denotes something shared by everyone, as opposed to an exchange in the sense of relinquishing something in return for something different.[267]

Finally, partnership profit distributions are similar to company dividends. Partnership profits are distributed on the basis of an agreement amongst the partners to distribute profits after, for example, the lapse of fixed periods.[268] The agreement is to distribute profits, and is clearly not intended as payment for contributions. Furthermore, the profit distributions are, logically, dependent on whether there are profits available for distribution. Had there been an obligation to pay for a contribution, then the partnership would have been indebted to pay for the contribution irrespective of the availability of profits. Profit distributions are the result of holding a partner's share, in the same way that dividends are the result of shareholding. It is a partner's holding of a partner's share that entitles him to claim a share of the profits.[269]

Considering the above, neither a partner's share, nor any profit distributions, is reciprocally connected and, therefore, not consideration for a partner's contribution. As a result, a partner does not make his required contribution to the partnership in exchange for consideration, except if the partners agree that the partner is to receive a specific payment for his contribution. These are undoubtedly payments made "in respect of, in response to, or for the inducement of" the partner's contribution, and may, consequently, be subject to VAT at the standard rate, except if the contribution is either zero rated or exempt.

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[264] Pothier *A Treatise* 81 paras 108 and 109; Ramdhin et al ibid at para 300. Pothier's work has been regarded by the courts as an important authority on partnership law. See Ramdhin et al ibid at para 256; Williams *Concise Corporate and Partnership Law* 40.

[265] See para 2.3 above.

[266] 'Contribution' according to the *Shorter Oxford English Dictionary*, means "something paid or given (voluntarily) to a common fund or stock; an action etc. which helps to bring about a result; the action of contributing".

[267] See the meaning of 'exchange' in the *Shorter Oxford English Dictionary*.

[268] The *Sacks* case1946 AD 31 at 40. See Williams *Concise Corporate and Partnership Law* 31-2.

[269] See Ramdhin et al "Partnership" para 289 and Benade et al *Ondernemingsreg* para 4.14.

In my view, a partner's contribution of services to a partnership, that is not a resident of the Republic,[270] can qualify for zero rating if the supply meets the requirements of section 11(2)(*ℓ*).[271] Paragraph (iii) to section 11(2)(*ℓ*) requires, for example, that the services must not be supplied directly to the partnership or any other person, if the partnership or such other person is in the Republic at the time the services are rendered.[272] I agree with Botes that this provision is aimed at ensuring that consumption or use which takes place in the Republic is not zero rated.[273] In my view, even if the partnership or other person, for example an individual partner, is considered to be present in the Republic at the time the services are rendered, if the partnership or other person's presence does not relate to the supply of the services, the services can still qualify for zero rating.[274]

In Australia, the ATO is of the view that a partner's capital contribution and his partnership interest are consideration for one another.[275] The ATO does not regard the partnership profits to be consideration for the partner's capital contribution. If it had intended profits to be seen in this light, I believe it would have said so. I suggest that, logically, the profit distributions would be considered to be received

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[270] Resident is defined in s 1(1) as meaning, inter alia, a 'resident' as defined in the IT Act. In terms of this definition a 'resident' can either be a natural person or a person other than a natural person. A partnership is not a 'person', whether natural or not natural, for purposes of the IT Act and is, therefore, not subject to income tax. See Stiglingh et al *Silke 2018* para 18.1; Haupt *Notes* para 9.4. A 'person' is also deemed, for the purposes of the VAT Act, to be a 'resident' to the extent that such person carries on in the Republic any enterprise or other activity and has a fixed or permanent place in the Republic relating to such enterprise or other activity. See s 1(1). I am of the view, therefore, that a partnership that does not carry on any enterprise or other activity in the Republic, and that does not have a fixed or permanent place in the Republic relating to such enterprise or other activity, is not a 'resident' for the purposes of the VAT Act.

[271] Section 11(2)(*ℓ*) zero rates services that are supplied to a person who is not a resident of the Republic, not being services which are supplied directly,

(i) in connection with land or any improvement thereto situated inside the Republic; or

(ii) in connection with movable property situated inside the Republic at the time the services are rendered, except movable property which-

(aa) is exported to the said person subsequent to the supply of such services; or

(bb) forms part of a supply by the said person to a registered vendor and such services are supplied to the said person for purposes of such supply to the registered vendor; or

(iii) to the said person or any other person, other than in circumstances contemplated in subparagraph (ii) (bb), if the said person or such other person is in the Republic at the time the services are rendered,

and not being services which are the acceptance by any person of an obligation to refrain from carrying on any enterprise, to the extent that the carrying on of that enterprise would have occurred within the Republic.

[272] In a Tax Court case, *VAT Case 969* para 34, the court expressed the view that in s 11(2)(*ℓ*)(iii) appears specifically to envisage a situation where the service is supplied (ie, contractually) to X but is physically supplied (ie, rendered) to Y.

[273] Botes *Juta's Value Added Tax* 11-39. In the Supreme Court of Appeal case of *XO Africa Safaris v Commissioner for SARS* (395/15) [2016] ZASCA 160 (3 October 2016) at para 30, the court stated that the history of the amendments made to s 11(2)(*ℓ*) showed that the statutory purpose underlying s 11(2)(*ℓ*) was to ensure that where services were rendered to a foreigner by a person liable to pay VAT, but the services themselves were rendered in the Republic and the benefit of them was enjoyed in the Republic, they would not enjoy the benefit of zero rating. VAT would be payable at the standard rate.

[274] See Botes ibid at 11-39.

[275] GSTR 2003/13 paras 32, 58, 59. In terms of Australian partnership law, an interest in a partnership includes the right to receive an appropriate share of the partnership profits and an entitlement to share in the capital of the partnership. See *Everett v Federal Commissioner of Taxation* Supreme Court of New South Wales 1 November 1977 at 4,480; GSTR 2003/13 para 34.

because of the partner's ownership of a partnership interest. A partner's contribution can, therefore, be subject to GST, whereas the profit distributions cannot.

It is clear from the *Bayly* and *Newman* cases[276] that the New Zealand courts do not regard a partner's share or partnership profit distributions as consideration for a partner's capital contribution. This is in view of the courts' finding that, what appears to have been the partners' contribution of the use of certain items, to have been made without consideration. Furthermore, according to the NZIR, a GST-registered partnership is not required to account for output tax on a capital contribution made by a partner.[277] The NZIR does, therefore, not regard a partner's contribution and a partner's share to be consideration for one another. In New Zealand, as in Australia, the partnership profits would logically be considered to be received on the basis of the partner owning an interest in the partnership. They would, consequently, not be subject to GST.

In the case of Canada, Arsenault and Kreklewetz claim that the CRA's position is that the making of a capital contribution to a partnership is characterised as a supply by the partner to the partnership in exchange for an exempt partnership interest.[278] A partner's capital contribution is, therefore, subject to GST in Canada. The authors contend, however, that a distribution of partnership profits is not subject to GST because it is a supply of money and is made pursuant to a right[279] to participate in partnership profits.[280]

I have pointed out that the UK follows the *KapHag* case, which I discuss below,[281] and that HMRC holds the view that where the partnership contribution consists of goods or services, neither admission into the partnership, nor any consequent share in partnership profits, constitutes consideration provided to the new partner for the goods or services he has contributed.[282]

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[276] See the discussion of these two cases in para 2.6.6 below.
[277] NZIR "Questions We've Been Asked QB 16/04, Goods And Services Tax – GST Treatment Of Partnership Capital Contributions" available at http://www.ird.govt.nz/resources/3/7/3716fa51-a2ec-42ac-b692-083ecb04679c/QB1604.pdf 1 paras 1, 2 (date of use: 8 December 2016).
[278] Arsenault & Kreklewetz "Partnerships" at 26. In support of this statement Arsenault and Kreklewetz referred to CRA Headquarters Ruling 11635-8 "*S 272.1(1) and the Eligibility of Certain ITCs Claimed by a Partnership* (27 September 2002)". (I have been unable to trace the original transcript of this case.)
[279] Arsenault & Kreklewetz ibid at 38.
[280] Ibid at 35.
[281] See para. 2.8 below.
[282] See para. 2.6.1 above.

2.6.6 The deeming of a partner's contribution to be made at market value

A partner's contribution will be deemed to have been at market value if the requirements of section 10(4) are met. These are that:

a. the supply is made by a person for no consideration, or for a consideration in money which is less than the open market value of the supply;
b. the supplier and the recipient are connected persons in relation to one another; and
c. if a consideration equal to the open-market value of the supply had been paid by the recipient, he would not have been entitled to make a deduction of the full amount of the tax in respect of that supply.[283]

A partnership and a member of that partnership are connected persons.[284] Section 10(4) could apply should the partner make his contribution for no consideration,[285] and where the partnership is not exclusively involved in the making of taxable supplies, for example, if the partnership also makes exempt supplies. Where the partnership is exclusively involved in the making of taxable supplies, section 10(4) will not apply because the partnership is entitled to deduct any VAT levied on the contribution in full as input tax. This is the case where the partnership acquires the contribution for purposes of consumption, use, or supply in the course of making taxable supplies as envisaged in the definition of 'input tax'.[286]

If section 10(4) applies, the consideration for the contribution is deemed to be the open-market value of that contribution. The partner must account for VAT on that open-market value, unless the supply is exempt from VAT. If the partner is not registered for VAT, and if the contribution involves continuous or regular activities as envisaged in the definition of 'enterprise', the partner must register for VAT if the deemed turnover exceeds the compulsory VAT-registration threshold. The implication here is that if a partner regularly contributes services for no consideration – eg, services the partnership does not acquire wholly for a taxable purpose – the partner must register and account for VAT on those services.

In the *Bayly* case the Trusts, who were members of a partnership, supplied the use of land and livestock to the partnership without charging the partnership rental. The court held, in terms of section 10(3) of the New Zealand GST Act, that the Trusts were deemed to supply the land at the open-market value.

[283] Although "market valuation" is a standard practice in VAT law, a specific discussion of the application of the principle to partnerships is warranted. This is so, as is evident from the discussion below, because the "default" market valuation rules cannot be applied to partnerships without complete consideration of the nature of the specific transaction so concluded.
[284] See the definition of 'connected persons' in s 1(1).
[285] Or for a consideration in money that is less than the open market of the contribution.
[286] See 'input tax' as defined in s 1(1).

It was what the provision of the interest in the land by the Trusts was worth that was assessed, and in each case the amount far exceeded the GST registration threshold.[287] As a result, the court held that the Commissioner of Inland Revenue had been correct in registering the Trusts for GST and assessing them on the open-market value of the provision of such use.[288] The circumstances in the *Newman* case are comparable to those in the *Bayly* case. The court came to the same conclusion: that the supply was for no consideration, or for less than the open-market value, and was between associated persons. This led to the inevitable conclusion that the open-market value must be applied.[289]

Section 10(3) read with section 10(3A) of the New Zealand GST Act, is similarly worded to section 10(4) of the VAT Act.[290] Section 10(3A) provides that section 10(3) does not apply where, inter alia, the recipient acquired the supply for the principal purpose of making taxable supplies.

Where no consideration is paid for the partner's contribution, and section 10(4) does not apply, the value of the contribution is, in terms of section 10(23), deemed to be nil. The partner will, of course, have no VAT liability on the contribution.

If the consideration is deemed to be nil under section 10(23), is the supply taxable? This question is relevant to the deduction of VAT as input tax on the expenses incurred by a partner in making the contribution. The court held in the *KCM* case, that section 10(23) does not deem a non-taxable supply for no consideration to be a taxable supply for no consideration.[291] One of the requirements of section 7(1)(*a*), is that the supply must be made in the course or furtherance of an 'enterprise'. Whether a partner's contribution for no consideration is a taxable supply, depends on whether the contribution is made in the course or furtherance of an enterprise carried on by the partner independently of the enterprise of the partnership.

[287] At the time of 30 000 New Zealand Dollars over 12 months.
[288] The *Bayly* case at 14079.
[289] Ibid at 15688 para 92.
[290] Section 10(3) provides that where -

a. a supply is made by a person for no consideration or for a consideration in money that is less than the open market value of that supply; and
b. the supplier and the recipient are associated persons,

the consideration in money for the supply shall be deemed to be the open market value of that supply.
[291] *KCM v Commissioner for the SARS* (VAT 711), [2009] ZATC 2 (14 August 2009) para 9.

As in the case of South Africa, New Zealand, the UK,[292] and Australia[293] only have general rules that apply to supplies for no consideration, instead of specific provisions that provide for the VAT/GST implications of capital contributions made by partners for no consideration.[294] HMRC is of the view that if the incoming partner is a taxable person, and makes his contribution for no consideration, he is treated as having made a deemed supply of goods or services if the 'deemed supply' criteria[295] are met.[296]

I stated that the ATO is of the view that a partner's capital contribution and his partnership interest are consideration for one another.[297] The general rules in Division 72 would only apply should the partnership interest be valued at less than the partner's contribution.

In the case of Canada, and according to Arsenault and Kreklewetz, it is not entirely certain whether section 272.1(3) of Canada's ETA applies to property contributed on the formation of a partnership. They contend that this provision's application would likely be redundant in view of the related-party[298] and the special deeming rule[299] in Canada's ETA, which deems a partner to be related to the partnership.[300] The latter provisions, they argue, have the same effect as section 272.1(3),[301] which essentially provides that where a person who is, or agrees to become, a member of a partnership, supplies property or a service to the partnership otherwise than in the course of the partnership's activities,

a. where the property or service is acquired by the partnership exclusively for commercial activities of the partnership, any amount that the partnership agrees to pay the person in respect of the property or service is deemed to be consideration for the supply; and

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[292] See, eg, Schedule 4 to para 5 of the UK VAT Act which treats certain supplies made for no consideration as supplies for VAT purposes; HMRC "Basic principles and underlying law: Supply for no consideration" available at https://www.gov.uk/hmrc-internal-manuals/vat-supply-and-consideration/vatsc03400 (date of use: 22 August 2018). See too Hemmingsley & Rudling *Tolley's Value Added Tax* para 71.22.

[293] See McCouat *Australian Master GST Guide* [E-book] Location 466. In terms of Division 72 of the Australian GST Act, a supply to an associate below market value is treated as if it was for market value, unless the associate is entitled to a full input tax credit.

[294] Or for a consideration below the market value.

[295] See, eg, Schedule 4 para 5 of the UK VAT Act.

[296] HMRC "Consideration: Partnership Contributions" available at https://www.gov.uk/hmrc-internal-manuals/vat-supply-and-consideration/vatsc68000 (date of use: 17 August 2018); Hemmingsley & Rudling *Tolley's Value Added Tax* para 50.7.

[297] See para 2.6.5 above.

[298] In s 155(1). In terms of this provision, where a supply of property or a service is made between persons not dealing with each other at arm's length, for no consideration or for consideration less than the fair market value of the property or service at the time the supply is made, and the recipient of the supply is not a registrant who acquires the property or service for consumption, use, or supply exclusively in the course of commercial activities of the recipient: (a) if no consideration is paid for the supply, the supply is deemed to be made for consideration, paid at that time, of a value equal to the fair market value of the property or service at that time; and (b) if consideration is paid for the supply, the value of the consideration is deemed to be equal to the fair market value of the property or service at that time.

[299] In s 126(3).

[300] Arsenault & Kreklewetz "Partnerships" 27.

[301] Ibid.

b. in any other case, the supply is deemed to have been made for consideration that is equal to the fair market value.

2.7 Deductions relating to contributions made to the partnership

A partner may have incurred VAT on the acquisition of goods or services which he subsequently contributes to the partnership.[302] Furthermore, if the partner is a vendor, his contribution will be subject to VAT at fifteen per cent if the supply meets the requirements of section 7(1)(*a*). The question arising is whether any deductions in relation to such acquisitions by the partner can be made, and if so, by whom.

'Input tax' is either the VAT levied on goods or services acquired wholly for the purpose of consumption, use, or supply in the course of making taxable supplies; or, where the goods or services are acquired partly for such purpose, to the extent that the goods or services are acquired by the vendor for such purpose.[303] The extent to which a vendor uses goods or services for a taxable purpose, is determined in accordance with the provisions of section 17(1). [304] In essence, the section provides that the basis for such apportionment is the ratio of the intended taxable use to non-taxable use.[305] Therefore, VAT levied on the acquisition of goods or services acquired by a vendor-partner to make contributions to the partnership that are taxable supplies, is deductible by that partner as input tax.

In a New Zealand case, *Case T10*,[306] the issue was whether the objecting husband and wife partnership was entitled to a GST input refund on their purchase of a title-based timeshare in a unit in a luxury hotel complex at a tourist resort. This depended on whether they purchased the timeshare for the purpose of making taxable supplies.[307]

The husband and wife partnership conducted a take-away food business which was registered for GST purposes. The resort's units were rented to the public.[308] The resort was run by a partnership consisting of the timeshare purchasers and known as the accommodation partnership.[309] The accommodation

[302] Goods, which have been acquired as second-hand goods and on which no VAT was charged, may also be contributed.
[303] 'Input tax' as defined in s 1(1). Input tax, which is commonly referred to as 'notional input tax', is also deductible on the non-taxable acquisition of second-hand goods. The amount of the input tax is equal to the tax fraction of the lesser of any consideration in money given by the vendor for or the open-market value of the supply to him. See para (*b*) of the definition of 'input tax'.
[304] See 'input tax' as defined in s 1(1).
[305] Note that in terms of proviso (i) to s 17(1), where the intended taxable use is equal to not less than 95 per cent of the total intended use, the goods or services concerned may be regarded as having been acquired wholly for the purpose of making taxable supplies. This is commonly referred to as the *de minimis* rule.
[306] (1997) 18 NZTC 8,055.
[307] Ibid at 8056.
[308] Ibid.
[309] Ibid.

partnership was registered for GST on the taxable rental activity.[310] Although the units were owned by the partners, including the objectors, the accommodation partnership accounted for output tax and claimed input credits on all rental activity.[311]

The TRA held that the workings of section 57 deprived the objectors of a GST input refund. In terms of section 57(2)(a) of the New Zealand GST Act,[312] the objectors could not be registered for GST in relation to the operation of the timeshare. Furthermore, the supply of the objectors' timeshare was deemed, by section 57(2)(b) of the New Zealand GST Act, to be made by the accommodation partnership and not the objectors. Any relevant taxable supplies were, therefore, deemed by section 57 not to be made by the objectors but by the accommodation partnership. Therefore, the objectors had not acquired the timeshare for the principal purpose of making taxable supplies as required by the definition of 'input tax'.[313] The TRA held that the objectors were not entitled to the GST input refund.[314]

Section 51(1)(*a*) similarly deems the partnership, as opposed to the partners, to be carrying on the partnership's enterprise. Applying the reasoning in the TRA in *Case T10*, a partner may not deduct input tax in relation to an acquisition of goods and services, on the basis of these items being used in the enterprise of the partnership. A partner is, instead, entitled to an input tax deduction relating to an enterprise he carries on distinct from the partnership. If the partner deducted the VAT on an acquisition as input tax, which is subsequently contributed to the partnership, then the partner would be deemed, in terms of section 18(1),[315] to have made a supply on which output tax is payable. This would be the case where the partner's contribution is not a taxable supply. The partner's earlier input tax deduction would then, effectively, be reversed.

Australia, New Zealand, and the UK have no specific provisions applicable to a partner's deduction of VAT/GST on acquisitions related to his capital contribution to the partnership. The ATO is of the view,

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[310] Ibid at 8057.

[311] Ibid.

[312] Section 57(2) provides that, "[w]here an unincorporated body that carries on any taxable activity is registered pursuant to this Act -

(a) the members of that body shall not themselves be registered or liable to be registered under this Act in relation to the carrying on of that taxable activity;

(b) any supply of goods or services made in the course of carrying on that taxable activity shall be deemed for the purposes of this Act to be supplied by that body, and shall be deemed not to be made by any member of that body; and (c) …"

[313] *Case T10* at 8060.

[314] Ibid at 8064.

[315] Section 18(1) provides that where goods or services have been "acquired, manufactured, assembled, constructed or produced" by a vendor wholly or partly to make taxable supplies, or the goods or services were held or applied for that purpose, and the goods or services are subsequently utilised wholly to make non-taxable supplies, the vendor is deemed to make a taxable supply.

however, that a partner is entitled to input tax credits related to a taxable, in-kind capital contribution of a thing, which he initially acquired in his own enterprise.[316]

Section 272.1(2) of Canada's ETA allows partners in the form of corporations, trusts, and other partnerships, to register for GST and obtain input tax credits paid on inputs intended for partnership activities.[317]

Even if a partner's contribution is not taxable, a deduction might still be available to the partnership under section 18(4). Where a partner acquires goods or services in the circumstances envisaged in section 18(4),[318] the partnership is allowed a deduction[319] if the partnership uses those goods or services to make taxable supplies.[320] Botes's submission that this is the case where the goods or services constitute partnership assets, or where the partner has merely granted the partnership the right of use of the goods or services, is in my view correct.[321] Botes's reference to 'partnership assets' is understood to refer to jointly-owned partnership property. I am in agreement with this view because a partnership will only be in a position to 'apply' goods or services that have been acquired by a partner,

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[316] GSTR 2003/13 paras 75 and 80. As in Australia, in New Zealand, and the UK, a partner's contribution to a partnership could be taxable, depending on the circumstances (see para 2.6.1 above), I am of the view that a partner should, in these countries, in principle be permitted a deduction of the VAT/GST levied on an acquisition made for the purpose of making a taxable contribution.

[317] Arsenault & Kreklewetz "Partnerships" 39. For *individual* partners who are excluded from much of the application of s 272.1 relief – eg, where they are not reimbursed by the partnership – is available under s 253 of Canada's ETA, which provides for employees' and partners' rebate rules. This rebate may be available to an individual who is a member of a partnership registered for GST. The partner must have personally paid the GST on expenses that he did not incur on the account of the partnership. A partner cannot, however, claim a GST partner rebate for the GST he paid on expenses for which the partnership paid him a reasonable allowance. See CRA "GST/HST Rebate for Partners" available at http://www.ryan.com/contentassets/ 715a003710244c5e80facae6b7862d4f/cra-rc4091.pdf (date of use: 18 August 2018).

[318] The circumstances envisaged under s 18(4) are, in broad outline,

(a) goods or services have been supplied to a partner prior to the commencement date of the VAT Act, ie, 30 September 1991, and such goods or services were applied by the partner in the course of an activity which would have been an enterprise if section 1 had been applicable prior to such commencement date;

(b) goods or services have been supplied to a partner on which tax was charged, and no deduction has been made in relation to such supply; and

(c) second-hand goods have been supplied, otherwise than under a taxable supply, to a partner and no deduction has been made in respect of such second-hand goods.

[319] The deduction is permitted under s 16(3)(*f*), which provides that the amount of tax payable in respect of a tax period is calculated by deducting from the sum of the amounts of output tax which are attributable to that period, the amounts calculated in accordance with s 18(4) or (5) in relation to goods or services applied during the tax period as contemplated in that section.

[320] The partnership is permitted a deduction in accordance with a formula set out in s 18(4). In terms of this formula, the deduction is equal to the tax fraction of the lesser of the adjusted cost, or the open-market value of the supply of the goods or services, multiplied by the percentage of the intended taxable use of such goods or services by the partnership. The taxable use must be determined in accordance with the apportionment method contemplated in s 17(1).

[321] Botes *Juta's Value Added Tax* 18-22.

if the partner has contributed either the ownership or the use of such goods or services to the partnership.

In terms of section 18(4), the partnership is entitled to the deduction if no deduction has been made in respect of, or in relation to, such goods or services.[322] In my view, whether either the partner or the partnership is entitled to a deduction, depends on whether the partner's contribution constitutes a taxable supply. If it does, the partner is entitled to an input tax deduction. If the partner has not obtained an input tax deduction, the partnership could be allowed the deduction under section 18(4).

As stated above,[323] the partnership may qualify for the section 18(4) deduction if it 'applies' the goods or services acquired by the partner. Importantly, section 18(4) provides that the "goods or services shall be deemed to be supplied" to the partnership. Section 18(4) does not specify whether either the ownership, or the use of the goods or services, is deemed to be so supplied.

Botes submits that where only the right of use of goods or services has been granted, but the goods or services are deemed to be supplied to the partnership under section 18(4), "such goods or services become assets of the partnership's VAT enterprise."[324] I understand Botes to be arguing that the goods or services are deemed by section 18(4), to become jointly- owned partnership property, even if only the use of the goods or services has been supplied to the partnership. She justifies her view by arguing that it ensures VAT neutrality where the partnership returns the goods or services to the partner when the right to use them terminates. Botes argues that such a return of the goods or services constitutes a supply, and as the partner and the partnership are connected persons in relation to one another, this supply is deemed to have been made at market value if all the requirements of section 10(4) are met. The VAT position will effectively then be neutral, as the deduction allowed to the partnership will merely be recouped.[325]

There is merit in Botes's argument considering that, according to the Report of the VATCOM,[326] the VAT Act introduced a consumption-type tax, which taxes supplies to consumers but grants businesses an input credit.[327] In other words, the private consumer must carry the tax burden. If VAT is not levied

[322] The deduction is permitted in the tax period during which the goods or services are applied by the partnership for use in the course of making taxable supplies. See s 18(4) read with s 16(3)(*f*).
[323] That is under this sub-heading.
[324] Botes *Juta's Value Added Tax* 18-22.
[325] Ibid.
[326] The VATCOM was a committee consisting of members from both the private and the public sectors, appointed by the Minister of Finance to consider the comments and representations made by interested parties on the Government's Draft Value-Added Tax Bill, which was published on 18 June 1990.
[327] Report of the VATCOM (Government Printer 1991) (hereafter the VATCOM Report) Ch 2 at 4.

on the partnership's return of the goods or services to the partner, no VAT is levied on a partner's private consumption, which would undermine the purpose of the VAT Act.

Furthermore, the deduction is equal to the tax fraction[328] applied to the lesser of the adjusted cost of the goods or services or their open-market value, but only to the extent of their intended taxable use as determined in accordance with section 17(1).[329] The extent to which a partnership uses a partner's contribution for a taxable purpose must, therefore, be determined by reference to the use of that contribution in the partnership's enterprise. That the deduction is based on the cost or value of the goods or services – which is the type of deduction that is normally allowed when ownership is acquired – and not, for example, on a deemed rental amount for their use, bolsters the argument that the ownership of the goods or services is deemed to have been acquired.

The next issue concerns the making of deductions in relation to any VAT levied on partners' contributions. The partners' contributions make up the capital of the partnership.[330] The partnership capital is part of the partnership assets[331] to the extent that the capital still exists.[332] The establishment of a jointly-owned partnership fund is a *naturale* of a partnership agreement. Therefore, in the absence of an agreement to the contrary, the partnership assets are jointly owned by the partners in undivided shares.[333]

Williams submits that if the partners intend to contribute the ownership of the property to the partnership (a contribution *quoad dominium*), then such property becomes 'common property', which the partners own jointly, and in which each partner has an undivided share.[334] Beinart contends that in this situation, a full right of ownership is converted into a shared right, and even if the capital is returnable to the partner in full, the right of ownership is replaced by an *actio in personam*.[335] The use of property may, however, be contributed to the partnership – as was confirmed by the court in *Fink v Fink* (ie, a

[328] 'Tax fraction' is defined in s 1(1) as meaning "the fraction calculated in accordance with the formula r/100 +r in which formula 'r' is the rate of tax applicable under s 7(1)."
[329] See s 18(4).
[330] Ramdhin et al "Partnership" para 286; Williams *Concise Corporate and Partnership Law* 26; Mongalo, Lumina & Kader *Forms of Business Enterprise* para 2.3.3.1.
[331] Partnership assets are also referred to as 'partnership property' or 'partnership funds'. See Ramdhin et al ibid at para 284; Williams *Concise Corporate and Partnership Law* 26.
[332] Ramdhin et al ibid; *Schlemmer v Viljoen* above at 315: The court distinguished between three groups of partnership assets, namely, profits derived from the partnership business, partnership capital contributed by the partners and assets lent by the partners to the partnership.
[333] Ramdhin et al ibid at para 287; Williams *Concise Corporate and Partnership Law* 26; Benade et al *Ondernemingsreg* para 3.61.
[334] Williams ibid at 28.
[335] Beinart 1961 *Acta Juridica* 155.

contribution *quoad usum*) – while the ownership of the property vests exclusively in one of the partners.[336]

I argue that whatever is supplied or acquired by the body of persons making up the partnership, within the course and scope of its common purpose, is supplied or acquired by the partnership as a separate person for VAT purposes.[337] In view of the partnership's status as a person, the ownership or use of the contribution is, for VAT purposes, deemed to be acquired by the partnership as envisaged in the definition of 'input tax', as opposed to by the partners. A partnership that is a vendor, would consequently be entitled to deduct any VAT levied on a partner's contribution as input tax, provided that the partnership acquires the contribution for a taxable purpose. The partnership will, conversely, be refused a deduction of input tax to the extent that it acquires the contribution for a non-taxable purpose, for example, the contribution is acquired to make exempt supplies.

Australia, Canada, New Zealand, and the UK do not have special provisions regulating a partnership's deduction of VAT/GST levied on a partner's contribution. Commenting on the position in the UK, Hemmingsley and Rudling argue that if an incoming partner contributes goods and/or services on which VAT is due, and the partnership uses them for its business purposes, the partnership can recover the VAT as input tax subject to the normal rules.[338] The ATO is of the view that a partnership's acquisition of a partner's in-kind contribution, relates to the making of supplies by the partnership in the course of its ordinary or general business. They argue, therefore, that any claim for input tax credits is determined by reference to the use of the in-kind capital contribution in the partnership's business activities, and is a creditable acquisition if the requirements for an input tax credit are met.[339]

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[336] *Fink v Fink* above at 244, 245; See Williams ibid.

[337] See para 2.3.

[338] Hemmingsley & Rudling *Tolley's Value Added Tax* para 50.7. In terms of the UK VAT Act, input tax, in relation to a taxable person, comprises VAT on goods and services supplied to him, provided the goods or services are used for the purpose of business carried on by him. See s 24(1); Hemmingsley & Rudling ibid at para 34.1.

[339] GSTR 2003/13 para 67. You are entitled to an input tax credit, in terms of the Australian GST Act, if you acquire the thing for a 'creditable purpose' (s 11-5; 11-20) which means that you must have acquired it in carrying on your enterprise (s 11-15). See McCouat *Australian Master GST Guide* [E-book] Locations 120 and 121. In Canada a registrant who acquires property or a service for consumption, use, or supply in commercial activities may claim input tax credits to recover all or part of the tax the registrant paid on the acquisition of the property or service. See Chabot et al *EY's Complete Guide to GST/HST* para 3,010. See also CRA "Input tax credits (ITCs)" available at https://www.canada.ca/en/revenue-agency/services/tax/businesses/topics/payroll/ benefits-allowances/remitting-gst-hst-on-employee-benefits/input-tax-credits-itcs.html (date of use: 19 August 2018). In terms of s 20(3C) of the New Zealand GST Act input tax as defined in s 3A(1)(a) of that Act, may be deducted to the extent to which the goods or services are used for, or are available for use in, making taxable supplies. See also NZIR "Apportionment input tax when goods and services are acquired" available at https://www.ird.govt.nz/gst/additional-calcs/change-adjust/apportion/input-tax.html (date of use: 19 August 2018). In my view, considering the requirements for an input tax credit in Canada and New Zealand, a partnership should be entitled to deduct the GST levied on a partner's contribution to the partnership, provided that such contribution is applied by the partnership for commercial activities in Canada, and for making taxable supplies in New Zealand.

2.8 The acquisition of partners' shares

When considering the VAT treatment of the acquisition of partners' shares on the formation of a partnership, it is important to determine whether the partners' shares are supplied to the partners, whether by the partners to each other in terms of the partnership agreement, or by the partnership to the partners.[340]

In the case of Canada, Arsenault and Kreklewetz argue that to the extent that the partners are viewed as obtaining an interest in the partnership as a result of the partnership's formation, or in return for their contribution of property, if any, the supply of that interest is 'issued' by the partnership to the partner.[341]

According to the ATO, the better view is that the interests in a partnership are supplied by the partnership and not by the partners to each other.[342] The ATO considers that the partnership as an entity, creates an interest in the partnership. This is a consequence, so the argument goes, of the acceptance of a partnership as an entity, and that supplies and acquisitions made by or on behalf of partners in their capacity as partners are treated as supplies and acquisitions by the partnership.[343] The ATO relies on section 184-5(1) of the Australian GST Act,[344] which provides that supplies and acquisitions made by, or on behalf of, partners in their capacity as partners, are treated as supplies and acquisitions by the partnership.

South Africa's VAT Act does not have a provision corresponding to subsection 184-5(1). The ATO's reliance on subsection 184-5(1) is in any event questionable, since a partner does not act in his capacity as partner representing the partnership when he enters into a partnership agreement. As stated,[345] a partnership is established by means of an agreement between the prospective partners. The partnership is not a signatory to the partnership agreement and can, therefore, not supply the partners' shares in terms of this agreement. The partner is, instead, contracting on his own behalf when he signs the partnership agreement.

In the *KapHag* case a partner was admitted to an existing partnership. It is important to note that the case did not concern the receipt of a partner's share on a partnership's formation. The *Bundesfinanzhof* took the view that when a partnership admits a partner in consideration of a contribution in cash or in kind, it makes a supply of services for consideration within the meaning of article 2(1) of the Sixth

[340] See GSTR 2003/13 para 54.
[341] Arsenault & Kreklewetz "Partnerships" 27.
[342] GSTR 2003/13 para 55.
[343] Ibid at para 56.
[344] See para 2.6.2 above.
[345] See para 2.1 above.

Directive. It considered, however, that the concept is questionable, as a partner is admitted, not on the basis of a bilateral contract between the new partner and the partnership, but on the basis of a partnership agreement concluded between partners. From the viewpoint of civil law, therefore, the new partner might be regarded as obtaining his share in the partnership from the other partners, not the partnership.[346]

The ECJ held in the *KapHag* case that a partnership which admits a partner in consideration of payment of a contribution in cash, does not effect a supply of services for consideration towards that person within the meaning of article 2(1) of the Sixth Directive.[347] It is irrelevant, the ECJ reasoned, whether the admission of the new partner is regarded as the act of the partnership itself, or as that of the other partners, since the admission of a new partner does not constitute a supply of services for consideration for the purposes of the Directive.[348] As pointed out previously, the UK follows the *KapHag* case.[349]

The NZIR is of the view that no existing partnership interests can be supplied when contributions are made by the partners to a newly created partnership. Rather, the partnership interests are created as a matter of law by the formation of the partnership.[350]

I agree with this view. A partner's share, received on a partnership's formation, is a product of the partnership agreement. When the partnership agreement is concluded the partners' shares simply accrue to the partners.[351] Moreover, as stated, it is an essential term of the partnership agreement that the partnership business be carried on in common,[352] hence each partner's right to share in the partnership profits, for example.[353] Additionally, a partner's share relating to his interest in jointly-owned partnership property is a *naturale* of the partnership agreement.[354] As a result, the partners' shares come into existence from the moment of the establishment of the partnership because of the relevant terms of the partnership agreement. That being the case, the partners' shares are not supplied to the partners when the partnership is formed, because at that moment there are no partners' shares which can be the subject of a supply.

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[346] *KapHag* case para 20.
[347] Ibid at para 43.
[348] Ibid at para 42.
[349] See para 2.6.1.
[350] NZIR "Questions We've Been Asked QB 16/04, Goods And Services Tax – GST Treatment Of Partnership Capital Contributions" available at http://www.ird.govt.nz/resources/3/7/3716fa51-a2ec-42ac-b692-083ecb04679c/QB1604.pdf 4 para 20 (date of use: 8 December 2016).
[351] See the *Sacks* case 1946 AD 31 at 43. See para 2.6.4 above.
[352] See para 2.5 above.
[353] See para 2.6.3 above.
[354] See para 2.7 above.

I also agree with the *Bundesfinanzhof's* argument in the *KapHag* case, that the partnership does not supply the partners' shares on formation because the partnership agreement, from which the partners' shares originate, is concluded by the partners and not by the partnership.[355]

The ECJ offers a different explanation of why there is no supply when a partner is admitted to a partnership. In the *Kretztechnik* case,[356] the ECJ considered the question of whether a public limited company makes a supply for consideration within the meaning of article 2(1) of the Sixth Directive, when listing on a stock market and in issuing shares to new shareholders in return for the issue price.[357] The court referred to the *KapHag* case and stated that the same conclusion must be drawn regarding the issue of shares for the purpose of raising capital.[358]

The court also agreed with the reasoning of Advocate-General Jacobs in points 59 and 60 of his opinion.[359] The Advocate-General contended that when a company issues new shares, it is not selling any existing intangible property or any right over a fraction of its existing assets. It is increasing its assets by acquiring capital, and acknowledging the new shareholders' rights as residual owners of a previously non-existent fraction of the increased assets which they contributed in the form of capital.[360] He further argued that from the company's point of view, there is an acquisition rather than a supply, of capital and thus no transaction capable of being taxed or exempted from VAT. From the shareholder's point of view, it is an investment, an employment of capital, and not an acquisition.[361]

The court reasoned that as far as the shareholder is concerned, payment of the sums necessary for the increase in capital, is not a payment of consideration but an investment or an employment of capital.[362] As a result, the court held that a share issue does not constitute a supply of goods or services for consideration within the meaning of article 2(1) of the Sixth Directive.[363]

In the *KapHag* and the *Kretztechnik* cases, the ECJ found not only that the partnership or the company did not supply a service in the relevant circumstances, but that, in addition, the contribution made by the partner or the shareholder did not constitute consideration.[364]

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[355] See para 2.1 above.
[356] *Kretztechnik AG v Finanzamt Linz* Case C-465/03, 26 May 2005 (hereafter the *Kretztechnik* case).
[357] Ibid at para 15.
[358] Ibid at para 25.
[359] Ibid at para 26.
[360] Opinion of Advocate-General Jacobs in the *Kretztechnik AG v Finanzamt Linz* case at para 59.
[361] Ibid at para 60.
[362] Ibid at para 26.
[363] Ibid at para 27.
[364] See *KapHag* case at para 43 and the *Kretztechnik* case at para 27.

Referring to the *Kretztechnik* case,[365] van Doesum argues that the ECJ draws no distinction between the admission of a partner to a partnership in consideration of a payment of a contribution in cash, and the issue of shares in a company.[366] Applying Advocate-General Jacob's opinion in *Kretztechnik*,[367] van Doesum argues that, from the partnership's perspective, there is an acquisition of capital, not a supply. Where a partnership grants a partner a 'share' in the partnership, it is not selling any existing intangible property or any right over a fraction of its existing assets. The partnership merely increases its assets by acquiring capital, and acknowledging the partner's rights as residual owners of a previously non-existent fraction of the increased assets which they contributed in the form of capital.[368]

The question is whether the ECJ's reasoning also applies to the South African VAT Act, so that a partner's acquisition of a partner's share on the establishment of a partnership, cannot result from a supply for the reasons given by the ECJ.

The term 'supply' is defined in the VAT Act to 'include', amongst others, performance in terms of a sale, rental agreement, and *all other forms of supply*, whether voluntary, compulsory, or by operation of law.[369] This definition is not exhaustive as the use of the word 'include' in the definition, suggests that both the things specifically mentioned in the definition are envisaged, as well as things that fall within the ordinary meaning of the defined term. The phrase 'all other forms of supply' has the same broadening effect. Considering that the VAT Act does not provide a clear definition of the term "supply", it is not always easy to determine whether a particular transaction constitutes a "supply. The dictionary meaning of 'supply', in the present context, is to "make available (something needed or wanted); provide for use or consumption, esp. commercially."[370]

In *Shell's Annandale Farm (Pty) Ltd v Commissioner for SARS,*[371] the court held that some form of act is required to constitute a supply for the purpose of VAT legislation. It can also be inferred from the judgment in *National Educare Forum v Commissioner for SARS,*[372] that 'supply' as defined in the VAT Act, means to provide something.[373] The courts' understanding of 'supply' in the VAT Act, accords with its dictionary meaning and the meaning given to the term by the courts in New Zealand. 'Supply' is

[365] The *Kretztechnik* case at paras 23-25.
[366] Van Doesum 2010-6 *EC Tax Review* 264.
[367] The *Kretztechnik* case para 59.
[368] Van Doesum 2010-6 *EC Tax Review* 267.
[369] See 'supply' as defined in s 1(1).
[370] *Shorter Oxford English Dictionary*.
[371] 62 SATC 97 at 107.
[372] *National Educare Forum v Commissioner of SARS* [2002] JOL 9423 (Tk).
[373] The applicant argued in this case that it performed no act in procuring 'the provision of food items' to school children (at 24). The court held, on the contrary, that the applicant indirectly supplied the food items through subcontractors (at 28).

defined in section 5(1) of the New Zealand GST Act, as including 'all forms of supply'. In *Databank Systems Limited v Commissioner of Inland Revenue,* the New Zealand High Court held that in the context of section 5(1), 'supply' simply means 'to furnish with or provide'.[374]

Van der Zwan and Stiglingh argue that, based on the meaning of supply as set out above essentially as an action where something is provided, grounds may exist to advance a similar argument to that of the ECJ, namely that the issuing of shares is not a form of supply as the company does not provide, furnish, or give something to the new shareholder.[375]

Otto and Trombitas[376] maintain that the ECJ follows a substance-over-form approach, which means that the nature of a supply is determined on the basis of its economic substance, instead of an analysis of its legal form.[377] Relying on the New Zealand Court of Appeal decision in *CIR v Gulf Harbour Development Limited,*[378] they question whether a New Zealand court would also prefer a substance-over-form approach.[379] This case concerned the sale to the public of redeemable preference shares in a company which operated a golf club and related facilities. The question was whether an 'equity security' had been supplied. An equity security is defined by section 3(2) as meaning, "… any interest in or right to a share in the capital of a body corporate."[380]

If an equity security had been supplied, it would qualify as the supply of a 'financial service' as defined in section 3(2), which by the operation of sections 6(3)(d) and 14(1), would be exempt from GST. The Commissioner of Inland Revenue contended that the supply was, in substance, membership in the golf club, which was not a 'financial service' and, therefore, attracted GST.

The court applied the principles enunciated in *Marac Life Assurance Ltd v C of IR; C of IR v Marac Life Assurance Ltd*,[381] where the court held[382] that the true nature of a transaction can only be ascertained by careful consideration of the legal arrangements actually entered into and carried out, rather than an assessment of the broad substance of the transaction measured by the results intended and achieved, or of the overall economic consequences. What is crucial, the court stated, is the determination of the

[374] (1987) 9 NZTC 6,213 High Court Wellington M328/87 at 6,223.
[375] Van der Zwan & Stiglingh 2011 *De Jure Law Journal* 334.
[376] Otto J & Trombitas E *What's happening in GST?* New Zealand 2014 Tax Conference.
[377] In jurisdictions where the "substance over form principle" applies, I believe that it can be argued that the economic substance remains the determining factor.
[378] (2004) 21 NZTC 18,915 (CA) (hereafter, the *Gulf Harbour* case).
[379] Otto J and Trombitas E "*What's happening in GST?"* New Zealand 2014 Tax Conference at 11.
[380] The *Gulf Harbour* case para 2.
[381] (1986) 8 NZTC 5,086, [1986] 1 NZLR 694.
[382] Ibid at NZTC 5,097; NZLR 705.

legal rights and duties actually created by the transaction into which the parties entered.[383] The court in the *Gulf Harbour* case held, therefore, that preference shares had been sold and that they were equity securities for purposes of the New Zealand GST Act.[384]

The South African courts' position on 'substance-over-form' in contractual interpretation corresponds to that of New Zealand. It is clear from the Appellate Division case *Erf 3183/1 Ladysmith (Pty) Ltd and another v CIR,*[385] that the question of taxability (or non-taxability) must be decided in accordance with the legal rights of a taxpayer arising from the transaction. A court only engages the substance, rather than the form, of a transaction if the transaction is in *fraudem legis* – ie, when it is intentionally disguised so as to escape the provisions of the law. The court must be satisfied that there is a real intention, definitely ascertainable, which differs from the simulated intention.[386]

Otto and Trombitas submit that in a share subscription, the legal form is the issue or allocation of an equity share in consideration of the invested funds. It constitutes a supply, ie, something is furnished under an enforceable agreement which creates reciprocal obligations. They further submit that it is unlikely the New Zealand courts would depart from the transactional analysis preferred in GST cases, and instead favour the economic analysis taken by the ECJ in the *Kretztechnik* case.[387]

I argue that South African courts will decide the VAT treatment of a share issue in accordance with the legal rights flowing from the transaction. Considering the nature of a share, a share issue is, in effect, a supply of a right to a proportionate part of the assets of the company, either by way of dividend, or through the distribution of assets in winding up, in return for the payment of a consideration.[388] The court will, in all likelihood, ignore the alleged substance of the transaction – ie, the acquisition of capital from the company's point of view, and the making of an investment from that of the shareholder.

A court will equally consider a partner's contribution to the partnership to be a supply rather than an investment. Furthermore, it is unlikely to agree with the ECJ's reasons for holding that a partnership is not making a supply when it admits a partner to the partnership based on the analysis that, in substance, the partnership is increasing its assets by acquiring capital.

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[383] The *Gulf Harbour* case para 19.

[384] In the *Nelson* case at para 16 the court confirmed that in the absence of sham, it is the legal character of the transaction actually entered into and carried out which is decisive.

[385] [1997] JOL 213 (A).

[386] Ibid at 18-20. Barry Ger states that, 'the courts will consider if the parties truly intended to give effect to the agreement in accordance with its terms. If they did, then substance follows the form and the agreement will stand'. See Ger B "High Court Challenges SCA's interpretation of simulated transactions" available at http://www.saflii.org/za/journals/DEREBUS/2013/25.pdf (date of use: 9 December 2016).

[387] Otto and Trombitas *What's happening in GST?* New Zealand 2014 Tax Conference 11.

[388] Cassim FHI et al *Contemporary Company Law* 2 ed (Juta 2012) 213.

Otto and Trombitas[389] point out that *Kretztechnik* reflects a position taken only in the EU, whilst all other indirect tax systems – eg, Australia,[390] Canada,[391] and Singapore[392] – follow a process similar to that in New Zealand,[393] and treat the first issue of shares as an exempt supply.

Assuming that a partner's acquisition of a partner's share results from a supply, and that the supply is made to the partner by the partnership, the question which arises is whether such a supply is made by the partnership in the course or furtherance of carrying on an enterprise as contemplated in section 7(1)(*a*). The ATO is of the view that the supply of an interest in a partnership, is made in the course or furtherance of the enterprise that the partnership carries on. It reasons that the supply of the interest in the partnership has the necessary connection with the enterprise to render the supply "in the course or furtherance of the enterprise".[394]

As stated above,[395] both 'economic activities' in the Sixth Directive, and 'enterprise' in the VAT Act, envisage on-going activities. In the *Wellcome Trust* case, the ECJ held that if the taking of shares does not in itself constitute an economic activity within the meaning of the Sixth Directive, the same must be true of activities consisting in the transfer of such shares.[396] In the *EDM* case, the ECJ held that activities which go beyond the compass of the simple acquisition and sale of securities, such as transactions carried out in the course of a business trading in securities, indeed fall within the scope of the Sixth Directive.[397]

The *De Beers* case, where the court held that unless one conducts business as an investment company, the investments one holds cannot on their own be regarded as constituting an enterprise,[398] is in keeping with both the *Wellcome Trust* and *EDM* cases.

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[389] Ibid at 11.
[390] McCouat *Australian Master GST Guide* [E-book] Locations 252 and 257; ATO "Financial supplies" available at https://www.ato.gov.au/Business/GST/When-to-charge-GST-(and-when-not-to)/Input-taxed-sales/Financial-supplies/ (date of use: 20 September 2018).
[391] Chabot et al *EY's Complete Guide to GST/HST* paras 13,005, 13,015 and 13,025; Barnett *Introduction to Federal Income Taxation in Canada* para. 7,930.
[392] Singapore Inland Revenue Authority "*Supplies Exempt from GST"* available at https://www.iras.gov.sg/irashome/GST/GST-registered-business/Working-out-your-taxes/When-is-GST-not-charged/Supplies-Exempt-from-GST/ (date of use: 9 December 2016).
[393] See McKenzie *GST A Practical Guide* [E-book] Location 43; NZIR "GST – Current Issues – Chapter 2 – Financial Services" available at http://taxpolicy.ird.govt.nz/publications/2015-ip-gst-current-issues/chapter-2 paras 2.1, 2.22 (date of use: 20 September 2018).
[394] GSTR 2003/13 para 59.
[395] See para 2.6.3.
[396] The *Wellcome Trust* case para 33.
[397] *Empresa de Desenvolvimento Mineiro SGPS SA (EDM) and Fazenda Pública* Case C-77/0129 April 2004 para 59 (hereafter the *EDM* case).
[398] See para 2.6.3 above.

Assuming that the partnership held the partners' shares, and that it supplied those shares to the partners upon the establishment of the partnership, I argue that those supplies would probably not be made by the partnership in the course or furtherance of carrying on an enterprise. In the unlikely event that the partnership supplied the shares in the course or furtherance of an enterprise which traded in partner's shares, the supply could be subject to VAT.

2.9 The deductibility of VAT on pre-formation and pre-business expenses

Expenses that may typically be incurred prior to the formation of a partnership (also referred to as 'pre-formation expenses') are, for example, legal fees incurred in drafting the partnership agreement, and accounting fees for services incident to the organisation of the partnership – such as setting up the partnership's accounting system.[399]

The question is whether the partnership may deduct the VAT levied on pre-formation expenses as an input tax deduction. Section 19 allows for the deduction of VAT levied on the acquisition of goods or services for or on behalf of a company, but before its incorporation, provided that certain requirements are met.[400] The relief under section 19 specifically applies only to companies,[401] and is therefore not available to partnerships.

Section 18(4)(*b*)(i), however, permits a deduction in relation to goods or services that were supplied to a person, if:

a. no deduction was made in respect of such goods or services; and
b. such goods or services are applied by that person, or, where he is a member of a partnership, by that partnership, for consumption, use, or supply in the course of making taxable supplies.

Badenhorst submits that VAT may be deducted by a partnership on goods or services acquired prior to the commencement of business operations under section 18(4).[402] As it is not required that a

[399] See Rickets & Tunnell *Practical Guide to Partnerships* 116.

[400] Section 19 requires, inter alia, that the goods or services must have been acquired prior to incorporation of the company, by a person who –

(a) was reimbursed by the company for the whole amount of the consideration paid for the goods or services; and
(b) acquired those goods or services for the purpose of an enterprise to be carried on by such company and has not used those goods or services for any purpose other than carrying on such enterprise.

[401] Section 1(1) defines a 'company' as meaning a company as defined in s 1 the IT Act, which defines a 'company' as including a company, co-operative, an association formed to serve a specified purpose, or a portfolio comprised in any investment scheme.

[402] Badenhorst G "*When VAT returns to your pocket"* 8 October 2007 *Business Day* at 6.

partnership actually commence business before it is established,[403] it is indeed possible for acquisitions to be made by the partnership after its establishment, but before the commencement of its business operations. I agree with Badenhorst; seeing that whilst section 19 permits an input tax deduction on goods or services acquired on behalf of a company prior to its incorporation, section 18(4)(*b*) does not allow a deduction related to acquisitions made prior to the establishment of a partnership. A scenario contemplated in section 18(4)(*b*), is where the goods or services have been supplied to a person, and such goods or services are applied, "where he is a member of a partnership", by the partnership. That the person making the acquisition is a member of the partnership, clearly implies the existence of the partnership at the time of the partner's acquisition. Section 18(4)(*b*) does not envisage a situation where the acquisition is made before the establishment of the partnership and, therefore, before the person making the acquisition became a member of the partnership. The relief under section 18(4)(*b*) is, therefore, more restricted than under section 19.

A partnership is, consequently, not allowed a deduction in relation to pre-formation expenses, but only for expenses incurred before the commencement of business (ie, pre-business expenses). Therefore, if the partners incur pre-business expenses, and the relevant goods or services are subsequently applied by the partnership for use in the course of making taxable supplies, the partnership qualifies for the section 18(4)(*b*) deduction.

In Australia and New Zealand, as in South Africa, only companies are permitted to deduct GST as input tax in relation to pre-incorporation supplies.[404]

In Canada and the UK, however, pre-registration relief is granted to persons, which should include partnerships. When a person registers for GST in Canada, he is considered to have acquired any assets used in a commercial activity immediately after that time, and to have paid GST on those assets. As a result, the new registrant is eligible to claim an input tax credit to the extent that the goods are used in commercial activity.[405] In the UK, provided that certain requirements are met, VAT incurred on goods

[403] See para 2.5 above.
[404] McCouat *Australian Master GST Guide* [E-book] Locations 20 and 132; ATO "Special rules for specific GST credit claims" available at https://www.ato.gov.au/Business/GST/Claiming-GST-credits/Special-rules-for-specific-GST-credit-claims/ (date of use: 19 August 2018); McKenzie *GST A Practical Guide* [E-book] Location 105; Marsden *Bookkeepers Guide* 428.
[405] Chabot et al *EY's Complete Guide to GST/HST* para 3,100. A similar legislative provision allows a new registrant to claim an input tax credit on GST which became payable before registration for services and which is rendered after registration. The input tax credits are available to the extent the service is used in a commercial activity. See Chabot et al *EY's Complete Guide to GST/HST* para 3,100. See also CRA "Eligibility for ITC on 'start-up' costs – Eligible capital property" available at https://www.canada.ca/en/revenue-agency/services/forms-publications/publications/p-019r/eligibility-on-start-costs-eligible-capital-property.html (date of use: 19 August 2018).

or services supplied to a taxable person before the date on which he was registered for VAT, may be treated as input tax.[406] The New Zealand GST Act similarly provides for pre-registration relief.[407]

As concerns the EU, in the *Polski Trawertyn*-case,[408] the future partners of a partnership, before the creation of the partnership, acquired immovable property for the future exploitation by the partnership. The partners' subsequent contribution of the immovable property to the partnership was exempt from VAT. The question was whether the partners were entitled to deduct the VAT as input tax, although the immovable property was used by the partnership (instead of by the partners) in its taxable activities.[409] The ECJ held that the partners may be considered to be taxable persons for the purposes of VAT and are, therefore, entitled to the input tax deduction.[410] The court reasoned that in applying the principle of neutrality in VAT, a taxable person whose sole object is to prepare the economic activity of another taxable person, and who has not effected any taxable transaction, may exercise a right to deduct in relation to taxable transactions carried out by the other taxable person.[411]

In the *Malburg*-case,[412] Malburg, who was a member of a partnership that had dissolved, founded a new partnership. Malburg made available a client base, which he had acquired following the dissolution of the old partnership, to the new partnership free of charge. The question before the ECJ was, having regard to the principle of neutrality, whether Malburg was entitled to deduct the VAT paid on the acquisition of the client base, as input tax.[413] The ECJ distinguished this case from *Polski Trawertyn*. In the latter case, the contribution of the immovable property fell within the scope of VAT, but constituted an exempt transaction. In the *Malburg*-case, however, the provision of the client base for use by the partnership free of charge did not constitute an "economic activity" within the meaning of the Sixth Directive.[414] Consequently, the ECJ reasoned, that there was no direct and immediate link between a

[406] Hemmingsley & Rudling *Tolley's Value Added Tax* para 34.10; HMRC "How to treat input tax: pre-registration, pre-incorporation and post-deregistration claims to input tax under regulation 111" available at https://www.gov.uk/hmrc-internal-manuals/vat-input-tax/vit32000 (date of use: 20 August 2018).
[407] Section 21B of the New Zealand GST Act permits a registered person to deduct input tax relating to goods or services acquired before registration. See NZIR "Subsequent registration" available at https://www.gov.uk/hmrc-internal-manuals/vat-input-tax/vit32000 (date of use: 20 August 2018). It is evident that transitional problems in respect of VAT are a common phenomenon and are, therefore, not exclusive to partnerships. In my view, transitional rules must be developed to ensure a smooth VAT transition. This study, however, focuses on partnerships primarily. A complete analysis of transitional rules is, therefore, not provided. The authorities referenced in the footnotes above offer general discussions on the topic.
[408] *Kopalnia Odkrywkowa Polski Trawertyn P. Granatowicz, M. Wąsiewicz spółka jawna v Dyrektor Izby Skarbowej w Poznaniu* Case C-280/10 1 March 2012.
[409] See 4 of the judgment.
[410] Ibid.
[411] Ibid.
[412] *Finanzamt Saarlouis v Heinz Malburg* Case C-204/13 13 March 2014.
[413] See 5 of the judgment.
[414] See 6 of the judgment.

particular input and output transaction giving rise to entitlement to deduct.[415] Moreover, seeing that the principle of fiscal neutrality is not a rule of primary law, but a principle of interpretation, the ECJ held that it does not allow the scope of the entitlement to deduct input tax, to be extended in the face of an unambiguous provision of the Sixth Directive.[416]

Ehrke-Rabel, criticising the *Malburg*-case argues, that as regards the requirement of a direct and immediate link between an input and output transaction for the entitlement of deduction of VAT, there is no substantial difference between an output transaction exempt from VAT and an output transaction not falling within the scope of VAT. In both cases, there is no right to deduct input VAT.[417] Ehrke-Rabel is of the view that *Malburg* seems to reduce the impact of *Polski Trawertyn* to specific situations, so that when determining the deductibility of VAT relating to preparatory acts, the particular circumstances need to be considered.[418]

According to Papis, the ECJ in *Polski Trawertyn* adopted a non-formalistic approach giving priority to the fundamental principles underlying and constituting an integral part of the VAT system before the formal obligations established by legislation of national laws of EU Member States.[419]

In my view, as the interpretive technique followed by South African courts according to which the "inevitable point of departure is the language of the provision itself", the ECJ's decision's in *Polski Trawertyn* and *Malburg* cannot serve as guidance to the interpretation of the VAT Act on the deductibility of VAT on pre-formation expenses.[420] Accordingly, the courts will not grant input relief beyond what is permitted by sections 18(4)(*b*) and 19.

2.10 Single entity selling a share in its business

The sale by a person of a share in his business could result in the establishment of a partnership if all the requirements for a partnership are met. The ATO regards this transaction as the supply of an enterprise to the partnership by the entity selling a share in the business, with the consideration being a supply of an interest in the partnership, together with a payment of money from the purchaser.[421]

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[415] Ibid.
[416] See 7 of the judgment.
[417] Ehrke-Rabel (2014) World Journal of VAT/GST Law 122.
[418] Ibid.
[419] Papis (2012) World Journal of VAT/GST Law 99.
[420] See *Natal Joint Municipal Pension Fund v Edumeni Municipality* 2012 (4) SA 593 (SCA), where the court stated at para. 18:
"The 'inevitable point of departure is the language of the provision itself', read in context and having regard to the purpose of the provision in the background to the interpretation and production of the document."
[421] GSTR 2003/13 para 84.

I argue that the VAT treatment of a transaction of this nature would depend on how the deal is structured. The seller could either sell an undivided interest in his business to the purchaser in return for a purchase consideration, after which they agree to each contribute their undivided shares in the business to the partnership. Alternatively, the owner of the business can contribute the business to the partnership, and the other party can make a capital contribution of his own, eg, a cash payment, to the partnership.

In my view, each party's contribution of an undivided share in the business to the partnership would not qualify for zero rating under section 11(1)(*e*), which zero rates the supply of an 'enterprise' which is capable of separate operation. The two contributions are two separate supplies that must be viewed independently of one another when considering the VAT treatment of each supply. The two undivided shares together constitute an enterprise, but each one, considered individually, does not constitute an enterprise distinct from the other. Moreover, each undivided share is not capable of separate operation as required by section 11(1)(*e*).

Australia, Canada, New Zealand, and the UK, like South Africa, do not have specific provisions that regulate the VAT/GST treatment of the above factual scenarios.[422]

[422] In my view, however, each party's contribution of an undivided share in the business to the partnership would also not qualify for zero rating in each of these VAT/GST jurisdictions as each undivided share would not be capable of operating separately as a business. In Australia the supply of a going concern is GST-free in certain circumstances. According to McCouat, it is possible to sell a going concern that consists of an enterprise which is part of a larger enterprise. He argues, however, that this does not apply if what is sold does not comprise an enterprising itself. See McCouat *Australian Master GST Guide* [E-book] Location 327. The ATO is likewise of the view that the supply of a going concern would be GST-free provided that all the things that are necessary for the continued operation of the enterprise is supplied. See ATO GSTR 2002/5 "Goods and services tax: When is a 'supply of a going concern' GST-free?" available at https://www.ato.gov.au/law/view/pdf?DocID=GST%2FGSTR20025%2FNAT%2FATO%2F00001&filename=law/view/pdf/pbr/gstr2002-005c5u1.pdf&PiT=99991231235958 (date of use: 21 December 2018) para 17. The New Zealand GST Act provides for the zero-rating of the supply of a going concern provided that, amongst others, the supplier and the recipient agree that the supply is of a going concern. There is a supply of a taxable activity, or part of a taxable activity, where that part is capable of separate operation. See McKenzie *GST A Practical Guide* [E-book] Location 296. According to the NZIR, to qualify for the zero-rating, it must be the supply of the whole or stand-alone part of a taxable activity. See NZIR "Zero-rated supplies" available at https://www.ird.govt.nz/gst/additional-calcs/calc-spec-supplies/calc-zero/calc-zero.html#salegoingconcern (date of use: 20 August 2018). In the UK, where certain conditions are met the transfer of a business as a going concern must be treated as neither a supply of goods, nor a supply of services and is, therefore, not subject to VAT. One of the conditions, in relation to a part transfer of a business, is that, that part must be capable of separate operation. See HMRC "Transfer of a business as a going concern (VAT Notice 700/9)" available at https://www.gov.uk/guidance/transfer-a-business-as-a-going-concern-and-vat-notice-7009 (date of use: 20 August 2018); Hemmingsley & Rudling *Tolley's Value Added Tax* paras 8.9 and 8.10. Canada's ETA does not have a provision which zero rates the supply of a business as a going concern.

2.11 Conclusion

The focus in this chapter has been on the VAT treatment of supplies that are typically made on the formation of a partnership. This required a consideration of the law of partnership, regarding the formation phase, as well as a consideration of pertinent provisions in the VAT Act, some of which compel a deviation from the common law. Deeming a partnership to be a person, for example, creates a strong dichotomy between the general legal nature, and the VAT character of a partnership transaction. How a transaction is seen for partnership law purposes, is often very different from how it is viewed from a VAT perspective. Determining the precise impact of the provisions in the VAT Act relevant to partnerships, on the character or nature of a partnership transaction raises difficulties in interpretation in that the extent to which the provisions are intended to supplant or alter the common law, is often not clear due to a lack of detailed guidance by the legislature.

The partnership law and VAT law dichotomy is an important theme that runs through most of the thesis,[423] and always requires careful consideration of the interplay between the common law and the VAT Act.

It was argued that whilst a partnership cannot be the bearer of rights and duties in terms of the common law, for VAT purposes, it is quite capable of making supplies and acquisitions, of registering for VAT as a single person, and of carrying on an enterprise independently of its members. Importantly, the partnership's status as a separate person enables supplies and acquisitions to be made between the partnership and its members, even though, legally, the same person is both supplier and acquirer in the same transaction. This separate-person status naturally enables more transactions that are subject to VAT to be recognised in the activities that are typically undertaken by a partnership, especially between the partnership and its members.

In the following chapter, the VAT treatment of transactions commonly entered into throughout the operation of a partnership, is considered – save for the transfer of partners' shares which is addressed in Chapter Four.

[423] See Arsenault & Kreklewetz "Partnerships" at 35 who also grapple with this common-law and GST-law dichotomy in their paper.

CHAPTER 3

OPERATION OF A PARTNERSHIP

3.1 Introduction

The following transactions are typically encountered in the operation of a partnership:

a. Supplies from a partner to the partnership, whether as a contribution of capital, or as a third-party supplier.[424]

b. Supplies by the partnership, including supplies made by a partner acting on behalf of the partnership, to a third party.

c. Acquisitions by the partnership.

d. Distributions to partners, including profit and *in specie* distributions.

e. Private or domestic use of partnership property.

f. The supply of partners' shares.[425]

The VAT implications of these transactions, which are not expressly provided for in the VAT Act, are discussed in this chapter, save for the supply of partners' shares.

3.2 Supplies from a partner to the partnership

3.2.1 The nature of a partner's supply

As stated above,[426] a partner's supply can be a contribution to the capital of the partnership. After the formation of the partnership, the agreed capital can, with the consent of all the partners, be added to or withdrawn at any time.[427] The partner, on the basis of the partnership agreement,[428] makes the contribution in his capacity as a partner. Where the partner, instead, makes the supply as a third-party

[424] A partner acts as a third-party supplier where he makes a supply to the partnership, also referred to as a third-party supply, as part of a transaction that does not involve a capital contribution. See GSTR 2003/13 para 104.

[425] See Van Doesum 2010-6 *EC Tax Review* 262; Ward J "GST and the Formation & Dissolution of Partnerships" available at http://www.tved.net.au/index.cfm?SimpleDisplay=PaperDisplay.cfm&PaperDisplay=http://www.tved.net.au/PublicPapers/June_2003,_Sound_Education_in_GST,_GST_and_The_Formation__Dissolution_of_Partnerships.html 4 (date of use: 2 May 2017).

[426] See paras 2.6 and 3.1 above.

[427] Ramdhin et al "Partnership" para 297; Williams *Concise Corporate and Partnership Law* 5; Scamell & I'Anson Banks *Lindley on the Law of Partnerships* 495. See also *Schlemmer v Viljoen en Andere* [1958] 2 All SA 309 (T) at 315.

[428] See Ramdhin et al ibid at para 263; Benade et al *Ondernemingsreg* paras 3.21 and 3.22. According to Bamford *Law of Partnership* 27, a partner is a debtor to the partnership for what he has agreed to contribute. See also Williams *Concise Corporate and Partnership Law* 5.

supplier (eg, as an independent contractor) he acts in a non-partner capacity, as the supply is not made in terms of the partnership agreement.[429] Strictly speaking, these supplies do not fall within the ambit of the partnership business as envisaged in the partnership agreement.[430]

I concluded in Chapter Two,[431] that a partner's contribution to the partnership may simultaneously serve as a supply as agent on behalf of the partnership, to a third party, and by carrying out that task, as an in-kind contribution of labour to the partnership. As an agent, the partner contracts an obligation in the name of the partnership.[432] Where the partner acts as a third-party supplier, he is not an agent of the partnership, but incurs an obligation in his personal capacity. The partner's actions would, consequently, not render the partnership liable.[433]

In my view, when a partner who is a vendor makes a contribution or a supply to the partnership as a third-party supplier, the supply will be subject to VAT at fifteen per cent, provided that all the requirements of section 7(1)(*a*) have been met.[434] Most important, here, is that the supply must be made for a consideration.[435] Should the partner act as an agent for the partnership, the partner is liable for any VAT on his supply of 'agency' or 'representation' services to the partnership, whilst the partnership is liable, through the partner as agent, for any VAT on the supply made to the third party.

3.2.2 The consideration for the partner's supply

The value of a partner's supply to the partnership is the amount of the consideration for such supply.[436] Where the supply is made for no consideration, or for a consideration which is less than the open-market value of the supply, and the partnership is not exclusively involved in the making of taxable

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[429] See Burke *Federal Income Taxation* [E-book] Locations 969 and 972.

[430] It is an *essentialia* of a partnership agreement that the partnership business must be carried on for the joint benefit of the parties. See Williams *Concise Corporate and Partnership Law* 5; Ramdhin et al "Partnership" paras 262 and 263; Benade et al *Ondernemingsreg* paras 3.32 to 3.35. A partner who makes supplies as an independent contractor, acts for his own benefit. According to Arsenault & Kreklewetz "Partnerships" 29, partners often provide personal services or personal property to their partnerships, which do not fall strictly within the ambit of the partnership's business.

[431] See para 2.6.2 above.

[432] Ibid.

[433] Henning *Perspectives on the Law of Partnership* para 8.4.1; Arsenault & Kreklewetz "Partnerships" 29.

[434] A supply by a partner to a partnership may also be zero-rated or exempt. A supply by a partner, who is a vendor, of an enterprise or of a part of an enterprise, which is capable of separate operation, is zero-rated subject to compliance with s 11(1)(*e*). A loan made by a registered partner to a partnership, which constitutes a 'financial service' as defined in s 2(1)(*f*), is exempt under s 12(*a*). See GSTR 2003/13 para 108.

[435] Section 7(1)(*a*) requires that the supply must be made in the course or furtherance of an enterprise carried on by the vendor. The definition of 'enterprise' in s 1(1), in turn, requires that the supply must be made for a consideration.

[436] The amount of the consideration for the supply is determined in accordance with s 10(3), which provides that such consideration shall be –

(a) to the extent that such consideration is a consideration in money, the amount of money; and
(b) to the extent that such consideration is not a consideration in money, the open market value of that consideration.

supplies, section 10(4) could come into play and deem the consideration for the supply to be its open-market value.

Should the partnership make taxable supplies only, the value of the supplies made to the partnership is not really important. This is because the VAT levied on such supplies is, in any case, deductible as input tax. Where, however, the partnership does not make taxable supplies only, the value of the partners' supplies matters as the VAT on those supplies is not fully deductible by the partnership.[437]

3.2.3 The distinction between consideration for a supply and profit distributions

In my opinion, it is important to distinguish between a payment made as consideration for a partner's supply, and a distributive share in profits, whether the supply is a capital contribution or a third-party supply. If the payment is consideration, the supply will be subject to VAT if it is made in the course or furtherance of the partner's enterprise. If, however, the payment is a profit distribution, it does not constitute consideration since, as I argue above,[438] a partner's share and any resultant profit distributions, are not reciprocally connected to a partner's contribution. A profit distribution would also not be consideration for a third-party supply because that distribution is clearly the result of ownership of a partner's share[439] and not intended to constitute payment for a supply. If section 10(4) – in terms of which the consideration for the contribution is deemed to be its open-market value – does not apply, the value of the supply will, in terms of section 10(23), be deemed to be nil.

Even though the partnership is entitled to deduct any VAT levied as input tax where it applies the contribution or other acquisition for a taxable purpose, it is clearly administratively more burdensome for a partner to register for VAT and to account for output tax on the transaction. Consequently, a partner would be in a more favourable position if the payment for the supply were classified as a profit distribution, as a profit distribution would not constitute consideration for either a capital contribution or a third-party supply. I argue that the partners could be disposed to claim that a payment is a profit distribution, and not a consideration, in order to 'shelter' the supply from VAT.[440]

Burke is of the view that the nature of a payment to a partner might not be clear which makes it difficult to distinguish between a payment for a supply, and a profit distribution.[441] What may cause this uncertainty, in my opinion, is that partners are unrestricted as regards agreeing on the amount of each

[437] See Arsenault & Kreklewetz "Partnerships" 29.
[438] See para 2.6.5 above.
[439] See para 2.6.3 above.
[440] See Arsenault & Kreklewetz "Partnerships" 45.
[441] Burke *Federal Income Taxation* Locations 2775 and 2778.

partner's profit share in the partnership agreement, and the formula used to determine the respective shares may be complex or unusual.[442]

The next issue is how the nature of a payment to a partner can be determined where it is unclear from the terms of the partnership agreement whether the payment is a profit distribution or consideration. The fundamental object of interpreting a contact is to establish and give effect to the common intention of the parties. To do this, a court will have regard to the language used in the contract and the surrounding circumstances.[443]

In my view, the following indicators could be useful in determining the nature of a payment made to a partner.

a. A specific payment made by a partnership to a partner, in return for a supply to the partnership, is required to be made to the partner after the payment of partnership creditors, but before the division of net profits.[444] I argue that if the payment is prioritised or sequenced in this way, it is indicative of the amount being a payment of consideration for the partner's supply, rather than a profit distribution. A payment made for a supply, consequently, reduces the profits available for distribution.[445]

b. An obligation of a partnership to make payment with respect to a liability that is certain, irrespective whether there are profits or not,[446] is, according to Burke, difficult to reconcile with the concept of a distributive share of partnership profits.[447] These may take the form of fixed, periodical payments that do not fluctuate depending on the partnership's net profits (eg, a fixed salary, although a partner cannot be employed by the partnership, or fixed interest payments). The liability could well exceed the partnership's profits at the end of an accounting year – for example, when profits are required to be distributed as agreed to in the partnership contract. If the amount or the fact of payment is, instead, contingent upon the entrepreneurial risks of the partnership business, and, accordingly, dependent on the partnership's net profits, the payment, in all likelihood, constitutes profit share.[448]

c. Payments made to a partner in addition to his profit share, and which are based on the partner's normal hourly rate for those types of service – or as Burke puts it, resemble the manner in which third parties compensate the partner – point to the payment of

[442] See Ramdhin et al "Partnership" para 295.
[443] Joubert WA "Contract" in Kühne M (ed) *Law of South Africa vol 9* (LexisNexis 2014) para 351.
[444] *Jameson v Irvin's Executors* (1887-1888) 5 SC 222 at 252; Ramdhin et al "Partnership" para 294.
[445] Burke *Federal Income Taxation* Location 1209, 1212.
[446] See *Jameson v Irvin's Executors* (1887-1888) 5 SC 222 at 252.
[447] Burke *Federal Income Taxation* Location 2776.
[448] Ibid at Location 2873.

consideration.[449] This reasoning would also apply to supplies of property in return for a related payment, without regard to the success of the partnership business. This type of transaction would more closely resemble a sale or an exchange, than a capital contribution that is placed at the disposal of the partnership and subjected to the risks of the business.[450]

d. The relative proximity in time between the supply and the payment, instead of the partner receiving payment when profit distributions are normally made, suggests a payment of consideration.[451]

e. In the case of a third-party supply, the partnership may withhold payment if the partner has not yet rendered performance, or if his performance is defective, by raising the defence of *exceptio non adimpleti contractus* against the partner.[452] A partner, however, is entitled to his share in the profits whether or not his contribution is defective. If his contribution is not forthcoming or is defective, the partner can, by means of the *pro socio*, only be compelled to contribute what he has agreed to the partnership.[453] The nature of the action available to the partnership against the partner is, therefore, a relevant consideration.

I believe that if the supply is a contribution, then it is more likely that the payment to the partner is a distribution of profits, since, as stated above,[454] it is a *naturale* of the partnership agreement that a partner is not entitled to compensation for his contribution. As a result, save where the partners otherwise agree, a partner is not rewarded for his contribution. A partner is, therefore, not normally paid a consideration for his contribution, but rather receives payment in the nature of profit distributions.

If, however, as stated,[455] a partner has performed special work beyond that performed by the other partners, and which was not envisaged as part of his duties under the partnership agreement, he is

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[449] Ibid at Location 2888. See also CRA *GST/HST Policy Statement P-244 – Application of Sub-s 272.1(1) of the Excise Tax Act* available at https://www.canada.ca/en/revenue-agency/services/forms-publications/publications/p-244/partnerships-application-subsection-272-1-1-excise-tax-act.html (date of use: 31 December 2018) 3-4 (hereafter CRA Policy Statement P-244). The CRA's administrative policy on the meaning of the phrase 'anything done by a person as a member of a partnership', as contemplated in sub-s 272.1(1) of Canada's ETA, is provided in this policy statement. Sub-s 272.1(1) provides that, "anything done by a person as a member of a partnership is deemed to have been done by the partnership in the course of the partnership's activities and not to have been done by the person." The practical effect of sub-s 272.1(1) is that a partner is not considered to have made any sort of supply to the partnership when he performs duties "as a member of a partnership", and the partner, accordingly, is not required to account for GST in relation to the performance of such duties. See Murray BF "Partner Contributions: Deeming Away any Supply to the Partnership" available at http://www.cch.ca/ newsletters/TaxAccounting/july2010/Article2.htm (date of use: 4 September 2014).

[450] See Burke *Federal Income Taxation* Location 2902, 2905; Williams *Concise Corporate and Partnership Law* 5; Ramdhin et al "Partnership" para 263; Benade et al *Ondernemingsreg* para 3.26.

[451] See Burke *Federal Income Taxation* Location 2875, 2878.

[452] See para 2.6.5 above.

[453] Ibid.

[454] Ibid.

[455] Ibid.

entitled to claim remuneration for his services. Consequently, a partner is normally paid a consideration for a third-party supply.

The partnership agreement might, however, not be clear on the nature of the supply.[456] In my view, the following indicators could be useful in determining the nature of a partner's supply, which could, in turn, be indicative of the nature of the partnership's payment to the partner.

a. If the partner's supply relates to the purpose of the partnership business, as specified in the partnership agreement, or, as Burke submits, the services are closely related to the partnership's activities,[457] it is more likely that the supply is a contribution and the payment a distributive share in the profits.[458] The argument, in my view, is that the partner's supply is intended to achieve the partnership's objective, as opposed to the partner's personal business objective.
b. That the partner is performing the activity not only for the partnership, but also for an enterprise which he carries on separately from the partnership, is indicative of a third-party supply.[459]
c. A partner is entitled to be reimbursed for expenses which he has incurred in connection with partnership affairs.[460] Therefore, where a partner is reimbursed by the partnership for necessary expenses he has incurred in order to make the supply to the partnership, this suggests a contribution.[461] As stated,[462] when making a contribution of labour to the partnership, that contribution may simultaneously serve as a supply by the partner as agent on behalf of the partnership to a third party. In terms of the law of agency, a principal must reimburse the agent for all expenses reasonably and properly incurred in carrying out his mandate.[463]
d. A partner has the right to be indemnified for losses which he personally suffers whilst carrying on the partnership business. The risk of such losses must, however, be directly and inseparably linked to the carrying on of the partnership business.[464] In accordance with agency law, a principal must, similarly, indemnify an agent for losses or liability incurred in the execution of his mandate.[465] The partnership is, therefore, liable for the actions of the partner

[456] Burke *Federal Income Taxation* Location 2795. See also Arsenault & Kreklewetz "Partnerships" 44.
[457] Burke ibid at Location 2790, 2793.
[458] See CRA Policy Statement P-244 at 2.
[459] Ibid.
[460] Williams *Concise Corporate and Partnership Law* 37; Ramdhin et al "Partnership" para 294; Benade et al *Ondernemingsreg* paras 4.17 and 4.18.
[461] See CRA Policy Statement P-244 at 2.
[462] See para 2.6.2 above.
[463] Du Bois et al *Wille's Principles* 997; Kerr *Law of Agency* 177.
[464] Ramdhin et al "Partnership" para 294; Benade et al *Ondernemingsreg* para 4.18; Williams *Concise Corporate and Partnership Law* 37.
[465] Du Bois et al *Wille's Principles* 997; Kerr *Law of Agency* 177.

carried out within the course and scope of the partnership business.[466] I argue that the existence of an obligation to indemnify a partner for losses resulting from his supply, points to the supply being a contribution.

e. A transaction effected by a partner with a third party as agent for the partnership, is binding as between the partnership, as principal, and the third party. The partnership is liable under the contract, and may consequently be sued by the third party, whilst no liability attaches to the partner under the transaction.[467] I argue, therefore, that if the partnership, rather than the partner, can be sued under the contract with the third party, the partner's supply is likely to be a contribution, in that he acted as agent for the partnership.

Clearly, the above indicators would not, singly, be decisive of the nature of a supply or payment. They must, however, be weighed together with all other relevant factors when determining the true intention of the parties.

There is no requirement that partners' contributions must take the same form, be of equal value, or of the same quantity.[468] Partners are also free to determine the amount of each partner's share.[469] Partners are, therefore, not required to share equally in the partnership profits. I stated[470] that in the absence of an agreement regarding profit share, the profits are shared in proportion to the value of the partners' respective contributions. Where the value of the individual contributions cannot be established, the profits are shared equally. In my opinion, inequalities in contributions or in profit sharing do not, in themselves, imply that the supply is in fact a third-party supply, or that the payment is a consideration in that such inequalities are perfectly normal in a partnership agreement.[471]

3.3 Supplies made by a partnership to third parties

3.3.1 The partnership's supply of partnership property

I argue[472] that a partnership can make supplies and acquisitions in view of its status as a person for VAT purposes. The property that will generally be supplied by the partnership, is property that forms

[466] See CRA Policy Statement P-244 at 2.
[467] Du Bois et al *Wille's Principles* 998; Kerr *Law of Agency* 177.
[468] See para 2.6 above.
[469] Ramdhin et al "Partnership" para 295; Williams *Concise Corporate and Partnership Law* 31; Benade et al *Ondernemingsreg* para 3.43.
[470] See para 2.6.5 above.
[471] See Murray BF "Partner Contributions: Deeming Away any Supply to the Partnership" available at http://www.cch.ca/newsletters/TaxAccounting/ july2010/Article2.htm (date of use: 4 September 2014).
[472] See para 2.3 above.

part of, or is used in, its enterprise. A partner's contribution, for example, must be placed at the disposal of the partnership[473] and will, therefore, be used in the partnership's enterprise.

All property used in the partnership is deemed to be partnership property if it is necessary for the proper functioning of the partnership business that the property should be a partnership asset.[474] Whether property made available to the partnership constitutes partnership property, depends on the intention of the partners as established from the partnership agreement and the surrounding circumstances.[475] Property can, therefore, be partnership property regardless of whether or not it is jointly owned by the partners.[476] As stated,[477] the establishment of a jointly-owned partnership fund is only a *naturale* of a partnership agreement. The question is, however, whether all partnership property, despite ownership, can be the subject of a supply made by the partnership.

In the New Zealand decision in *Case S83,*[478] the objector – a father-and-son farming partnership – used farmland separately owned by each partner. A family company purchased the farmland from each partner. The Commissioner for Inland Revenue considered that the land had been sold in the course of the partnership's taxable activity, and assessed the partnership for GST output tax on the respective sales by the partners to the family company.

The dispute in this case turned on the correct interpretation of section 57(2)(b) of the New Zealand GST Act, which provides that, "any supply of goods and services made in the course of carrying on that taxable activity shall be deemed for the purposes of this Act to be supplied by that body, and shall be deemed not to be made by any member of that body."[479]

The Commissioner submitted that because the land formed part of the taxable activity of the partnership, the sale is deemed by section 57(2)(*b*) to have been made by the partnership rather than by the individual partners, and that this is so irrespective of whether the land is also partnership property under general law. It was submitted for the Commissioner, in the alternative, that if section 57(2)(*b*)

[473] See para 3.2.3 above.
[474] Ramdhin et al "Partnership" para 285; Bamford *Law of Partnership* 28, is of the view that normally, if it is necessary for the effective execution of the agreement that the asset be partnership property, this will be implied as the intention of the parties. According to Williams *Concise Corporate and Partnership Law* 26, 'partnership property' or 'partnership assets' means all the assets which belong to the partnership.
[475] *Muller en 'n Ander v Pienaar* [1970] 2 All SA 410 (C) at 415; *Fortune v Versluis* [1962] 1 All SA 414 (A) at 357; Bamford *Law of Partnership* 28; Ramdhin et al ibid at para 285. According to Mongalo, Lumina & Kader *Forms of Business Enterprise* para 2.3.6.1, 'partnership property' are those assets (or property) in respect of which partners agree that they would be used for the realisation of the object of the partnership. See also Williams *Concise Corporate and Partnership Law* 30.
[476] Ramdhin et al ibid at para 285; Benade et al *Ondernemingsreg* paras 3.61 to 3.63.
[477] See para 2.7 above.
[478] (1996) 17 NZTC 7,515.
[479] Ibid at 6.

cannot apply unless the land is partnership property, then the land in question was partnership property.[480]

The court held that section 57(2)(*b*) requires not only that the land be supplied in the course of carrying on the partnership's taxable activity, but also that it be partnership property. According to the court, there was no compelling evidence that the partners supplied ownership of the land to the partnership.[481] As a result, the court held that the land could not have been sold by the partnership because it did not own it. The land was, therefore, not sold in the course of carrying on the partnership's taxable activity of farming.[482] The court determined that in making the objector partnership's GST assessment, the Commissioner had acted incorrectly by concluding both that the land was the objector partnership's property used in its taxable activity, and that the supply of the land was made by the objector partnership. The objector partnership, accordingly, succeeded.[483]

In explaining the reason for its decision, the court stated that section 57(2)(*b*) cannot be taken to mean that the sale of land made in the course of a partnership's taxable activity of farming, is deemed to be made by the partnership. The flaw, according to the court, is that in the absence of some clear deeming legislative provision, a person or partnership cannot supply what that person or partnership does not own. A supply which is not made by the partners, as partners, or for them, cannot be made in the course of carrying on the partnership's taxable activity or as part of its termination.[484] In my view, the collection of individuals constituting the partnership and acting in the course and scope of the partnership's common purpose, must be supplying the ownership of the property in order for the partnership, as the deemed person, to be the supplier of such ownership. The interpretation of section 57(2)(*b*) in *Case S83* was confirmed in *Case S84*[485] and in *CIR v Dormer and Anor*.[486]

Considering that section 51(1)(*a*) deems the partnership to be carrying on the partnership's enterprise, it is in my view similar to section 57(2)(*b*), as this provision in effect deems any supply of goods or services made in the course of carrying on that enterprise, to have been made by the partnership. That being so, I argue that the above New Zealand cases can provide guidance on the interpretation of section 51(1). As the two provisions have the same effect, section 51(1)(*a*) cannot also be taken to

[480] Ibid at 7.
[481] Ibid at 10.
[482] Ibid at 11.
[483] Ibid at 12.
[484] Ibid.
[485] *Case S84* above.
[486] (1997) 18 NZTC 13,446 at 11. In *Case S84* at 8, the court held that all the assets used by a partnership in its taxable activity form part of that taxable activity. The partnership cannot, however, make a supply of the ownership of assets which it does not own. The court held, accordingly, that the land in question had not been sold in the course of carrying on the partnership's taxable activity because the partnership did not own the land.

mean that the supply of property used in the partnership's taxable activity, is necessarily deemed to be made by the partnership. As was held in the New Zealand cases, a partnership can only supply what it owns – subject, however, to section 18(4)(*b*), which is considered below.[487]

In *Lewkowitz v Commissioner for Inland Revenue,*[488] the court referred to the following general principle[489] to be applied when interpreting deeming provisions:

> When a statute enacts that something shall be deemed to have been done, which in fact and in truth was not done, the Court is entitled and bound to ascertain for what purposes and between what persons the statutory fiction is to be resorted to.[490]

Considering, in addition, the purpose of section 51(1) of the VAT Act, in *Case S84*[491] the court expressed the view that section 57(2) of the New Zealand GST Act was intended to apply to the day-to-day supplies to or from an unincorporated group (eg, a partnership) by making it clear that, where partners make or receive supplies, they are deemed to be doing so on behalf of the partnership. The court suggested that the aim of section 57(2) is to clarify that where people operate a partnership, they can register the partnership for GST purposes, and do not need to register each partner. Supplies in the course of the partnership's activity, made by one or more partners, are deemed to have been made by the partnership and not by the partner. The same applies to inputs regarding supplies to a partner for the partnership. In the light of the meaning and purpose of section 57(2), it appeared to the court to be stretching the concept to submit that land owned by a partner is supplied by the partnership, just because the partnership was conducting an activity on it.[492]

In my view, section 51(1) achieves the same aim as section 57(2) of the New Zealand GST Act, namely, that where the members of a partnership carry on an enterprise, the partnership, instead of its members, must register for VAT independently of the members. Supplies and acquisitions made by the members in conducting the partnership's enterprise must, therefore, be accounted for under the partnership's VAT registration number. There is nothing in section 51(1) to suggest that it also has as its purpose, to allow a partnership that which is generally not permitted to any other vendor, and that is to account for VAT on the supply of the ownership of property which the particular vendor does not own, but is only,

[487] That is below under this sub-heading.
[488] 1946 AD 579.
[489] Quoted in *Leitch v Emmot* 1929 2 KB 236 at 245 and taken from *Ex parte Walton* 17 Ch D 746 at 756.
[490] Ibid at 590.
[491] *Case S84* above.
[492] Ibid at 8.

for example, using in its enterprise. Only in exceptional cases provided for in the VAT Act may one person, account for VAT on the supply of property which belongs to another person.[493]

In line with the judgment in *Johannesburg Municipality v Cohen's Trustees* referred to above,[494] the court held in *Casserley v Stubbs*,[495] that before ruling that a statute intends to alter the common law, the statute must either explicitly say that it is the intention of the legislature to alter the common law, or the inference from the statute must be such that no conclusion is warranted other than that the legislature had such an intention.[496] Although commenting on the UK's tax system, Loutzenhiser's statement that, in the case of deeming provisions, the courts will not allow one "to deem too far",[497] also applies to deeming provisions in South African law. I argue that a deeming provision is taken too far if there is no evidence of either an expressed or implied intention of the legislature which supports the particular interpretation.

Section 51(1), and particularly subparagraph (*a*), does not explicitly state, and nowhere in this provision is there evidence of a legislative intent, that all property used in the partnership's enterprise, whether that property is jointly owned by the partners or not, is capable of being supplied by the partnership. In the circumstances, arguing the contrary is simply taking the deeming provision too far, given the lack of evidence of such an alleged intent. There is, consequently, no evidence of a legislative intent "to alter the course of the common law",[498] which requires that in the case of an agreement of purchase and sale, the seller must agree to deliver to the purchaser the free possession of the thing sold (ie, the *merx*).[499] In my view the partners, acting together in partnership, cannot honestly make such an undertaking if they are not the rightful owners of the *merx*.

As stated above,[500] where goods or services are deemed to be supplied to the partnership under section 18(4)(*b*), such goods or services are then effectively deemed to be jointly owned partnership property, even if only the use of the goods or services has been supplied by the partner to the partnership. It follows that if such goods or services are subsequently supplied, the supply will be

[493] Section 54(5), for example, provides that in the case of the auction of goods, where the supply would not be a taxable supply, the principal and the auctioneer may agree that the supply shall be treated as if it were made by the auctioneer and not by the principal. Section 18(4)(*b*) is another exception.
[494] See para 2.2.2.
[495] 1916 TPD 310 at 312.
[496] See Devenish *Interpretation of Statutes* 160. See also Botha *Statutory Interpretation* 86 para 7.3.4.
[497] Loutzenhiser *Tiley's Revenue Law* para 71.6.3
[498] See *Johannesburg Municipality v Cohen's Trustees* 1909 TS 811 at 823.
[499] Du Bois et al *Wille's Principles* 889. Note that ownership in a movable is transferred by delivery, that is, by the transfer of possession. See Van der Merwe CG "Things" in Kühne M (ed) *Law of South Africa vol 27* (LexisNexis 2014) para 219.
[500] See para 2.7 above.

deemed to be made by the partnership, and in the course or furtherance of its enterprise, even though the ownership of such goods or services is held by a partner.

Therefore, save for the ownership of property that is deemed under section 18(4)(*b*) to have been acquired by the partnership, it can only supply jointly-owned partnership property.[501] Jointly-owned partnership property not only comprises property contributed *quoad dominium*, but includes, in the absence of a contrary agreement, all other partnership assets.[502] Other examples of jointly-owned partnership property is property acquired with partnership funds during the partnership's existence, unless otherwise agreed,[503] and profits resulting from the partnership business.[504] Contributions *quoad usum,* do not stop being assets in the partners' respective personal estates as the partnership only acquires the right of use of the contributions.[505]

As a partnership does not have legal personality, third parties do not conclude agreements with the partnership but with the partners. The partners, therefore, carry the rights and obligations flowing from these agreements, which usually arise by way of contract.[506] Furthermore, because a partnership cannot own property in its own name, the supply of the jointly-owned partnership property will be made by the individual partners acting together in partnership.[507]

Arsenault and Kreklewetz submit, in relation to the Canadian partnership law, that all partners maintain their individual, undivided interests in the partnership property, in the sense that when it is acquired or sold, it is regarded as an acquisition or sale by each individual, undivided interest in it.[508] This view, in my opinion, also represents the position under the South African partnership law in that jointly-owned partnership property is held by the partners in undivided shares.[509] When a supply or acquisition is made by the partnership, each partner should, logically, be supplying or acquiring his undivided share in the property concerned. The fact that an ownership interest in the property may remain with the supplying partners, is irrelevant for VAT purposes, since, as stated above,[510] that which is supplied or

[501] In *Case S83* above at 9, the court expressed the view that with respect to land, the best evidence that the land does not fall within s 57(2)(b) and is private property, is the existence of a lease between the individual partners and the partnership. The court also stated that the best evidence that s 57(2)(b) should apply to the land is where the land is partnership property. In my view, the court must have been referring to jointly-owned partnership property.
[502] The *Sacks* case at 40. See also *Oosthuizen v Swart* [1956] 2 All SA 304 (SWA) at 307; Ramdhin et al "Partnership" para 287; Benade et al *Ondernemingsreg* para 3.62.
[503] Ramdhin et al ibid at para 285; Williams *Concise Corporate and Partnership Law* 30. See for example *Fink v Fink* 1945 WLD 226 where reference is made at 242 to partnership assets that have been acquired out of partnership profits.
[504] Ramdhin et al ibid; Williams ibid; *Schlemmer v Viljoen en Andere* [1958] 2 All SA 309 (T) at 315.
[505] Williams ibid at 28; Ramdhin et al ibid at para 287.
[506] Benade et al *Ondernemingsreg* para 5.01; Ramdhin et al ibid at paras 281 and 305.
[507] See *Case S84* above at 9.
[508] Arsenault & Kreklewetz "Partnerships" 11-12.
[509] See para 2.7 above.
[510] See para 2.3 above.

acquired by the partners as partners of the partnership, is supplied or acquired by the partnership as a separate person for VAT purposes.[511]

In Australia and Canada, a partnership is liable for the GST on a supply that falls within the ambit of, respectively, section 184-5(1) of the Australian GST Act, or section 272.1(1) of Canada's ETA.[512] In my view, it is not clear from these provisions whether the partnership can only supply the ownership of jointly-owned partnership property, as is the case in New Zealand. In terms of the Australian GST Act, a supply is normally something that passes from one entity to another.[513] Considering the factors listed below,[514] which, according to the ATO are indicative of a supply being made by a partner in his capacity as a partner, especially that the supply must be made in the names of all the partners, the ATO's view seemingly, is that a partnership can only supply property which belongs to it. Canada's ETA defines 'supply' to mean the provision of property or services in any manner, including a sale.[515] It stands to reason that an entity can only provide ownership in an item under an agreement of sale, if that item belongs to that entity.

As in the case of New Zealand, I argue that a partner's supply of the ownership of an item can only constitute a supply as envisaged in section 184-5(1) and section 272.1(1), and therefore be deemed to be made by the partnership, if such ownership vests in the partnership.

The UK VAT Act, does not have a provision similar to the above Australian and Canadian provisions, or which serves to clarify when a supply should be considered to have been made by the partnership.[516]

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[511] ATO Goods and Services Tax Ruling: GSTR 2009/1 "Goods and services tax: General law partnerships and the margin scheme" available at https://www.ato.gov.au/law/view/pdf?DocID=GST%2FGSTR20091%2FNAT%2FATO%2F00001&filename=law/view/pdf/pbr/gstr2009-001c2.pdf&PiT=99991231235958 (date of use: 22 December 2018) (hereafter GSTR 2009/1) para 39.

[512] GSTR 2003/13 para 27; McCouat *Australian Master GST Guide* [E-book] Locations 66 and 67. See also Chabot et al *EY's Complete Guide to GST/HST* para 10,010; CRA Policy Statement P-244.

[513] ATO Goods and Services Tax Ruling: GSTR 2006/9 "Goods and services tax: Supplies" available at https://www.ato.gov.au/law/view/pdf?DocID=GST%2FGSTR20069%2FNAT%2FATO%2F00001&filename=law/view/pdf/pbr/gstr2006-009c9.pdf&PiT=99991231235958 (date of use: 21 December 2018) paras 93, 94; McCouat ibid. Location 64. In terms of s 9-40 of the Australian GST Act, GST is levied on a 'taxable supply'. Section 9-10 defines 'supply' as 'any form of supply whatsoever'.

[514] See para 3.3.2 below.

[515] Section 123(1); Chabot et al *EY's Complete Guide to GST/HST* para 2,005; CRA 'General Information for GST/HST Registrants' available at https://www.canada.ca/en/revenue-agency/services/forms-publications/publications/rc4022/general-information-gst-hst-registrants.html (date of use: 22 August 2018).

[516] Section 4(1) of the UK VAT Act provides that VAT is charged on the 'supply' of goods or services made in the UK. 'Supply' is defined in s 5(2) as meaning "all forms of supply, but not anything done otherwise than for a consideration." In the UK the consensus is that a supply of goods usually means the transfer of both title to the goods and possession of, or control over, the goods. If possession of goods is transferred but title is retained, for example, when goods are lent out on hire, this is a supply of services. See HMRC "Basic principles and underlying law: What is a supply of goods?" available at https://www.gov.uk/hmrc-internal-manuals/vat-supply-and-consideration/vatsc04100 (date of use: 20 August 2018); Hemmingsley & Rudling *Tolley's Value Added Tax* para 64.3. According to HMRC there are several ways by which a supply

3.3.2 Partner acting as agent for the partnership when making a supply

A partner has authority to contract on behalf of the partnership by reason of the partnership relationship. This is based on a partner having the powers of an agent, and not by reason of an act of authorisation.[517] There are, however, certain requirements that must be met in order for the partnership to be bound by a contract entered into by a partner with a third party.[518] Those requirements are that the partnership must have existed at the relevant date; that the contracting partner had authority to bind the partnership; and that the partner entered into the contract in the name of the partnership.[519]

A partner enters into a contract in the name of the partnership if it is the intention of the contracting partner and the third party that the contractual obligation will be incurred by the partnership and not by the contracting partner in his personal capacity.[520] Whether this was the intention of the partner and third party is a question of fact depending on the circumstances of each case.[521]

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can be made, the most common being the transfer of ownership or the transfer of possession of goods, or the provision of a service by one party to another. See HMRC "Basic principles and underlying law: Supply for consideration" available at https://www.gov.uk/hmrc-internal-manuals/vat-supply-and-consideration/vatsc03300 (date of use: 22 August 2018). In the UK VAT Tribunal Decision of *W & J Tang (t/a Ziploc)* MAN/97/1123 (VTD 15426) the chairman observed that when determining whether a supply is made by the partnership or an individual partner, "the critical and decisive factor [was] the inclusion of the proceeds in the partnership accounts as income of the partnership". See Dolton & Rudling *Tolley's VAT Cases* para 47.31. In my view, all the partners would only be entitled to the proceeds of the sale if they jointly owned the sold property. The position in the UK, therefore, is the same as the other jurisdictions considered: namely, that a partnership can only supply the ownership of property under an agreement of sale, if that property belongs to that partnership.

[517] Henning *Perspectives on the Law of Partnership* para 8.1.1. In *Potchefstroom Dairies and Industries Co Ltd v Standard Fresh Milk Supply Co* 1913 TPD 506 (above), the court stated, for example, at 512 that, "for once it has been shown that several persons are partners, so far as they act within the scope of their authority the one, *ex lege*, binds the other. No written authority is requisite …". See also *Muller en 'n Ander v Pienaar* [1968] 3 All SA 290 (A) at 296. Save where the partners otherwise agree, it is a *naturalia* of partnership that every partner is entitled, without permission from his co-partners, to represent the partnership in transactions that fall within the ambit of the partnership business. See Benade et al *Ondernemingsreg* para 3.50; Bamford *Law of Partnership* 50; and Williams *Concise Corporate and Partnership Law* 39. Furthermore, according to Benade et al ibid at para 5.04, a partnership will always be represented by another party, whether by a partner or a third party, when entering into a contract, as it is not physically or legally capable of negotiating and signing contracts.

[518] Henning ibid at para 8.1.3; Benade et al ibid at para 5.02; Bamford *Law of Partnership* 50-51.

[519] Ibid.

[520] Henning *Perspectives on the Law of Partnership* para 8.4.1. See *Sacca Ltd v Olivier* [1954] 2 All SA 279 (T) where the court gave judgment against the plaintiff holding, at 283, that it had not been proved that any agreement had ever been entered into between the plaintiff and a certain Nel, as agent for the partnership, even though the goods in question had been supplied for the benefit of the partnership. Benade et al ibid at paras 5.16 and 5.17, are of the view that a partnership will normally not be a party to a contract if the person, who had the necessary authority to conclude the contract on behalf of the partnership and the third party, did not have the intention that the partnership should be a contracting party.

[521] Henning ibid at para 8.4.1. It is also Bamford's view that it will depend on the circumstances of each case whether 'personal' or 'partnership' liability has been created, and the conduct, knowledge and intention of the contracting partner and the third party must be considered when making that determination. See Bamford *Law of Partnership* 56.

Arsenault and Kreklewetz argue, correctly in my view, that the terms of the partnership agreement may well be the most important criteria in considering whether a partner's actions are as a partner of the partnership.[522] An agreed contribution in the form of labour, for example, could be clearly set out in the partnership agreement to leave no doubt about the duties which a partner is required to fulfil on behalf of the partnership. The partners' duties might, however, not be clearly or precisely set out in the partnership agreement, and this will demand a consideration of other relevant indicators to determine the contracting parties' intention.

The indicators proposed above,[523] that could be relevant in determining the nature of a partner's supply – ie, whether the supply qualifies as a capital contribution or a third-party supply – may also be relevant in determining whether the partner acted as agent on behalf of the partnership. It is important to make this determination because the partnership is not required to levy VAT on a supply where, in making that supply, a partner acted as principal in his own name, rather than as agent for the partnership.

The factors proposed by the ATO[524] which may indicate that a supply is made by a partner in his capacity as a partner, are:

a. that the consideration for the supply is paid to a common fund, or to all the partners;
b. that the supply is of a kind typically made in the type of enterprise carried on by the partnership;
c. that the invoice, or tax invoice, shows the firm or business name, or the names of all the partners as supplier;
d. that all the partners agree to the supply being made; and
e. that any agreement under which the supply is made, is in the names of all the partners.

These indicators may be relevant for the South African VAT Act in determining the intention of the parties, but not without qualification.

I agree that whether the consideration for the supply is paid into a common fund or to all the partners, is a relevant indicator considering certain reciprocal duties on the partners. A partner is under a duty to account for, and deliver to the partnership, whatever he has acquired as a partner on behalf of the partnership.[525] Consequently, if the supply was made by the partnership, the consideration therefor

[522] Arsenault & Kreklewetz "Partnerships" 44.
[523] See para 3.2.3 above.
[524] In GSTR 2003/13 para 29 and ATO Goods and Services Tax Ruling: GSTR 2003/D5 "Goods and services tax: Tax law partnerships" at para 44 available at https://www.ato.gov.au/law/view/pdf?DocID=DGS%2FGSTR2003D5%2FNAT%2FATO%2F00001&filename=law/view/pdf/pbr/gstr2003-d005.pdf&PiT=99991231235958 (date of use: 21 December 2018).
[525] Or within the scope of the partnership business, or in continuance of partnership transactions, or was his duty to acquire, or was intimately connected with the partnership. See Bamford *Law of Partnership* 33; Williams *Concise Corporate and*

must be accounted for to the partnership. In my view, this duty to account facilitates the fulfilment of the duty to share profits. Each partner must allow his co-partner the latter's agreed share of the profits.[526]

In terms of the proviso to section 54(1), where the relevant supply is a taxable supply and the agent is a vendor, the agent may issue a tax invoice in relation to such supply as if the agent had made a taxable supply. However, the proviso only applies if the agent is a vendor. It follows that a partner who is a vendor, acting as agent for the partnership, may issue the tax invoice in his own name even though the partnership is the supplier. Conversely, if the partner is not a vendor, the partnership's particulars must be reflected on the tax invoice. If the issued (or received) tax invoice is in the name of the partner, and the partner acted as agent on behalf of the partnership, the requirements of section 54(3) must be met.[527]

In terms of South African partnership law, all partners need not always agree on the making of a supply in order for that supply to be a partnership supply. Each partner is entitled to participate in the management of the partnership business.[528] This right is, however, a *naturale* of partnership and can be contractually excluded, limited, or varied.[529] Subject to the terms of the partnership agreement, therefore, the general rule is that every partner has the implied authority (mutual mandate) to conclude transactions falling within the scope of the partnership business. According to Ramdhin et al, a resolution by the majority of partners is (apparently) required for the alienation of partnership assets other than the normal merchandise of the business.[530] In this light, I am of the view that the inquiry should be directed at the management powers of the partners in terms of the partnership agreement, to determine: which partners had the authority to make the relevant supply; whether those partners, who were so empowered, consented to the supply; and the nature of the supply – ie, whether partnership assets or normal trading stock were supplied – before inferences are drawn as to the probable identity of the supplier.

I argue that a contract under which a supply is made, need not be in the names of all the partners, in the sense that all the partners must be co-signatories to the contract, provided that the partner(s) who

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Partnership Law 37. Benade et al *Ondernemingsreg* para 4.28*,* are of the view that partners must give an account of all assets acquired and all expenses incurred while they acted within the ambit of the partnership business.

[526] Bamford ibid at 37; Williams Ibid at 6; Benade ibid at para 3.32.

[527] Section 54(3) provides that where a tax invoice in relation to a supply has been issued by or to an agent as contemplated in s 54(1) or (2), the agent must maintain sufficient records to enable the name, address, and VAT registration number of the principal to be established. In terms of proviso (i) to s 54(3), in respect of all supplies made by or to an agent on behalf of the principal, the agent must notify the principal in writing by means of a statement of certain particulars.

[528] Bamford *Law of Partnership* 29; Ramdhin et al "Partnership" para 296; Williams *Concise Corporate and Partnership Law* 38; Benade et al *Ondernemingsreg* para 3.32.

[529] Benade et al ibid at para 3.32.

[530] Ramdhin et al "Partnership" para 296. See also Benade et al ibid para 4.20.

signs the contract is duly authorised, and it is intended that the contractual obligation be incurred by the partnership.[531]

3.4 Acquisitions made by a partnership

3.4.1 The partnership's acquisition of ownership

In terms of the definition of 'input tax', a partnership which is a vendor, is entitled to deduct the VAT payable on acquisitions where the goods or services concerned are 'acquired' by the partnership, either wholly or partially, for the purpose of making taxable supplies.[532] As 'acquired' is not defined in the VAT Act, its ordinary meaning must be considered, but in the context within which it is used.[533] 'Acquire' means to "come to possess (something)".[534] Considering the meaning of 'supply' within the relevant context, a person can acquire, or come to possess, an item under different forms of supply, eg, a sale, rental, or an importation.[535]

In *Case T35*,[536] the issue before the TRA was whether the NZIR acted incorrectly in disallowing the objector's claim for input tax levied on the importation of computer boards.[537] Section 2 of the New Zealand GST Act defines 'input tax' in paragraph (b) of its definition[538] as meaning:

> Tax levied … on goods entered for home consumption … by that person
> … being in any case goods and services acquired for the principal purpose of making taxable supplies.

The TRA confirmed that legal ownership is the basis of inputs and outputs.[539] Therefore, to acquire an item one must obtain legal rights in the nature of proprietary rights. The TRA held that the objector had not acquired the computer boards because it did not own them. The computer boards belonged to the manufacturer. The objector held the boards as agent for the manufacturer for supply to customers on behalf of the manufacturer, to allow the manufacturer to comply with its contractual warranties made upon sale.[540] The supply to the customers was, therefore, made by the manufacturer and not by the objector. The TRA, accordingly, agreed that the NZIR had not acted incorrectly in disallowing the objector's claim for input tax levied upon the importation of the computer boards.[541]

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[531] See para 3.3.2 above.
[532] See 'input tax' as defined in s 1(1).
[533] *New Union Goldfields Limited v Commissioner for Inland Revenue* 17 SATC 1, 1950 (3) SA 392 (A) at 15.
[534] *Concise Oxford English Dictionary* at 11.
[535] See the definition of 'supply' in s 1(1); Botes *Juta's Value Added Tax* 1 input tax-5.
[536] (1997) 18 NZTC 8,235.
[537] Ibid at 8,236.
[538] As it read at material times.
[539] *Case T35* above at 8,239.
[540] Ibid at 8,240.
[541] Ibid.

There was no allegation that the objector had acquired the use of the computer boards. In my opinion, the TRA obviously did not intend to hold that the meaning of 'acquire' does not extend to the acquisition of the use of an item under, for example, a lease arrangement. Had the use of the mother boards been supplied in such circumstances, the objector would have acquired their use and an acquisition of ownership would not have been required.

The argument regarding the precondition for a partnership's output tax liability, in my view, also applies to an entitlement to input tax. In other words, a partnership can only supply or acquire an item, if it supplies or acquires ownership of that item (eg, if the relevant transaction, is a purchase and not a lease), regardless of whether the item forms part (or will form part) of its taxable activity. An exception is, once again, section 18(4) which permits the partnership a deduction, assuming all relevant requirements have been met, even if it only acquires the use of the goods or services from a partner.

As stated above,[542] where an acquisition of ownership is made by the partnership, each partner acquires his undivided share in the ownership of the property concerned. For VAT purposes, however, such an acquisition is made by the partnership as a separate person.

The SARS has expressed the view that when a partner acquires goods as agent on behalf of the partnership, the partnership will only be permitted an input tax deduction if the asset is reflected in the partnership's financial statements.[543] Ramdhin et al submit, on the contrary, that it is not a condition precedent that property must be entered in the partnership's accounts in order for it to become jointly-owned partnership property. Such entry, however, is evidence of the fact that the assets have been acquired for the partnership.[544] This view is correct considering how property becomes jointly-owned partnership property and that entering it in the partnership accounts is not set as a requirement.[545]

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[542] See para 2.7 above.

[543] SARS VATNews No 4 – December 1995 available at http://www.sars.gov.za/AllDocs/Documents/VATNews-Archive/LAPD-IntR-VATN-Arc-2013-04%20-%20VATNews%204%20December%201995.pdf (date of use: 12 March 2017).

[544] Ramdhin et al "Partnership" para 288.

[545] For example, movables initially contributed, which are in the possession of a partner at the date of entering into the partnership, become *ipso iure*, in other words by operation of law, common to the partners without delivery, incorporeal rights must be ceded, and fixed property requires formal transfer. See *Oosthuizen v Swart* [1956] 2 All SA 304 (SWA) at 309; *Berman v Brest* 1934 WLD 135 at 139. When a partner acquires movable property as agent on behalf of the partnership, such property becomes the joint property of the partners *ipso iure*. See Ramdhin et al "Partnership" para 288. Furthermore, whether property made available by a partner to the partnership constitutes partnership property depends on the partnership agreement and the surrounding circumstances (see para 3.3.1 above). In my view, whether property is entered into the partnership's accounts can at most be a relevant factor in determining the partners' intention with regard to that property.

Furthermore, to qualify for the input tax deduction, the partnership must acquire the goods or services for the purpose of making taxable supplies.[546] This means that the supplies must be made in the course or furtherance of an enterprise carried on by the partnership.[547] The partnership is deemed, by section 51(1)(*a*), to carry on the partnership's enterprise. It is for this reason that in *Case T10,*[548] the TRA held that because the objectors' taxable activity regarding the timeshare had been subrogated from them to the accommodation partnership by section 57 of the New Zealand GST Act, they should have claimed the input tax through the accommodation partnership regarding the acquisition of the timeshare.[549] It is, therefore, the partnership which may deduct input tax in relation to acquisitions made, as it is similarly deemed to carry on the partnership's enterprise.

In the case of Australia and Canada, reference was made above[550] to section 184-5(1) of the Australian GST Act, and section 272.1(1) of Canada's ETA, respectively. These sections effectively deem acquisitions made by partners, acting in their capacity as partners, to be made by the partnership. In terms of the Australian GST Act, an 'acquisition' is any form of acquisition whatsoever.[551] As in the case of a supply, having regard to the factors which the ATO considers to be indicative of an acquisition being made by a partner in that capacity – eg, that the acquisition was made with the consent of all the partners and paid for out of partnership profits[552] – the ATO holds the view that a partnership can only acquire property, under an agreement of sale, for example, in respect of which the partnership acquires ownership.

In the case of Canada, registrants are entitled to an input tax credit for tax paid on 'purchases' that relate to a commercial activity.[553] Reference was made above to section 272.1(2) of Canada's ETA,[554] which permits partners an input tax credit where the relevant property or service was acquired by the partner, "in the course of activities of the partnership but not on the account of the partnership."[555] Section 272.1(2) is an exception to the general rule in section 272.1(1).[556] It follows that a partnership is entitled to an input tax credit on the basis of section 272.1(1), and in contrast to section 272.1(2),

[546] See the definition of 'input tax' in s 1(1).
[547] See the definition of 'taxable supply' in s 1(1) and s 7(1)(*a*).
[548] See para 2.7 above.
[549] *Case T10* above at 8064.
[550] See para 2.6.2 above.
[551] Section 11-10.
[552] GSTR 2003/13 para 30. Other factors mentioned by the ATO are that the acquisition is used in the enterprise of the partnership and that the invoice or tax invoice shows the firm or business name, or the names of all the partners as recipient.
[553] CRA "Input tax credits (ITCs)" available at https://www.canada.ca/en/revenue-agency/services/tax/businesses/topics/payroll/benefits-allowances/remitting-gst-hst-on-employee-benefits/input-tax-credits-itcs.html (date of use: 19 August 2018); Chabot et al *EY's Complete Guide to GST/HST* para 3,010.
[554] See para 2.7 above.
[555] See s 272.1(2) of Canada's ETA.
[556] Arsenault & Kreklewetz "Partnerships" 29.

where a partner makes an acquisition on the account of the partnership meaning, in my view, for or on behalf of the partnership. This implies that to qualify for an input tax credit under an agreement of sale, the partnership must acquire ownership of the property or service.

The UK has no specific provisions which deal with when an acquisition should be considered to have been made by the partnership.[557] Section 24(1)(a) of the UK VAT Act provides that 'input tax', in relation to a taxable person, means VAT on the supply to him of any goods or services that are used for the purpose of a business carried on by him. In the UK, for an input tax claim to be valid, the claim must be made by the person to whom the supply was made. Therefore, a partnership is only entitled to deduct input tax in the case of an acquisition of ownership, if such ownership is supplied to the partnership.[558] In my view, the position in the UK is that, in the case of a sale, the supply of ownership of the item must be made to the partnership if the partnership is to obtain an input tax credit on the purchase.

3.4.2 Partner making an acquisition as principal

Van Doesum argues that a partner may acquire goods or services for the partnership when he acts in one of three capacities. A partner can either make the acquisition as an organ (ie, an agent) representing the partnership. He can also act as an investor (ie, a partner) acquiring the item for the purpose of making a contribution to the partnership; or he can supply the item to the partnership as a third-party supplier.[559] According to the ATO, a partner making an acquisition in relation to the enterprise of the partnership, ordinarily makes it in his capacity as partner. It submits, however, that the fact that an acquisition relates to the partnership's enterprise, does not necessarily mean that the acquisition was made by the partner in his capacity as partner. The ATO gives as an example, a partner making calls from a private telephone to partnership clients.[560]

Where a partner acting as principal, acquires goods or services for use in the partnership's enterprise, such goods or services will only become jointly-owned partnership property if their ownership is transferred to the partnership.[561] The expense incurred in making an acquisition as principal, is the partner's expense, and entitles him to an input tax deduction if the relevant requirements are met – eg,

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[557] See Hemmingsley & Rudling *Tolley's Value Added Tax* para 34.5; HMRC "VAT Input Tax basics: Introduction" available at https://www.gov.uk/hmrc-internal-manuals/vat-input-tax/vit10100 (date of use: 21 August 2018).

[558] Furthermore, the UK Government importantly confirms that VAT charged on 'purchases' is input tax. See UK Government VAT guide (VAT Notice 700) available at https://www.gov.uk/guidance/vat-guide-notice-700 para 4.1 (date of use: 30 August 2018).

[559] Van Doesum 2010-6 *EC Tax Review* 263.

[560] GSTR 2003/13 para 110.

[561] Ramdhin et al "Partnership" para 288; Bamford *Law of Partnership* 29. According to Benade et al *Ondernemingsreg* para 3.63, a partner is required to transfer the ownership of property to the partnership in order for the partners to be co-owners of that property. See also Williams *Concise Corporate and Partnership Law* 26.

where the acquisition is made for the purpose of making a taxable contribution to the partnership.[562] As stated above, even if a partner's contribution is not taxable, and the partner does not qualify for an input tax deduction, a deduction might still be available to the partnership under section 18(4).[563] Any subsequent reimbursement received by the partner from the partnership, would not constitute a payment for the supply made by the third party to the partner, as the partnership has no obligation to pay the third party. The VAT treatment of the partner's subsequent supply of the property to the partnership, depends on whether the supply is made as a capital contribution or as a third-party supply, the VAT implications of which have been dealt with.[564]

The situation envisaged in section 18(4) must be distinguished from the situation where a partner makes an acquisition as an agent for the partnership. Section 18(4)(*b*)(i) applies where 'goods or services have been supplied to' the partner. The partner, therefore, acts as principal in acquiring the goods or services, and he subsequently supplies their ownership or use to the partnership.

3.4.3 Partner acting as agent for the partnership when making an acquisition

Section 54(2) provides that where a vendor makes a taxable supply of goods or services to an agent who is acting on behalf of his principal, that supply is deemed to have been made to the principal and not the agent. Therefore, where a partner acquires something as agent for the partnership, the partnership is deemed to have made the acquisition of the relevant goods or services. As a result, the partnership, and not the partner, is entitled to deduct the VAT levied on the supply as input tax. This is because the supply is deemed to be made to the partnership, which also incurs the liability for the supply through the partner as agent. To qualify for the deduction, all the requirements of the definition of 'input tax' must be met, and the partnership must also be in possession of a tax invoice as required by section 16(2)(*a*). A partner who acts as agent for the partnership may, on the strength of the proviso to section 54(2), request that he be provided with a tax invoice, and the vendor may issue a tax invoice as if the supply had been made to the partner.[565]

Following on from the above and in terms of the common law, a contracting partner will have made an acquisition as agent on behalf of the partnership, if that partner and the third party intended that the obligation, created by the contract which they concluded, will be an obligation of the partnership.[566] Even though a contract may be for the benefit of the partnership, the partnership will not be liable if the

[562] See the definition of 'input tax' in s 1(1).
[563] See para 2.7 above.
[564] See paras 2.6 and 3.2.1 above.
[565] Note that the tax invoice can even be made out in the name of an agent who is a non-vendor.
[566] See para 3.2.1 above.

contracting partner and the third party intended the obligation to be incurred personally by the partner.[567] A question is whether the common-law requirement for liability as principal under a contract, also applies when determining whether a partnership is entitled to an input tax deduction of the VAT levied on goods or services acquired by a partner acting on behalf of that partnership.

In *Mr X v The Commissioner for the SARS,*[568] the court came to the conclusion that it is the contracting party who is entitled to the input tax deduction. The court held that a member of a close corporation who was registered for VAT, was not permitted to deduct input tax in respect of expenditure incurred relating to two construction contracts. The court found on the evidence, that the close corporation – which was not a registered vendor – was the contracting party in respect of these contracts.[569]

The SARS subscribed to the same view in its now withdrawn rulings on VAT,[570] and is continuing to propagate this view in its *Draft Guide on the Taxation of Professional Sports Clubs and Players*.[571] The main criteria for a deduction of input tax by an employer according to the SARS, besides other administration related requirements, is whether the employee incurred the expense contractually as agent on behalf of his employer when making the purchase. It is for this reason, Retief submits, that the SARS will not permit an input tax deduction for some reimbursement expenses, such as reimbursing the employee for cell phone costs. The argument is that the services are generally rendered by the cell phone provider to the employee, and the employer is not party to the contract, nor is the contract entered into for and on behalf of the employer.[572]

The UK VAT Tribunal case of *The British Broadcasting Corporation v The Commissioners,*[573] was an appeal by the BBC against a decision of the Commissioners disallowing the deduction of an amount of VAT as input tax. The VAT was paid by an employee of the BBC on a hotel bill when staying away from

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[567] Henning *Perspectives on the Law of Partnership* para 8.4.1. In *Alcock v Mali Dyke Syndicate* 1910 TS 567 at 569, for example, the plaintiff argued that the partnership was liable for the payment of goods which had been supplied on credit, because the goods were used by the partnership, and were ordered by a partner. The court held, inter alia, that the plaintiff was not entitled to look to the partnership for payment as the credit was really given to the partner personally (at 570). See also *Sacca Ltd v Olivier* [1954] 2 All SA 279 (T) at 283 and *Guardian Insurance and Trust Company v Lovemore's Executors* (1887-1888) 5 SC 205 at 211. According to Williams *Concise Corporate and Partnership Law* 45, if a partner enters into a contract in his own name and on his own behalf, only he is bound to the contract.

[568] *Mr X v The Commissioner for the SARS*, TC-VAT 867 (hereafter, *VAT Case 867*).

[569] *VAT Case 867* at para 36.

[570] SARS Rulings 284 and 384. See Botes *Juta's Value Added Tax* 105 and 150.

[571] SARS *"Draft Guide on the Taxation of Professional Sports Clubs and Players"* para 5.9.1(b) available at http://www.sars.gov.za/Alldocs/LegalDoclib/Drafts/LAPD-LPrep-Draft-2016-43%20-%20Draft%20Guide%20on%20the%20Taxation%20of%20Professional%20Sports%20Clubs%20and%20Players.pdf (date of use: 25 January 2017).

[572] Retief (2014) 21 *Tax Professional* 20-21.

[573] [1974] VATTR 100 (hereafter the *BBC* case).

home on BBC business. This issue turned on whether the hotel accommodation had been supplied to the BBC.

The Tribunal held that the mere fact that the hotel accommodation was supplied to the employee in the course of his duties for the BBC, does not mean that the supply was made to the BBC. Holding that this is a question of fact, the Tribunal took into account that the employee was free to make whatever arrangements he wished for his accommodation – ie, he could stay at a cheap hotel or an expensive one and the BBC would neither know nor care. He could, therefore, make his own arrangements to which the BBC was not a party. The Tribunal considered, further, that if a dishonest person in the employee's position had left the hotel without paying his bill, the hotelier would have had no recourse against the BBC. From this, the Tribunal held that the supply of the hotel accommodation had not been made to the BBC and, as a result, it was not entitled to the input tax deduction. The appeal was dismissed.

Another UK VAT Tribunal case, *Stirlings (Glasgow) Ltd v The Commissioners*,[574] also concerned whether VAT levied on supplies made to employees was deductible by their employer as input tax. In this case, Stirlings (Glasgow) Ltd (the Company) appealed against a decision by the Commissioners disallowing a deduction of input tax paid on supplies of petrol covered by allowances made by the Company to its employees employed as travellers. The Tribunal accepted that the petrol was used by the employees for business purposes.

The Tribunal was correct, in my view, in maintaining that the *ratio* of the *BBC* case is that the question turns largely on who the parties to the contract of supply are. As a result, the Tribunal held that the supply of the petrol was made to the travellers personally as the contracts of supply were between the travellers and the respective garages. It was the travellers who had the choice of garage, and who purchased such petrol as they required. The Tribunal further held that the travellers were not agents, and had no authority to purchase in the name of the Company. If they had obtained the petrol on credit, the garages could not have sued the Company for the price, but would have had recourse against the other party to the contract of sale, namely, the traveller. The Company's appeal, therefore, failed.

Commenting on the above two cases, De Koker and Kruger argue that whether a supply is made to the employer or the employee does not depend on who physically receives the supply, but instead on the identity of the contracting parties.[575]

[574] [1982] VATTR 116 (hereafter the *Stirlings* case).
[575] De Koker & Kruger *Value-Added Tax* para 2.3.

The NZIR disagrees with these UK cases, and submits that an employer should not only be permitted a deduction where the employer is in a contractual relationship with the supplier. This view, according to the NZIR, is too limited. An employer should also qualify for a deduction, so the NZIR submits, where the expenditure initially incurred by the employee and subsequently reimbursed by the employer, was incurred by the employee in the course of the employer's business. This view, the NZIR claims, is in line with the purpose of the legislation.[576] The qualifying criterion for deduction, therefore, is not whether the employer is a party to the contract with the supplier, but whether the employee incurred the relevant expense in the course of the employer's business. In both of the UK cases the courts were well aware that the acquisitions were used in the employers' businesses, and in the *BBC* case, in particular, the court expressly rejected this as a relevant consideration.

In *Canada v Merchant Law Group*,[577] which is discussed below,[578] the disputed point was whether the relevant disbursements were incurred by the respondent as agent for its clients and, therefore, whether the respondent was liable for GST on the disbursements.[579] The court held that the issue depended on whether the respondent's clients were bound by the contracts with third-party suppliers and were, accordingly, liable for payment under the contracts and also exposed to any risk as party to the contracts.[580]

Whether a person is considered to be acting either as principal or agent in Australia, depends on the party who is in a contractual relationship with the supplier. The ATO and McCouat are of the view that some of the factors that indicate that a person is acting as a principal are that: he decides prices; assumes the commercial risks; acts in his own name; and does not have to disclose his remuneration.[581] The positions in Canada, the UK, and Australia therefore, correspond.

In my view, the above UK and Canadian cases can provide guidance on the meaning of 'acquired' in the definition of 'input tax' in that they are consistent with the common law on partnerships. There is no evidence of a legislative intent in the VAT Act to deviate from the common law. Therefore, for the purposes of both the common law and the VAT Act, a person will be considered to have supplied or acquired goods or services, if he is a party to the contract under which that supply or acquisition is made. This means that the person must have incurred the obligation created by the contract. In the

[576] NZIR Tax Information Bulletin Vol 2 No 3 at 5 available at https://www.ird.govt.nz/resources/b/a/badb15d0-2e78-446a-984b-127bf7e8a14b/tib-vol2-no03.pdf (date of use: 31 December 2018).
[577] 2010 FCA 206.
[578] See para 3.4.4 above.
[579] *Canada v Merchant Law Group* 2010 FCA 206 at para 15.
[580] Ibid at para 25.
[581] ATO Goods and Services Tax Ruling: GSTR 2000/37 "Goods and services tax: Agency relationships and application of the law" para 28 available at https://www.ato.gov.au/law/view/document?DocID=GST/GSTR200037/NAT/ATO/00001 (date of use: 31 December 2018); McCouat *Australian Master GST Guide* [E-book] Location 458.

above Canadian cases, the employees concluded the contracts as principals because they were personally liable under the contracts. In my view, de Koker and Kruger are correct where they state that while it could possibly be argued that the employees would not have entered into these contracts but for the fact of their employment, this is simply a matter of subjective motive.[582]

As stated,[583] whether a partner acquires goods or services as agent for the partnership depends on whether the partner and the third-party supplier intended the contractual obligation to be incurred by the partnership. Relevant factors could indicate in what capacity a partner made an acquisition. I argue that factors such as whether the acquisition is used in the enterprise of the partnership, or whether the acquisition is paid for out of partnership profits, or from a partnership account,[584] might not always be helpful. As the cases illustrate, acquisitions made by a partner, acting either as agent or principal, could be for use in the partnership business, or ultimately paid for with partnership funds. In my view, factors that are also relevant are, for example, whether the partner or the partnership is liable under the contract and, therefore, liable to make payment to the supplier; whether the partner is given an allowance with the freedom to contract with whomever and whenever he so pleases; and the nature of the acquisition that could suggest that the supply must have been made to the partner in his personal capacity, such as services supplied by a cell phone provider.

I further argue that where a third party makes a supply of goods or services to a partner, who in making the acquisition acts as an agent for the partnership, the intervention of the partner does not change the nature of, or the VAT rate applicable to, the third party's supply. There is no reason for the character of the third party's supply to change considering that it is deemed to be made to the partnership. If, for example, the third party's supply is zero rated, then the supply will retain its zero rating. If the partner makes an acquisition as principal, however, and on-supplies the relevant goods or services to the partnership for an amount, which includes the cost of the third party's supply, that cost could lose its zero rating. That the supply to the partner is zero rated is irrelevant when determining the VAT rate of the partner's supply to the partnership.

In the Canadian Tax Court case of *SLM Direct Marketing Ltd v The Queen*[585] (the *SLM* case) the appellant, SLM Direct Marketing Ltd (SLM), was assessed on the basis that its costs of postage (or mailing costs) to destinations outside of Canada, were inputs to re-supplies of a service to clients, that the re-supplies were taxable supplies, and that GST applied to the entire re-supply. The nature of SLM's business was to distribute clients' products, such as letters, for a fee. SLM addressed envelopes, folded

[582] De Koker & Kruger *Value-Added Tax* para 2.3.
[583] See para 3.2.1 above.
[584] See GSTR 2003/13 para 30.
[585] 2007 TCC 415.

material, inserted the material into envelopes and packages, and delivered them to a carrier, such as Canada Post, for delivery to their eventual destination. Where mail was to be delivered outside of Canada, SLM paid the cost of mailing to the carrier and in its invoice to the client included the postage it had paid as a reimbursement charge. The Minister of National Revenue (the Minister) assessed SLM on its failure to charge GST for postage it paid for the clients to the carriers, and for which it was reimbursed.[586]

The court held, on the basis of Canadian Agency Law and the evidence, that SLM was an agent of its clients when it paid the costs of its clients' mailings to destinations outside Canada, and mailed the material. When SLM paid the costs of mailing, it did so on behalf of the client, not for itself.[587] As agent, SLM was, therefore, not liable to pay the GST.[588] SLM's appeal was allowed.

Chabot et al submit that because the relationship in the *SLM* case was considered an agency relationship, the court determined that supplies of postage or mailing services to destinations outside Canada, retained their zero-rated status even though SLM paid for those supplies and was reimbursed by its clients.[589] The court, in my view, did not explicitly make this point, but it is to be implied in the judgment. The court, instead, stated that because of its finding that SLM acted as agent for its client, it did not need to consider whether, had SLM re-supplied the mailing service to its client, this re-supply service qualified for zero rating.[590] With this statement the court was clearly implying that because SLM acted as agent, the supply retained its character and, therefore, its rate of zero per cent. Had SLM's intervention, even as agent, resulted in the supply forfeiting the zero rating, then the court would have said so, because it would have been a noteworthy point.

In the Canadian Federal Court case of *Canada v Merchant Law Group*,[591] the respondent was a partnership that practised law. In the course of providing legal services, the respondent acquired various goods or services from third-party suppliers and treated their cost as disbursements billed to clients. The respondent did not levy GST on disbursements it viewed as having been incurred as agent for its clients. The Minister argued that such disbursements were consideration for the supply of legal services

[586] SLM claimed that it was acting as an agent of the client when it purchased postage (or paid mailing costs) and mailed the material to destinations outside of Canada. SLM also submitted that it was not liable for GST on the postage costs for material shipped to a destination outside of Canada since these services are zero-rated in terms of Canada's ETA (at para 9). It was the Minister's view that the cost of mail to a destination outside of Canada paid by SLM and for which it invoiced the client, constituted an input to a re-supply of a service which is taxable and applied GST on the whole amount of the supply. In the Minister's view no agency relationship existed between SLM and its client. SLM was assessed as a re-supplier of a service (at para 10).
[587] Ibid at para 24.
[588] Ibid at para 15.
[589] Chabot et al *EY's Complete Guide to GST/HST* para 2,130.
[590] The *SLM* case para 25.
[591] *Canada v Merchant Law Group* 2010 FCA 206.

and so were taxable supplies and subject to GST.[592] What was in dispute in this case, as previously stated,[593] was whether the relevant disbursements were incurred by the respondent as agent for its clients.[594] The court held that the respondent could not meet the onus of establishing that it acted as agent for its clients when it incurred the disbursements,[595] and dismissed the respondent's appeal.[596]

In answering some of the concerns raised by the respondent, the court explained that an exempt disbursement may become taxable if it is an input to a lawyer's services. Equally, a disbursement that is subject to GST and is an input to a lawyer's services, may become a zero-rated disbursement if the client is not resident in Canada.[597]

Whether a partner acts as agent or principal will in most cases not affect the incidence of tax if the partnership makes taxable supplies only.[598] The VAT levied by the third-party supplier or by the partner who, as principal, on-supplies the third party's supply to the partnership, will be deductible as input tax by the partnership which conducts a fully taxable business. The situation could be different if the partnership only partially makes taxable supplies. The third party could, for example, make a supply that is not taxable (eg, the supply is exempt or the third party is not a vendor) or that is zero rated. If the partner acts as principal, then the cost of the third party's supply would be included in his fee charged to the partnership. The whole fee could then be subject to VAT if that partner is a vendor, resulting in a VAT cost to the partnership as it would not be entitled to a full input tax deduction.

3.4.4 Partnership reimbursing partner's expenses

In addition to his own share, a partner is entitled to be refunded for expenses he incurred in connection with the partnership business. A partner who pays a partnership creditor, or who pays for the maintenance of partnership property with his own funds, is therefore entitled to be refunded by the partnership. The partnership is also liable to the partner for interest on these items.[599] The question then arises whether the partnership is entitled to deduct the VAT on such expenses reimbursed to the partner.

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[592] Ibid at para 2.
[593] See para 3.4.3 above.
[594] *Canada v Merchant Law Group*2010 FCA 206 at para 15.
[595] Ibid at para 26.
[596] Ibid at para 37.
[597] Ibid at para 33.
[598] See Chabot et al *EY's Complete Guide to GST/HST* para 2,130.
[599] Ramdhin et al "Partnership" para 294; Williams *Concise Corporate and Partnership Law* 37; Benade et al *Ondernemingsreg* para 4.18; Bamford *Law of Partnership* 38. See *Pataka v Keefe and Another* [1947] 3 All 125 (A) at 129 and *Schneider NO v Raikin* [1954] 4 All SA 59 (W) at 61 where the court confirms that in *Pataka v Keefe* at 129 Tindall JA, mentions the possibility that a partner may in certain circumstances sue his partner for reimbursement of money spent by the former on the business of the partnership.

In the *BBC* case*,* reference was made by the BBC's representative to a public notice issued by the Commissioners, which provided that where an employee pays expenses, including VAT, that tax can be treated as input tax by the employer if the employee has been reimbursed for his expenditure. The Tribunal held, however, that there was no reimbursement in this case, and set out its views on the distinction between a disbursement and an allowance. According to the Tribunal, there must be some specific link between the original payment and the subsequent repayment, before the latter can be said to be in reimbursement of the former. The Tribunal could find no such link in this case regarding the hotel bill for accommodation, although, the 80p VAT itself was reimbursed. It stated that an allowance is paid irrespective of the actual expenditure of the staff member concerned. The Tribunal held that the allowance in this case, was an allowance to enable a staff member to meet the cost of staying away from home without loss to himself, but it could not be said to be a reimbursement of any specific expenses. The Tribunal did not express a view on whether the Commissioner's public notice was correct, ie, whether in the case of the reimbursement of an expense, the employer would be entitled to deduct input tax.

I argue that whether the amount paid by the partnership is a reimbursement of the costs which the partner incurred, or the partner was paid an allowance by the partnership to defray costs, is not decisive in determining the partnership's entitlement to input tax. Different meanings can be ascribed to 'reimbursement'. Moreover, distinctions can be made between different categories of reimbursement considering, for example, the SARS's policy on input tax deductions related to reimbursements. I stated that the SARS will not even permit an input tax deduction for some reimbursement expenses.[600] There is, however, merit in the argument of the Tribunal in the *BBC* case, namely, that there is a closer connection between the payment of costs, and an amount paid in reimbursement of those costs, as opposed to an allowance to defray future costs. The argument, in my view, is that with an allowance an employee has more freedom to choose what and where to purchase in the future, suggesting that the expense is incurred by the employee as principal, although in the course of the employer's business. In the case of a reimbursement, the employer reimburses specific expenses already incurred by the employee. The employer's willingness to reimburse the expenses could imply his acceptance that they are for his account. I argue, however, that whether an amount is a reimbursement or an allowance can, at most, be an indicator, together with other relevant indicators, when determining whether the relevant obligation was incurred personally by an employee or a partner, or by the employee or the partner as agent for the employer or the partnership, rendering it liable.

[600] See para 3.4.3 above.

Section 54(2) deems a supply made to a partner, acting as agent for the partnership, to be made to the partnership. In terms of agency law, the partnership is liable under the contract concluded by a partner as agent for the partnership, with a third party. I argue, therefore, that the supply is not only deemed to be made to the partnership, but the partnership is also considered to have incurred the expense for that supply. The payment made by the partner for the supply to the third party is a payment made on behalf of the partnership because the obligation to make the payment is the partnership's obligation. In other words, it is as if the partnership itself made the payment for the supply, including the VAT levied thereon, as the activities of an agent are attributed to his principal in terms of the law of agency.[601]

In my view, the payment of the partner to the third party will, therefore, be subject to VAT and could trigger the time of supply under the general time of supply rule in section 9(1), which deems the supply to have taken place at the earlier of either the time an invoice is issued, or any payment of consideration is received in respect of that supply. The partnership is permitted an input tax deduction based on the payment made by the partner as agent.

I am of the view that the amount of the reimbursement paid by the partnership to the partner, reimbursing the partner for the payment he made to the third party, is not a payment made for any supply, and in particular, not for the supply made by the third party. It is therefore not subject to VAT. The partner will have already paid for the third party's supply, and is only later reimbursed by the partnership. The reimbursement is, therefore, not intended to be a payment for a supply.

I further argue that the third party does not make a supply to the partner, who in turn 'on-supplies' the third party's supply to the partnership. The partner could well be supplying an agency service to the partnership by representing the partnership in its dealings with the third party. Any fee charged by the partner to the partnership for this agency or representation service, could include the costs which he personally incurred in order to fulfil his agency mandate. The fee, including such costs, would potentially be subject to VAT if the partner is a vendor. The partner is, of course, required to provide the partnership with a tax invoice.[602] The partnership is then entitled to an input tax deduction if the service was acquired for a taxable purpose.[603]

Support for this analysis can be found in the case of *Commissioner for SARS v British Airways Plc*.[604] In this case British Airways Plc (BA), an international air carrier, charged its passengers a fare made up of the aggregate of various elements reflected separately on the passenger ticket. The bulk of the

[601] See para 2.6.2 above.
[602] See s 20(1).
[603] See 'input tax' as defined in s 1(1).
[604] 67 SATC 167.

fare was an amount designed to recover its operating costs and its profit. The remainder of the fare comprised various smaller elements. The appeal concerned the VAT treatment of one of these latter elements included in the composite fare.[605] That element was a 'passenger service charge' (the charge) levied by Airports Company Ltd (Airports Company) for general airport services[606] available to passengers at its airports. BA reflected this charge separately on the ticket as one of the elements that made up the composite fare.[607]

It was submitted on behalf of the Commissioner, that although Airports Company supplied the airport services for which the charge was made, it supplied those services to BA, which in turn supplied them to its passengers, and the supply of the services by BA attracted tax. The court disagreed with this argument. It held that, on the evidence, the relevant services were supplied by Airports Company and that VAT was levied when that supply was made. A further tax, explained the court, does not accrue when BA did no more than recover the charge it was required to pay for the supply of the service by Airports Company. As a result, the court held that moneys recovered by BA were not a consideration for its provision of airport services simply because it did not supply them at all.[608]

Although the role of BA was not described as that of an agent acting on behalf of its passengers, BA was in a similar position to that of an agent because of the court's finding that Airports Company supplied the airport services to the passengers, notwithstanding BA paying for those services. What is important, however, is the court's confirmation that BA's recovery of the charge from its passengers was not subject to VAT because it was not payment for a supply made by BA to the passengers.

The UK case of *Rowe & Maw (a firm) v Customs and Excise Commissioners*[609] (the *Rowe & Maw* case) and the Canadian cases discussed below,[610] also support this view. The *Rowe & Maw* case was an appeal against a decision of a VAT tribunal in which it was found that the reimbursement of travel fares, disbursed by the appellants in the exercise of their profession as solicitors, was part of the consideration for their provision of legal services, and therefore subject to VAT. The question was whether there was a taxable supply of legal services as regards the reimbursement of the travel fares.

Bridge J distinguished between two different classes of disbursement which a solicitor may expend on his client's behalf. In the one situation a solicitor may purchase goods or services as agent for his client. The goods or services purchased are supplied to the client, not to the solicitor, who merely acts as an

[605] Ibid at para 3.
[606] That is baggage handling facilities, waiting lounges, check-in counters, etc.
[607] Ibid at para 6.
[608] Ibid at para 15.
[609] [1975] STC 340.
[610] See under this sub-heading.

agent in making the payment. In his view no VAT is payable because such payments form no part of the consideration for the solicitor's own services to his client. The situation is different, however, where the goods or services purchased are supplied to the solicitor – as in the *Rowe & Maw* case – in the form of travel tickets to enable him effectively to perform the service supplied to his client. In such case, Bridge J held, VAT is payable because the payment is part of the consideration which the client pays for the service supplied by the solicitor. The appellants' appeal was, accordingly, dismissed.

Therefore, where a partner who is a vendor, makes an acquisition as principal and subsequently on-supplies the relevant goods or services to the partnership as part of a taxable supply in return for payment of an amount, which includes the cost of such acquisition, then the full amount will be subject to VAT.

Bearing in mind the distinction drawn by Bridge J between the two classes of disbursement, in my view, where a partner incurs expenses that are reimbursed by the partnership, the partnership would be entitled to an input tax deduction where the partner acted as agent for the partnership. A question is whether the partnership would, nevertheless, qualify for a section 18(4) deduction, where a partner who is not a vendor, makes the acquisition as principal and is reimbursed by the partnership.

A partner could acquire goods or services as principal, and thereafter on-supply the ownership or use of the goods or services to the partnership. It is my view that in these circumstances the partnership would be entitled to a section 18(4) deduction, provided that it applies the goods or services for a taxable purpose.[611] However, instead of the partner on-supplying the goods or services to the partnership, he may simply use such goods or services for the purpose or benefit of the partnership's business.[612] An example is where the partner makes calls from a private telephone to partnership clients.[613] The goods or services can also be acquired by the partner in the course of his duties, although the acquisition is made by the partner as principal. An example here is where the partner incurs accommodation costs while away from home on partnership business.[614] In the latter circumstances, the NZIR is in favour of granting an employer a deduction where the employee, who is later reimbursed by his employer, incurs the expense as principal.[615]

Where a partner makes an acquisition as principal, a distinction must, therefore, be made between the partner merely applying the goods or services for the benefit of the partnership's business, and a partner

[611] See para 2.7 above.
[612] See the discussion of the *Stirlings* case in para 3.4.3 above.
[613] See GSTR 2003/13 para 110.
[614] See the discussion of the *BBC* case in para 3.4.3 above.
[615] See para 3.4.3.

who on-supplies their ownership or use to the partnership, who then applies such goods or services. In the former scenario, the partnership would not qualify for a section 18(4) deduction, whilst in the latter scenario the partnership could qualify. It might, in my view, be difficult always to distinguish between these two scenarios as in each case the goods or services are 'applied' by a partner(s). I argue that the answer depends on whether there is a contract in place between the partner and the partnership, in terms of which the ownership or use of the goods or services is supplied to the partnership. On this basis the partnership could be entitled to a section 18(4) deduction.

In Australia, the VAT treatment of reimbursements made to partners, employees, and other persons who act on behalf of entities, is specifically regulated. Section 111-5(1)(*c*) of the Australian GST Act provides that if a partnership reimburses a partner for an expense, he incurs related directly to his activities as a partner in the partnership, the reimbursement is treated as consideration for an acquisition made by the partnership from the partner. This provision, therefore, allows a registered partnership to claim input tax credits on certain acquisitions made by its partners where these expenses are reimbursed.[616] The partnership may not, however, claim an input tax credit if the partner himself is entitled to claim one.[617] According to the ATO, section 111-5(1)(c) applies where partners incur expenses directly related to their activities as partners of the partnership, but not actually incurred in their capacities as partners.[618] In order to qualify for the deduction, the supply to the partner must be taxable,[619] and the partner needs to provide the partnership with the tax invoice.[620] Where a partner makes an acquisition and is acting in his capacity as a partner of the partnership, the acquisition is taken to be by the partnership and reimbursement does not arise.[621]

In the case of Canada, reference was made to sections 272.1(1) and 272.1(2) of Canada's ETA,[622] which permit either the partnership, or a partner, a deduction, depending on whether the acquisition was made 'on the account of the partnership'. If section 272.1(2) applies, the partnership is deemed not to have acquired the property or service except as otherwise provided in section 175(1) of Canada's ETA, which applies where the partner is reimbursed by the partnership.[623] Section 175(1) enables the partnership to claim an input tax credit in respect of an amount reimbursed to partners for the acquisition of property or services for consumption or use in relation to partnership activities. When the conditions

[616] GSTR 2003/13 para 111; McCouat *Australian Master GST Guide* [E-book] Location 133.
[617] McCouat ibid.
[618] GSTR 2003/13 para 110.
[619] Ibid at para 112.
[620] Ibid; McCouat *Australian Master GST Guide* [E-book] Location 133.
[621] GSTR 2003/13 para 112.
[622] See paras 2.6.2 and 3.4.1 above.
[623] CRA "Reimbursements" para 6 available at https://www.canada.ca/en/revenue-agency/services/forms-publications/publications/9-4/reimbursements.html (date of use: 21 August 2018); Chabot et al *EY's Complete Guide to GST/HST* para 10,010.

under section 175(1) are met, the partnership is deemed to have received the property or service, and to have paid the GST in respect of the supply at the time the reimbursement is paid.[624] Section 175(1), therefore, permits the partnership a deduction even though the relevant acquisition was made by a partner.

In the case of New Zealand, it was stated[625] that according to the NZIR, an employer should also qualify for a deduction where the expenditure initially incurred by the employee and subsequently reimbursed by the employer, was incurred by the employee in the course of the employer's business. The NZIR would, presumably, also permit a partnership a deduction where a partner incurs an expense as principal, but in the course of the partnership's business.

The UK VAT Act does not have special rules regulating the deductibility of VAT by a partnership relating to expenses incurred by its members. Considering the judgments in the *BBC* and *Stirlings* cases, however, in my view a partnership is only entitled to an input tax credit if it, as opposed to the partner who is reimbursed, is a party to the relevant contract and therefore makes the acquisition as principal.

3.4.5 Whether property is acquired for a taxable purpose

In terms of the definition of 'input tax'[626] a partnership is entitled to an input tax deduction if the goods or services are acquired for the 'purpose' of making taxable supplies. As a partnership is not a natural person and does not have legal personality, a question arises as to how the purpose of a partnership should be determined for VAT purposes. 'Purpose' is not defined in the VAT Act. Its dictionary meaning is, inter alia, "the reason for which something is done or for which something exists."[627]

Case N27,[628] in my opinion, is useful in understanding how the 'intention' of a partnership can be established. In this case, the issue was whether the objecting partnership was carrying on a 'taxable activity' under the New Zealand GST Act, which would entitle it to claim certain input tax deductions and to GST registration.[629] Section 6(1)(*a*)[630] defines 'taxable activity' as "any activity which is carried

[624] Ibid. Where the partner is not an individual (ie, the partner is a corporation, trust, or other partnership), he is deemed to have acquired the property or service and to be engaged in those activities of the partnership. Consequently, the partner is entitled to claim input tax credits in respect of those acquisitions. See Chabot et al *EY's Complete Guide to GST/HST* para 10,010. Therefore, the partnership is not eligible to claim an input tax credit for the tax paid even though it has reimbursed the partner. See CRA "Reimbursements" ibid at para 28.
[625] See para 3.4.3 above.
[626] See s 1(1).
[627] *Concise Oxford English Dictionary* at 1167.
[628] *Case N27* above.
[629] New Zealand GST Act at 6.
[630] As it read at material times.

on continuously or regularly by any person … and involves or is intended to involve … the supply of goods and services to any other person for a consideration …". In terms of section 6(3), however, 'taxable activity' does not include, in relation to any person:

> (a) Being a natural person, any activity carried on essentially as a private recreational pursuit or hobby; or
> (aa) Not being a natural person, any activity which, if it were carried on by a natural person, would be carried on essentially as a private recreational pursuit or hobby; …[631]

The TRA held that in considering whether the activity of the partnership is a taxable activity, consideration must be given to section 57 of the New Zealand GST Act, which provides that the partnership, and not its individual members, is liable to be registered for GST as a person.[632] In other words, the partnership's intention is the relevant intention as the partnership is the GST-registered entity and the entity claiming the input tax deduction.

As I understand the TRA's argument, the reason why one can speak of a partnership as having an intention, is because for the purposes of the GST Act, the partnership has "its own collective personality", although under general law a partnership has no legal personality of its own, distinct from that of the individual partners. Additionally, the TRA reasoned that because the collective purpose of the partnership may be separate from its members, when determining whether the partnership is carrying on a taxable activity, the collective purpose of the partnership, rather than that of the partners, must be considered.[633]

According to the TRA, the partnership's intention and the purpose of its activity must be determined from the partnership agreement and the surrounding circumstances.[634] In my view, the partnership contract is, of course, important because it should reflect the common intention of the partners and describe the nature of the business carried on for their joint benefit.[635]

The TRA concluded that the partnership agreement, as executed by the partners, established that the partnership carried on a taxable activity, although some of the individual members of the partnership probably derived private and personal enjoyment from the undertaking, as envisaged in section 6(3)(a)(aa).[636]

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[631] Ibid at 7.
[632] Ibid at 11.
[633] Ibid at 11.
[634] Ibid at 10.
[635] See the *Pezzutto* case, where the court confirmed that one of the *essentialia* of partnership is that the business be carried on for the joint benefit of the parties. See para 2.1 above.
[636] New Zealand GST Act.

The New Zealand Court of Appeal decision in *C of IR v National Distributors Limited*,[637] although dealing with an income tax issue, is nonetheless instructive. In determining whether the sale of certain shares was subject to income tax, it was necessary for the court to establish the purpose of the taxpayer company. The court held that where the taxpayer is a company, the collective purpose in the minds of those in control of the company's relevant decisions is determinative. In *CIR v Richmond Estates (Pty) Ltd*, the Appellate Division held that as a company is an artificial person, the only way to establish its intention is to find out what its directors, acting as such, intended. Their formal acts in the form of resolutions, constitute evidence as to the intentions of the company of which they are directors.[638]

The TRA's decision in *Case N27* also, in principle, applies to the VAT Act, in that it is the partnership that is deemed – in terms of section 51(1)(*a*) – to be carrying on the partnership's enterprise as a separate person. The purpose of the partnership, rather than that of any individual partner, must be considered when determining the partnership's 'purpose' as envisaged in the definition of 'input tax'.

I stated above [639] that the management of the partnership can be entrusted to a particular partner(s). If one partner is, for example, authorised to make the relevant purchase, then an argument can be made that the individual intention of that partner – ie, the person in control of the purchase – should also be considered together with all other relevant indicators – eg, any resolution passed authorising the purchase. Therefore, depending on the circumstances, an individual partner's purpose could also be relevant in determining the purpose of the partnership as a collective.[640]

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[637] (1989) 11 NZTC 6,346.

[638] 20 SATC 355, 1956 (1) SA 602 (A) at 361.

[639] See para 3.3.2 above.

[640] In Australia an input tax credit is deductible if the thing is acquired for a 'creditable purpose'. See McCouat *Australian Master GST Guide* [E-book] Location 120; ATO "Mergers and acquisitions – claiming input tax credits" available at https://www.ato.gov.au/Business/GST/In-detail/Rules-for-specific-transactions/Business-asset-transactions/Mergers-and-acquisitions---claiming-input-tax-credits/?page=4 (date of use: 21 August 2018). In Canada, eligibility for an input tax credit is generally based on the registrant's 'intention' at the time he acquires the property or service. See Chabot et al *EY's Complete Guide to GST/HST* para 3,010; CRA "Calculating Input Tax Credits" available at https://www.canada.ca/en/revenue-agency/services/forms-publications/publications /8-3/calculating-input-tax-credits.html (date of use: 21 August 2018). In the UK, one of the requirements for deducting VAT as input tax, is that the acquisition must have been for the 'purposes' of business. See Hemmingsley & Rudling *Tolley's Value Added Tax* paras 34.2 and 34.6; HMRC "VAT Input Tax basics: introduction" available at https://www.gov.uk/hmrc-internal-manuals/vat-input-tax/vit10100 (date of use: 21 August 2018). The effect of s 184-5(1) of the Australian GST Act, s 272.1(1) of Canada's ETA, and s 45(1) of the UK VAT Act, is that the partnership is deemed to carry on the enterprise and commercial or business activity of the partnership. As a partnership is treated as a separate person for VAT/ GST purposes in each of these jurisdictions (see para 2.2.3 above), and is deemed be carrying on the partnership's enterprise, I argue that when establishing the purpose or intention with which an acquisition is made, the relevant purpose or intention is that of the partnership and not an individual partner(s). Therefore, in my opinion, the positions in these jurisdictions correspond to that in South Africa and New Zealand.

3.5 Distributions to partners

During the existence of a partnership agreement, the partnership property is jointly owned by the partners in undivided shares. Consequently, save where the partnership agreement provides otherwise, the receipts and accruals in the partnership business are acquired by the partners in common, without any one partner acquiring a separate right of ownership thereto. A partnership agreement, however, almost invariably provides for the division of profits after the lapse of fixed periods of time.[641]

Partners have certain rights and duties regarding their capital contributions. A partner is, as a general rule, required to keep his contributed capital in the partnership until it dissolves. The partnership agreement may, however, provide that the partnership's capital be either added to or withdrawn.[642]

The partners may also agree to distribute jointly-owned partnership property, other than partnership profits and contributed capital, to a partner.[643]

Therefore, if authorised in the partnership agreement, a partnership can make distributions of profits, contributed capital, or other jointly-owned partnership property, to the partners. The question is whether these distributions, in cash or *in specie*, are subject to VAT.

3.5.1 Profit and non-profit cash distributions

I argue that a partner's contribution of capital is not connected to profit distributions made to him as such distributions result from the holding of a partner's share.[644] As a result, a profit distribution does not constitute consideration and is not subject to VAT. Furthermore, a profit distribution in money is not a supply of 'goods' or 'services', as money is specifically excluded from the definitions of these terms.[645] A profit distribution in money can, therefore, not be a taxable supply.

In my opinion, any non-profit cash distribution made by a partnership, although not a supply of goods or services, could still be consideration for a supply made by the partner to the partnership, and the partner's supply may well be subject to VAT on that basis.

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[641] *Sacks Commissioner for Inland Revenue* 1946 AD 31 at 40; Ramdhin et al "Partnership" para 297; Williams *Concise Corporate and Partnership Law* 31.
[642] See para 3.2.1 above.
[643] See *Whiteaway's Estate and Others v CIR* 1938 TPD 482.
[644] See para 2.6.5 above.
[645] See the definitions of 'goods' and 'services' in s 1(1).

3.5.2 *In specie* distributions

For VAT to be levied, section 7(1)(*a*) requires a supply of goods or services. I stated that 'supply' in the VAT Act means 'to provide something' and that the term has been interpreted by the New Zealand High Court to mean "to furnish with or provide".[646]

According to McKenzie, there has been some speculation that *in specie* distributions are not supplies.[647] In support of his argument that *in specie* distributions are indeed supplies,[648] he refers, inter alia, to a number of New Zealand cases on the meaning of the word 'supply' in the New Zealand GST Act. In *Case M108*,[649] for example, the TRA had regard to the very wide meaning given to the word 'supply'. In *Case P74,*[650] the court held that the nature of the supply was the provision of a training programme, and it constituted a supply because 'something of value' was conferred. The latter case went on appeal in *Television NZ Ltd v Commissioner of Inland Revenue.*[651] The High Court confirmed the decision of the TRA and held that what is decisive is the contractual obligation undertaken to provide training, which in the court's view, could only be regarded as a supply of services. The NZIR also holds the view that an *in specie* distribution is a supply of goods for GST purposes.[652]

The South African and New Zealand courts' understanding of 'supply' in a VAT/ GST context, is in line with that of the Australian, Canadian, and the UK courts.[653]

McKenzie's and the NZIR's conclusion that an *in specie* distribution constitutes a supply, is correct because one entity transfers property of value to another person. This also applies to a partnership where, by means of an *in specie* distribution, all the partners transfer their undivided ownership interest in the property concerned to one of the partners. For VAT purposes, however, it is the partnership making the supply to the partner.[654]

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[646] See para 2.8 above. In New Zealand, GST is also charged on a 'supply' of goods and services in terms of s 8(1) of the New Zealand GST Act.
[647] McKenzie *GST: A Practical Guide* [E-book] Locations 315.
[648] Ibid, Locations 316 to 319.
[649] (1990) 12 NZTC 2,684 TRA No 90/22 Dec No 87/90.
[650] (1992) 14 NZTC 4,496 TRA No 91/88 Dec No 74/92.
[651] (1994) 16 NZTC 11,295.
[652] NZIR, Appendix A to Tax Information Bulletin No 11 June 1990 "Distributions *in specie* upon liquidation or dissolution of a company – Income Tax, Stamp Duty and GST implications" at 2 available at https://www.ird.govt.nz/resources/e/a/eaa2c015-52d2-4a76-9680-a31b75d96fa4/tib-vol1-no11appendixa.pdf (date of use: 19 December 2018)
[653] See para 3.3.1 above.
[654] See ATO Goods and Services Tax Ruling: GSTR 2003/13A3 – Addendum "Goods and services tax: General law partnerships" para 85A available at https://www.ato.gov.au/law/view/document?docid=GST/GSTR200313A3/NAT/ATO/00001 (date of use: 31 December 2018) (hereafter GSTR 2003/13A3 - Addendum).

Questions arising, are whether an *in specie* distribution is a supply made in the course or furtherance of the partnership's enterprise, and is for consideration. The ATO believes this is the case.[655] It reasons that the application of an asset in an enterprise establishes the necessary connection between the supply of the asset and the relevant enterprise.[656] The ATO's view is correct in light of the New Zealand judgment in *Case K55*.[657] Therefore, if the relevant goods are used to carry on the partnership's enterprise, the *in specie* distribution of those goods is in the course or furtherance of the enterprise.

A distribution *in specie* could be subject to VAT if the partner makes a payment – in cash or in kind – to the partnership in return for the distribution. When considering possible payment options a partner could make in return for an *in specie* distribution, it is important to distinguish between partnership property and partnership capital.

As regards the nature of a partnership's capital, I stated[658] that one of the *essentialia* of a partnership agreement is that each partner must make some contribution to the partnership. These contributions can be in money or something having a monetary value, and make up the capital of the partnership.[659] The contributions go into a common fund termed the 'partnership capital', and are kept separate from the personal estates of the partners. This capital is a fixed sum constituted by the aggregate monetary value of the partners' contributions.[660]

Jointly-owned partnership property means all the property owned jointly in undivided shares by the partners.[661] Partnership capital, while it subsists, forms part of the partnership property, but it is merely a portion thereof.[662] The importance of the separate identity of the partnership capital is that when the partnership is dissolved this amount, or its value, is returned to the partners. Partnership 'property', on the other hand, is sold and the proceeds divided between the partners.[663]

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[655] Ibid.
[656] Ibid at para 85E.
[657] See para 2.6.1.
[658] See para 2.3.
[659] Williams *Concise Corporate and Partnership Law* 26. Williams also states here that where a partner contributes services or skill, the value of such contributions does not form part of the partnership capital. See also Mongalo, Lumina & Kader *Forms of Business Enterprise* para 2.3.3.1; Ramdhin et al "Partnership" para 286.
[660] Williams ibid; Mongalo, Lumina & Kader ibid.
[661] Williams ibid at 29; Ramdhin et al "Partnership" para 287; Benade et al *Ondernemingsreg* paras 3.53 and 3.54.
[662] *Schlemmer v Viljoen en Andere* [1958] 2 All SA 309 (T) at 315; Ramdhin et al "Partnership" para 286; Williams ibid at 26. The aggregate value of the partnership property fluctuates. If the partnership is making a profit, the aggregate value of partnership property increases, whilst it decreases if the partnership is making a loss.
[663] Ramdhin et al ibid; Mongalo, Lumina & Kader *Forms of Business Enterprise* para 2.3.3.1; Benade et al *Ondernemingsreg* para 6.47; *Ferreira v Fouche* [1949] 1 All SA 130 (T) at 132; *Schlemmer v Viljoen en Andere* ibid. As partners are entitled to a return of their contribution, it is advisable for the partnership agreement to assign a monetary value to a contribution that consists of property and not of money. See Williams ibid. As the contribution is subjected to the risks of the business,

The question arises as to whether a partner may apply either his capital contribution or other partnership property, in exchange for the partnership's distribution to him.

The ATO is of the view that an *in specie* distribution of partnership property by a partnership to a partner is made for consideration. This consideration, it submits, may be monetary, non-monetary, or a combination of both.[664] In support of this view, it argues that the term 'consideration', as defined in subsection 9.15(1) of the Australian GST Act,[665] is a broad term for GST purposes. It not only incorporates the meaning of the term in contract law, but also its broader meaning in conveyancing referred to by Dixon J in the High Court decision in *Archibald Howie Pty Ltd v Commissioner of Stamp Duties (NSW) 49B* (*Archibald Howie*).[666]

In *Archibald Howie* the issue was whether the transfer of shares could be assessed for duty under, inter alia, section 66(3B) of the Stamp Duties Act.[667] Section 66(3B) applied to a conveyance made on a *bona fide* consideration in money or money's worth of not less than the unencumbered value of the property conveyed.[668]

The facts were that the appellant company transferred certain shares in other companies – which formed part of the assets of the appellant company – to two of its shareholders. The purpose of the transfer was to give effect to a resolution for a reduction in the share capital of the appellant company. The reduction was carried out by a distribution of these assets *in specie*.[669]

The court[670] held that under section 66, the word 'consideration' should receive the wider meaning it is accorded in conveyancing, rather than the more limited meaning under general contract law. The court, whilst acknowledging that the difference between the two meanings is perhaps not very material, stated that in the law of contracts the consideration is the amount offered and accepted. In conveyancing, however, the consideration is the money or value passing which moves the conveyance or transfer.[671]

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the partner's contribution will only be returned to him if the fortunes of the business so permit. See Ramdhin et al ibid at para 263.

[664] GSTR 2003/13A3-Addendum para 85H.

[665] 'Consideration' is defined in sub-s 9.15(1) to include any payment, or any act or forbearance, in connection with, in response to or for the inducement of a supply of anything.

[666] (1948) 77 CLR 143, [1948] HCA 28 (herafter *Archibald Howie*); GSTR 2003/13A3-Addendum para 85I.

[667] 1920-1940 (NSW).

[668] *Archibald Howie* at 154.

[669] Ibid at 151.

[670] Per Dixon J.

[671] Ibid at 152.

The court agreed that the transfers were made for consideration in money or money's worth within the meaning of section 66. It held that in a distribution *in specie* in consequence of a reduction in capital based on the possession of surplus assets, there are aspects of the transaction which evidence an adequate consideration in money or money's worth.[672]

The court explained that while a shareholder has no proprietary interest in the assets of an incorporated company, his 'share' is a portion of the company's share capital in relation to which he has certain rights. The shareholder is, for instance, entitled to have share capital applied in accordance with the memorandum and articles of association. Furthermore, insofar as assets are available for this purpose, the shareholder is entitled to have his paid-up capital returned on liquidation or on a reduction of capital, if the method of returning is sanctioned in the articles of association.[673] The court held that the return of the paid-up amount is the discharge *pro tanto*[674] of a claim by the shareholder on the assets of the company.[675] The reduction in both the amount and value of the share, therefore, afforded an adequate consideration in money and in money's worth.[676]

As stated above,[677] the Australian GST Act's definition of 'consideration' differs from that in the VAT Act to the extent of its use of the phrase 'in connection with'. Australian case law, or the views of the ATO, on the meaning of 'consideration' for GST purposes must, therefore, be carefully considered before placing any reliance thereon. Furthermore, there is no justification for adopting the view of the court in *Archibald Howie* that 'consideration' must, for South African VAT purposes, be given its wider meaning in conveyancing – whatever that might mean in South African law. I argue[678] that for the purposes of the VAT Act, a payment that is reciprocally connected to a supply, is consideration for that supply. I nonetheless hold the view that the reasoning in *Archibald Howie* is persuasive, namely that the proportionate reduction in both the amount and value of the share could be consideration paid by the shareholder for the company's return to him of share capital. Considering the meaning of 'consideration' in the VAT Act, I argue that such a reduction would constitute consideration for the return of the share capital if there is, in the circumstances, a reciprocal connection between the proportionate reduction in the value (or amount) of the share, and the return of the share capital. In other words, the reduction in the share value occurs as payment for the return of the share capital in the form of, for example, an *in specie* distribution.

[672] Ibid.
[673] Ibid at 152.
[674] That is, to such extent.
[675] Ibid at 153.
[676] Ibid at 154.
[677] See para 2.6.4.2 above.
[678] See para. 2.6.5 above.

The ATO is of the view that the comments of Dixon J in *Archibald Howie,* apply equally to *in specie* distributions by partnerships to partners.[679] The ATO argues that such an *in specie* distribution has the effect of discharging a claim that the partner has over the assets of the partnership. Consequently, when an *in specie* distribution is made, the partner's entitlement or claim over the assets of the partnership is reduced proportionately.[680]

In my view, *Archibald Howie* can be distinguished from the ECJ judgment in *Case 154/80*[681] where the Secretary of State for Finance assessed a cooperative association on the basis of its members' reduction in the value of their shares, as consideration for the cooperative's providing storage services.[682] The issue before the ECJ was whether the cooperative had charged its members consideration for its services within the meaning of article 8(a) of the Second Directive.[683]

The ECJ referred to Annex A point 13 regarding article 8(a) which provides that, "[t]he expression 'consideration' means everything received in return for the supply of goods or the provision of services …".[684] The ECJ held that there must be a direct link between the service provided and the consideration received, which does not happen in a case where the consideration consists of an unascertained reduction in the value of the shares held by the members of the cooperative.[685] The European Commission submitted that it is difficult to establish with any certainty, the real effect which the annual decision on the storage charges had on the value of the shares because that value could also be influenced one way or the other by various other factors.[686] The ECJ also held that such consideration

[679] GSTR 2003/13A3-Addendum para 85K.

[680] Ibid at para 85N.

[681] *Staatssecretaris van Financiën v Coöperatieve Aardappelenbewaarplaats* GA Case 154/80 5 February 1981 at 445 (herafter the *Aardappelenbewaarplaats* case).

[682] Ibid at 447. The facts in this case were that the cooperative ran a cold-storage depot in which it laid in potatoes and stored them for its members' account. Each grower owning shares was entitled to deposit 1 000 kilograms of potatoes a year for each share against payment of a storage charge fixed by the cooperative. Pending the sale of the cold-store, the cooperative did not 'impose or receive' any storage charge as remuneration for the services it provided for the relevant financial years. Consequently, in the belief that its services had been provided for no consideration, the cold-storage did not account for VAT on the services. The Secretary of State for Finance, however, considered that the cooperative had nevertheless charged its members something in return, owing to the reduction in value of their shares resulting from the non-collection of their storage charges. He, therefore, assessed what was received in return to be the storage charge ordinarily charged.

[683] The Second Council Directive of 11 April 1967 on the harmonisation of legislation of member states concerning turnover taxes – Structure and procedures for application of the common system of value-added tax (1967 English Special Edition *Official Journal* 16).

[684] The *Aardappelenbewaarplaats* case 447. In terms of art 2(a) of the Second Directive: "The following shall be subject to the value-added tax:

(a) The supply of goods and the provision of services within the territory of the country by a taxable person against payment"; while art 8 provides: "'The basis of assessment shall be: in the case of supply of goods and the provision of services, everything which makes up the consideration for the supply of the goods or the provision of services …".

[685] Ibid at 454.

[686] Ibid at 451.

must be a subjective value, which is the consideration actually received, and not a value assessed according to objective criteria.[687] The inspector had calculated the consideration by applying 'the most usual price' for the storage charge.[688] The ECJ concluded that such a loss of value may, therefore, not be regarded as a payment received by the cooperative providing the services,[689] and that the cooperative's services were not taxable.[690]

In my view, had the cooperative and its members, firstly, agreed that a reduction in the members' shares would constitute payment for the cooperative's supply of the storage services, and, secondly, had they agreed on the amount by which the value of the shares would be reduced, the ECJ would probably have gone along with the assessment.

In *Commissioner for Inland Revenue v Estate Whiteaway,* the court held that a partner's capital is a debt due to him from the partnership, and has nothing to do with his share of the assets – save that he has a lien over those assets for repayment of capital once outside creditors and advances by partners have been paid.[691] I argue that, subject to the consent of all the partners, the debt comprising of a partner's capital can immediately be due by the partnership to that partner, and not only when the partnership is dissolved.[692] It stands to reason that if a partner is required to pay the partnership for an *in specie* distribution, and the partnership is indebted to the partner for an amount of capital, the partner and the partnership would be reciprocally indebted.

I have stated that although a partner is not entitled to acquire an individual right to ownership in any partnership property before a general distribution, the partners may agree on a division of profits after the lapse of fixed periods of time.[693] On the agreed date for profit sharing, the partner will have a claim for his proportionate share of the partnership's net profits.[694] In my opinion, in the case of an *in specie* distribution, the partner would be indebted to the partnership for his obligation to pay for the distribution, whereas the partnership could be indebted to the partner for an amount of capital which the partner, as

[687] Ibid at 454.
[688] Ibid at 451.
[689] Ibid at 454.
[690] Ibid at 455.
[691] 1933 TPD 486 at 501.
[692] See para 3.2.1 above where I state that after the formation of the partnership, the agreed capital can at any time, with the consent of all the partners, be added to or withdrawn.
[693] See para 3.5 above.
[694] See Ramdhin et al "Partnership" para 297. Note that only once the state of the partnership affairs has been determined, will it be clear whether a partner is entitled to claim any amount from the partnership, and if so, the extent of his claim. In a given situation, a partner would not be entitled to institute a claim for his share of the profits, but actually be liable to pay over his share of the nett loss of the partnership. See Benade et al *Ondernemingsreg* para 4.42. According to Williams *Concise Corporate and Partnership Law* 31, until the agreed date for profit sharing has arrived, none of the partners has any rights to profits.

per agreement between all the partners, is entitled to withdraw, or an amount of profit share that is due to the partner.

In *Schierhout v Union Government,*[695] the court held that when two parties are mutually indebted to one another, if both debts are liquidated and fully due, the doctrine of compensation comes into play. The one debt extinguishes the other *pro tanto* as if payment had been made.[696] The doctrine of compensation or *compensatio* is also referred to as 'set-off'.[697] Set-off constitutes payment, and is the total or partial discharge of debts owed reciprocally by two persons.[698]

The firm KPMG is correct, in my view, that a shareholder's debt arising from his obligation to pay for an *in specie* dividend, can be set off against the company's indebtedness to him – for example, where the company sets off the value of the dividend *in specie* against its loan obligation to the shareholder.[699] A partner's indebtedness for an *in specie* distribution for which payment is required, can likewise be offset against the partnership's indebtedness to the partner in the form an amount of capital which the partner is entitled to withdraw, or a share in profits due to the partner. In my opinion, the payment for the *in specie* distribution can also be structured in the form of a barter,[700] which I deal with below.[701]

As concerns the time of supply when set off is applied, in the SARS's (since withdrawn) Ruling 193,[702] it is stated that where set off is applied before any invoice has been issued, set off will take place, and, therefore, payment will be made when the vendor delivers the goods to clients to whom he is personally indebted. This is in line with *Schierhout v Union Government* where the court held that the claim in that case would be regarded as having been extinguished from the moment the mutual debts were both extant.[703] Therefore, in the case of set-off, payment as envisaged in section 9(1), takes place at the moment when both liquidated and fully due debts co-exist. At the moment the partnership makes an *in specie* distribution to the partner which results in mutual indebtedness between the partnership and the partner as regards any capital or profit distributions due to the partner, the time of supply in

[695] 1926 AD 286.
[696] Ibid at 289; Botes *Juta's Value Added Tax* 9-6.
[697] Du Bois et al *Wille's Principles* 832.
[698] Ibid. In *Symon v Brecker* 1904 TS 745 at 747, Innes CJ explained that compensation in our law is equivalent to payment. It operates *ipso facto* (ie, by the very fact or act) as a discharge. As soon as two debts exist between which there is mutuality so that the one can be compensated against the other, then, by operation of law, the one debt extinguishes the other *pro tanto*.
[699] KPMG "VAT implications of dividends, including dividends *in specie*" available at https://www.saica.co.za/integritax/1997/413_VAT_implications_of_dividends_including_dividends_in specie.htm at 3 (date of use: 13 March 2017).
[700] "Barter" means an exchange of goods or services for other goods or services. See *Concise Oxford English Dictionary* at 110.
[701] That is below under this sub-heading.
[702] Botes *Juta's Value Added Tax* SARS Rulings - 70.
[703] *Schierhout v Union Government* 1926 AD 286 at 289.

section 9(1) is triggered. Each party receives payment from the other at the moment of set off, and a potential VAT liability arises for both parties. Support for this view can be found in the case *Van Heerden and Others v The State,*[704] where estate agency commissions were sacrificed by means of set off. The court held that output tax was nonetheless payable on the commissions even though the supplier did not invoice the recipient for the commissions, and the recipient made no payment of the commission to the supplier.[705]

The ATO is of the view that the consideration for an *in specie* distribution from a partnership is the proportion of the partner's interest in the partnership that would be:

a. an amount debited to the capital account of the partner;
b. an amount debited to the current account of the partner; or
c. a combination of amounts debited to both the partner's capital account and current account.[706]

The ATO's view accords with the accounting for a partnership. In the books of the partnership, three accounts will be opened for each of the partners, namely a capital, drawings, and current account.[707] A withdrawal of capital, and a drawing against money due to a partner, are debits to his capital and current accounts, respectively.[708]

I agree with the NZIR's submission that the mere credit entry to, for example, a partner's account within the partnership's books of account, is not accepted as payment as this simply acknowledges the debt. To be treated as a payment, according to the NZIR, the amount credited must be applied in some way to the partnership's benefit. In line with my argument above, the NZIR submits that payment would occur, for instance, if the credit was set off against an amount(s) owing by the partner.[709]

The ATO submits that to the extent that the total credit standing to a partner, as reflected in the combined balance of the partner's capital and current account, is insufficient to pay for the *in specie* distribution, the consideration for the distribution could also include:

a. any monetary payment by the partner; and

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[704] 73 SATC 7. See Botes *Juta's Value Added Tax* 1 consideration-2A.
[705] *Van Heerden and Others v The State* 73 SATC 7 at para 139.
[706] GSTR 2003/13A3 – Addendum para 85N.
[707] Flynn & Koornhof *Fundamental Accounting* 23-3.
[708] Ibid at 23-4. The difference between the drawings and the current account is that drawings against *expected* profits are from the drawings account, whereas drawings from the current account are against moneys *due* to the partner (ibid at 23-5).
[709] NZIR Tax Information Bulletin Vol 1 No 4 at 1 available at https://www.ird.govt.nz/resources/c/c/ccd4dbdc-97f0-4a6e-9730-3cb4ba68916b/tib-vol1-no04.pdf (date of use: 31 December 2018); McKenzie *GST: A Practical Guide* [E-book] Location 341.

b. any entry into an obligation, or promise by the partner to pay the partnership.[710]

The ATO's approach also applies to South African law because when set-off is applied, equal debts are both discharged. In the case of unequal debts, the lesser debt is discharged whilst the larger remains in force for the balance or excess only.[711] The *in specie* distribution could, therefore, be made to the partner by the partnership either wholly or partially on credit. The parties may agree that the partner is liable for interest on the outstanding amount. A partner is, after all, liable for the repayment, together with interest, of the partnership's money he has used in his private affairs.[712]

I have pointed out that the payment for the *in specie* distribution can be structured in the form of a barter. Set off must be distinguished from a barter contract or an exchange. In the case of barter, the consideration for the supply of the goods sold is entirely in some other commodity.[713] In other words, the partnership and the partner may agree that in exchange for the *in specie* distribution, the partner will supply goods or services to the partnership. In my view, a shareholder's agreement to a reduction in the value of his share, as in the case of *Archibald Howie*, constitutes the supply of a service in the form of the surrender of a right in relation to a certain portion of the share capital.

The case of *Whiteaway's Estate and Others v Commissioner for Inland Revenue*[714] illustrates how partnership capital was used to pay for an *in specie* distribution. In this case, the partners agreed to transfer certain fixed partnership property to two of the partners for their joint use and sole benefit. It was further agreed that the purchase price for the fixed property would be paid by the partners through an adjustment of their capital accounts.[715]

The leading case on barter in New Zealand is *Lanauze v King & Anor*.[716] In this case, two parties, Lanauze and King, entered into an agreement in terms of which Lanauze was to transfer 930 kilograms of paua quota to King, in return for the transfer to him of a house and its contents. The issue concerned the time of supply of the paua quota. Section 9(1) of the New Zealand GST Act, like section 9(1) of the

[710] GSTR 2003/13A3 – Addendum para 85O.
[711] Du Bois et al *Wille's Principles* 832; Ramdhin A et al "Obligations" in Kühne M (ed) *Law of South Africa vol 19* (Lexis 2016) para 244.
[712] Ramdhin et al "Partnership" para 297; Scamell & I'Anson Banks *Lindley on the Law of Partnerships* 568. To the extent that the partnership supplies the goods to the partner on credit, and the partner is liable to pay interest on the provision of the credit, the partnership would be making a supply of a financial service to the partner that is exempt from VAT in terms of s 12(*a*) read with s 2(1)(*f*). See para 2.6 above.
[713] Du Bois et al *Wille's Principles* 891. In a sale the price must be in money. If it is not money but is chiefly or entirely in some other commodity, it is no longer a contract of sale, but of barter or exchange. See Claassen *Dictionary of Legal Words* "Barter".
[714] *Whiteaway's Estate and Others v CIR* 1938 TPD 482.
[715] Ibid at 485.
[716] (2001) 20 NZTC 17,360; McKenzie *GST A Practical Guide* [E-book] Location 249.

VAT Act, deems the supply of goods or services to be made at the earlier of the time of issue of an invoice, or when payment is received. The court held that in the context of a swap arrangement where house and contents were to be exchanged for a quota, the vesting of ownership and equitable title in the property is payment for the purposes of section 9(1).[717]

I argue, therefore, that if registered for VAT, the partnership and the partner could each have a VAT liability for their respective supplies – ie, the partnership's supply of goods by means of the *in specie* distribution, and the partner's supply of a service in the form of surrendering a right. Both supplies would, in terms of section 9(1), be deemed to have taken place from the moment that ownership of the goods or services supplied vests in the recipient.

In *South Atlantic Jazz Festival (Pty) Ltd v Commissioner for SARS,*[718] the vendor staged annual international jazz festivals. The vendor concluded sponsorship agreements with various sponsors. In terms of these agreements the sponsors, inter alia, provided goods and services for the festivals, in return for which the vendor provided goods and services to the sponsors in the form of branding and marketing. Both the vendor and the sponsors were registered for VAT. It was common cause that the vendor was liable to levy output tax on the goods and services provided to the sponsors under the sponsorship agreements. The issue before the court was whether the vendor should be entitled to set that output tax liability off against a deduction of input tax in relation to the supplies made by the sponsors to the vendor.[719] According to the court, the transactions under the sponsorship agreements could, in essence, be regarded as barter transactions.[720] The sponsors were required to levy VAT on their supply of the goods and services concerned to the vendor.[721] As these were barter transactions, the value of the goods and services supplied by the sponsors was, in terms of section 10(3)(*b*), the open-market value of the consideration received in return for the supply.[722] The court noted that the sponsors did not account separately for the VAT on the consideration provided by the vendor. The court held that the VAT levied by the sponsors is thus deemed, in terms of proviso (ii) to section 10(2), to have been an amount equal to the tax fraction of the open-market value of the goods and services

[717] *Lanauze v King & Anor* ibid at para 22. See also *Case T61* (1998) 18 NZTC 8,461, where a partnership received cash for the entire commercial building sale, save for $800 000 for which the purchaser company issued fully paid-up ordinary shares in itself to the partnership. The TRA held that payment occurred once the parties had performed their obligations under the sale and purchase agreement. That was done with regard to the $800 000 by the purchaser company issuing the shares to the partnership in satisfaction of part-payment of the purchase price. The TRA also held that such share issues constitute payment by way of barter. Ibid at para 17.

[718] 77 SATC 254.

[719] Ibid at para 3.

[720] Ibid at para 4.

[721] Ibid at para 5.

[722] Ibid at para 9. Section 10(3) provides that the amount of consideration shall be-

(a) to the extent that such consideration is a consideration in money, the amount of the money; and

(b) to the extent that such consideration is not a consideration in money, the open market value of that consideration.

received as consideration for the supply.[723] By virtue of its counter-performance under the barter transaction, the vendor must be taken to have paid the tax.[724] The vendor's appeal was upheld.

As an *in specie* distribution in return for a partner surrendering his right to, for example, a portion of the capital, is also a barter transaction, the value of the goods and services supplied by the partnership and the partner is, in terms of section 10(3)(*b*), the open-market value of the consideration each party receives in return. Each party is entitled to an input tax deduction of the VAT levied on the other party's supply, subject to the applicable provisions in the VAT Act.

The partnership would be liable for VAT on the *in specie* distribution at fifteen per cent. If, however, the distribution constitutes the supply of an enterprise (or part of an enterprise which is capable of separate operation), disposed of as a going concern to a partner registered for VAT, the supply will be zero rated under section 11(1)(*e*).[725]

Section 10(4) could apply if the partnership makes the *in specie* distribution for no consideration, or for a consideration in money that is less than its open-market value. Section 10(4) would, for example, apply where the partner is not registered for VAT, because had a consideration equal to the open-market value been paid, the partner would not have been entitled to a full input tax deduction. The consideration for the *in specie* distribution would then be deemed, by section 10(4), to be the open-market value of that distribution.

A partner who is a vendor, is entitled to deduct the VAT levied[726] on the *in specie* distribution where the goods are acquired by the partner for the purpose of making taxable supplies.

In the case of Canada, Arsenault and Kreklewetz are of the view that where a partnership distributes partnership property to a partner, there is potential GST liability, and the supply is deemed to have been made at the free-market value under section 272.1(4) of Canada's ETA.[727]

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[723] Section 10(2) provides that the value to be placed on any supply of goods or services shall be the amount of the consideration for such supply, as determined in accordance with s 10(3), less so much of such amount as represents tax. In terms of the proviso (ii) to s 10(2), where the portion of the amount of the said consideration which represents tax is not accounted for separately by the vendor, that portion is deemed to be an amount equal to the tax fraction of the consideration.

[724] *South Atlantic Jazz Festival* at para 10. A substantial portion of the judgment concerns the documentary proof required by the vendor to support the input tax deductions in question, which is not relevant for current purposes.

[725] See KPMG available at https://www.saica.co.za/integritax/1997/413_VAT_implications_of_dividends_including_dividends_in specie.htm (date of use: 13 March 2017). See also McKenzie *GST A Practical Guide* [E-book] Locations 255 and 256.

[726] At fifteen per cent.

[727] Arsenault & Kreklewetz "Partnerships" 49. Section 272.1(4) provides that where a partnership disposes of its property to a person who is a member of the partnership, the partnership is deemed to have made to the person, and the person is deemed to have received from the partnership, a supply of the property for consideration equal to the total fair-market

The UK has no specific provisions to deal with the VAT implications of distributions by a partnership to its partners.[728]

3.6 Private or domestic use of partnership property

A partner may use partnership property for private purposes, but subject to limitations, provided that this does not conflict with the partnership business.[729]

When a partner applies partnership property for private purposes, it is an application or use of the property by the partner and not the partnership, simply because they are two distinct persons for VAT purposes. As a result, the partnership would be supplying the use of the property to the partner, who, in turn, subjects the property to his private use. Should the partner pay consideration to the partnership for such use, the supply could be subject to VAT.[730]

In my opinion, a supply of goods or services acquired for use in the partnership's enterprise without a charge, by a VAT-registered partnership to a partner, could provide an opportunity for VAT abuse. This could result in the supply not being subject to VAT ending in a VAT-free acquisition by the partner, whilst the partnership claimed an input tax deduction when the goods or services were acquired. To avoid this result, these supplies without charge, Schenk and Oldman submit, should be treated as supplies for consideration subject to VAT.[731]

Where the supply of use is made for no consideration, or for a consideration below the open-market value of the supply, and the partner does not intend to use the property exclusively for a taxable purpose, section 10(4) could apply and the consideration for the supply could be deemed to be the open-market value of that supply. The partnership would then be required to levy VAT on that market value.

If, however, the partnership does not charge the partner a consideration, and section 10(4) is not applicable, the question is whether the partnership would still be making a taxable supply to the partner.

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value of the property. The view that a partnership's distribution to a partner can potentially be subject to GST is correct considering the meaning of 'supply' in Canada's ETA as "the provision of property or a service". See above under this sub-heading and s 272.1(4).

[728] Considering the meaning of 'supply' in the UK as the transfer of ownership or possession (para 3.3.1 above), in my view, an *in specie* distribution by a partnership to a partner could potentially be subject to VAT in the UK.

[729] Ramdhin et al "Partnership" para 297; Benade et al *Ondernemingsreg* para 3.70; Pothier *A Treatise* para 84.

[730] In terms of s 7(1)(*a*).

[731] Schenk, Thuronyi & Cui *Value Added Tax* 108.

Section 10(23) provides that, save as otherwise provided in section 10, where a supply is made for no consideration, the value of that supply is deemed to be nil. The Tax Court held in *KCM v Commissioner for SARS,*[732] that the purpose of section 10(23) is merely to provide a value of nil for a supply in certain instances. There is nothing in the wording of section 10(23), the court reasoned, to justify reading into it a purpose to deem a non-taxable supply for no consideration to be a taxable supply for no consideration.[733] The SARS is correct in submitting that in determining whether the making of supplies for no consideration is a taxable supply, it must be clear that the activities which gave rise to the supply were conducted in the course or furtherance of business or enterprise activities.[734]

There is also an argument that where a partnership permits a partner to use partnership property for private purposes and for no consideration, this activity is inherently not aimed at advancing the partnership's enterprise, but is for the sake of the partner. Therefore, depending on the circumstances, the partnership would not be providing such use in terms of a taxable supply. As a result, the partnership could be required to make a change in use adjustment in terms of section 18(2).[735]

Where a partner uses partnership money in his private affairs, that money must be repaid to the partnership, together with interest.[736] The partnership would be making a supply of a financial service to the partner that is exempt from VAT,[737] to the extent that the partner is liable to pay interest for the use of the money. Depending on the amount of interest charged to the partner, and the value of any other amounts received which are unrelated to the making of taxable supplies, the partnership could be required by section 17(1) to apportion the VAT levied on its acquisition of goods or services.[738]

Australia, New Zealand and the UK, have no GST/VAT provisions that specifically apply where a partner uses partnership property for a domestic or private purpose.

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[732] Case No VAT 711.
[733] Ibid at para 9.
[734] SARS Interpretation Note 70 – 14 March 2013 para 3.3.
[735] Section 18(2) provides that where capital goods or services have been acquired, manufactured, assembled, constructed or produced by a vendor, wholly or partly for the purpose of consumption, use or supply in the course of making taxable supplies, and if the extent of the application or use of such goods or services in the course of making taxable supplies is subsequently reduced in relation to their total application or use, an adjustment is required. The adjustment is based on the extent of the increased non-taxable use of such goods or services. See s 10(9). No adjustment is, however, necessary where the cost of the goods or services (excluding VAT) is less than R40 000 – see proviso (i) to s 18(2).
[736] See para 3.5.2 above.
[737] In terms of s 12(a), read with s 2(1)(*f*).
[738] As stated above (para 3.6), a partner's private use of partnership property will, however, be negligible. If the intended use of goods or services for non-taxable purposes is less than five per cent of their total intended use, the VAT on such goods or services will, on the basis of the *de minimis* rule in proviso (i) to s 17(1), not be apportioned.

Considering that in New Zealand the meaning of 'supply' is "to furnish with or provide",[739] and that section 10(3) of the New Zealand GST Act[740] is worded similarly to section 10(4) of the VAT Act,[741] in my view, section 10(3) could apply to deeming a partnership's supply of partnership property to a partner for his private use, to be at the open-market value of that supply.[742] Supplying use in this form would, therefore, potentially be subject to GST.

The ATO considers that when goods are removed from the partnership for private consumption by a partner, there is a supply by the partnership in the course or furtherance of its enterprise.[743] The supply may, therefore, be subject to GST. If there is no consideration, or the supply is for inadequate consideration, the supply may be taxable on application of Division 72.[744] Where Division 72 applies, the value of the supply is its GST exclusive market value.[745]

As pointed out above,[746] section 272.1(4) of Canada's ETA, applies where a partnership 'disposes' of partnership property to a partner. According to Arsenault and Kreklewetz, provided the ownership of the underlying property is not being transferred to partners, the transaction will not attract GST under section 272.1(4). They argue, however, that where a partnership confers a benefit on a partner, section 172(2) of Canada's ETA could still apply.[747] This would deem the partnership to have made a supply of the property or service for consideration equal to its fair-market value.[748] The conferring of the

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[739] See para 3.5.2 above.

[740] Read with s 10(3A) of the New Zealand GST Act.

[741] See para 2.6.6 above.

[742] Section 10(3) of the New Zealand GST Act provides that where -

a. a supply is made by a person for no consideration or for a consideration in money that is less than the open market value of that supply; and
b. the supplier and the recipient are associated persons,

the consideration in money for the supply shall be deemed to be the open market value of that supply. Section 10(3A) provides that s 10(3) does not apply where, inter alia, the recipient acquired the supply for the principal purpose of making taxable supplies.

[743] GSTR 2003/13 para 102.

[744] Ibid para 102.

[745] Ibid para 90. See also McCouat *Australian Master GST Guide* [E-book] Location 464. The views of the ATO on how Division 72 is applied accord with those of PiperAlderman. Section 72-5 of the Australian GST Act provides that a supply to an associate for no consideration will be a taxable supply if the associate is not registered or required to be registered, or the associate acquires the things applied otherwise than solely for a creditable purpose. According to Piper Alderman, even though the supply is not being made for consideration, a distribution made by a discretionary trust may still be a taxable supply where Division 72 of the GST Act applies. See PiperAlderman "GST on in specie transfers of assets from discretionary trusts to beneficiaries" available at https://www.piperalderman.com.au/__files/f/4074/tax%20alert%2015.pdf (date of use: 22 August 208). A partnership and its members are associates. See McCouat *Australian Master GST Guide* [E-book] Location 464.

[746] See para 3.5.2 above.

[747] Arsenault & Kreklewetz "Partnerships" 33.

[748] Section 172(2) provides that where a partnership appropriates property or a service that was acquired in the course of commercial activities of the partnership, for the benefit of a partner, the partnership is deemed to have made a supply of the property or service for consideration equal to the fair market value of the property or service. Chabot et al *EY's Complete Guide to GST/HST* para 2,135 agree that s 172(2) applies to partnerships, amongst others, where property or services are appropriated for the personal use of a partner.

benefit is, therefore, potentially subject to GST. This would be the case, they contend, where the partnership grants the exclusive use of property, for example a computer or cell phone, to a partner in the course of partnership activities.[749]

In the UK, where at the direction of a person carrying on a business, goods held by the business are put to any private use or made available to any person for use for a non-business purpose, a supply of services is seen to have taken place[750] and gives rise to a VAT liability.[751] This would probably also apply where a partnership allows a partner to use partnership property for a non-business purpose.

3.7 Conclusion

In this chapter I explored the VAT treatment of various transactions that commonly occur during a partnership's operation. A concern I highlighted, is the potential for inaccurate classification of payments made by a partnership to a partner, which could make the difference as regards a partner's liability to register and account for VAT on his supplies to the partnership. In Chapter Six I consider the desirability of taxing a partner's capital contributions to the partnership, and whether there is justification for an amendment to eliminate such a requirement to account for VAT.

I further explored the dichotomy between the nature of different partnership transactions in partnership law and VAT law, particularly during the partnership's operation, and I emphasised once again that a departure from the common law must be justified.

I examined the role of a partner, and illustrated how the capacity in which he acts when transacting for the benefit of the partnership – whether as agent or as principal – impacts on related supplies and acquisitions for both the partner and the partnership.

That the collective purpose of the partnership is important when determining whether an acquisition has been made for a taxable purpose, is a reminder that when applying a VAT provision to a partnership transaction, the partner's status as a separate person for VAT purposes must be borne in mind.

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[749] Arsenault & Kreklewetz "Partnerships" 33, 34.

[750] Hemmingsley & Rudling *Tolley's Value Added Tax* para 47.6. See also HMRC "Private use and self-supply of goods and services for VAT" available at https://www.gov.uk/guidance/vat-private-use-and-self-supply-of-goods-and-services (date of use: 22 August 2018).

[751] The same applies to services. Where a person carrying on a business puts services supplied to him to any private or non-business use, he is treated as having supplied those services in the course or furtherance of the business. Private use includes use outside the business by any person, and own personal use where a business is carried on by an individual. See Hemmingsley & Rudling *Tolley's Value Added Tax* para 47.6. See also HMRC "Private use and self-supply of goods and services for VAT" available at https://www.gov.uk/guidance/vat-private-use-and-self-supply-of-goods-and-services (date of use: 22 August 2018).

I considered the VAT treatment of distributions and the alternative payment options therefor that could serve as consideration. It was also shown that the VAT Act adequately counters the potential for VAT abuse when partnership property is applied by partners for private or domestic purposes.

In the following chapter, the VAT implications of transactions that arise when a partnership is dissolved but its business is continued by a new partnership, are discussed. Special focus is placed on the supply of partners' shares that typically occur during this phase.

CHAPTER 4

THE TECHNICAL DISSOLUTION OF A PARTNERSHIP

4.1 Introduction

In theory, the dissolution of a partnership requires that it be liquidated. In practice, however, either in the partnership or a subsequent agreement, or by will, or by conduct, the remaining partners often take over the business of the partnership. On dissolution there is, accordingly, a succession to the rights and liabilities of the dissolved partnership by one of the partners or by a new partnership.[752] It is only in the absence of such an agreement that a formal liquidation takes place.[753] That a partnership has been dissolved, therefore, does not mean that it has been liquidated.[754] A dissolution that does not result in the liquidation of the partnership's assets and liabilities, is known as a 'technical dissolution', whereas a dissolution that does result in such liquidation, is termed a 'general dissolution'.[755] The VAT implications of a general dissolution and liquidation of a partnership are addressed in Chapter Five.

In this chapter, the VAT treatment of transactions typically related to the technical dissolution of a partnership, especially the transfer of partners' shares, is discussed. In addition to what has already been stated regarding partners' shares, a more in-depth understanding of the nature of a partner's share is required to answer the threshold question of whether its supply, in the context of dissolutions, is subject to VAT. The associated question is whether such VAT, and the VAT on related expenses, are deductible as input tax. The relevance or application of section 11(1)(*e*), which zero rates the supply of an enterprise, to the supply of partners' shares and to the transfer of the partnership's enterprise from the dissolved to the new partnership, is considered.[756] Other issues examined are the VAT implications of the transfer of the partnership's liabilities to the new partnership, and the application of the reorganisation provisions of section 8(25) to partnerships.

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[752] *Berco Sameday Express v McNeil and others* [1996] 4 All SA 100 (W) at 105; Bamford *Law of Partnership* 110; Benade et al *Ondernemingsreg* para 6.16; Williams *Concise Corporate and Partnership Law* 47.
[753] See *Berco Sameday Express* ibid; Benade et al ibid at para 7.01.
[754] *Ferreira v Fouche* [1949] 1 All SA 130 (T) at 132. Ramdhin et al "Partnership" para 314.
[755] GSTR 2003/13 para 127; Morse *Partnership Law* para 7.32 at 225.
[756] Batistich M, Stuk J & Stuk J "GST and the Sale of a Partnership Interest" available at http://www.tved.net.au/index.cfm?SimpleDisplay=PaperDisplay.cfm&PaperDisplay=http://www.tved.net.au/PublicPapers/July_2000,_Lawyers_Education_Channel,_GST_and_the_Sale_of_a_Partnership_Interest.html (date of use: 31 December 2018).

4.2 Causes of dissolution

A partnership can be dissolved through a number of different causes, for example:

a. *Agreement of dissolution:* Partners can dissolve the partnership by express or implied agreement.[757]

b. *Change in membership*: Any change among the partners destroys the identity of the partnership.[758] The retirement of a partner, or the admission of a new partner, therefore, dissolves the partnership.[759]

c. *Death of one of the partners*: The death of one of the partners dissolves the partnership.[760]

d. *Sequestration*: The sequestration of the estate of the partnership or of the private estate of a partner dissolves the partnership.[761]

e. *Partner becoming alien enemy*: Alien enemies are barred during war from entering into a partnership agreement.[762]

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[757] Ramdhin et al "Partnership" para 312; Benade et al *Ondernemingsreg* para 6.02; Bamford *Law of Partnership* 75; Williams *Concise Corporate and Partnership Law* 48.

[758] Ramdhin et al ibid at para 312; Benade et al ibid at para 6.09; Bamford ibid at 76; Williams ibid at 48 - 49. In *Executors of Paterson v Webster, Steel & Co* (1881) 1 SC 350 at 355, the court stated that "[t]here can be no doubt that, as a general principle, the Court can only recognise the members of which the firm consists, and that any change among them destroys the identity of the firm". In *Standard Bank v Wentzel & Lombard* 1904 TS 828 at 833, the court held that when the new partner, Aldred, joined the partnership there was a change in its constitution, and that the identity of the firm was altered.

[759] *Berco Sameday Express v McNeil and others* [1996] 4 All SA 100 (W) at 105; Ramdhin et al ibid at para 312; Benade et al ibid at paras 6.08 to 6.10; Bamford ibid at 75, 76; Williams ibid at 48, 49.

[760] Ramdhin et al ibid at para 312; Benade et al ibid at para 6.11; Bamford ibid at 77; Williams ibid at 49. See *McLeod and Shearsmith v Shearsmith* 1938 TPD 87 at 89, where the court stated that, "[a]s the partnership share of the deceased was specifically bequeathed in trust to the executors, it is as trustees and not as the legal representatives of the deceased that they figure in the present partnership, which is clearly not the same partnership as that between McLeod and the testator." See also *Van der Merwe v Sekretaris van Binnelandse Inkomste* [1977] 1 All SA 591 (A) at 596, 597.

[761] Ramdhin et al ibid at para 312; Benade et al ibid at para 6.23; Bamford ibid at 79; Williams ibid at 49.

[762] Ramdhin et al ibid; Benade et al ibid at para. 6.22; Bamford ibid at 80; *Monhaupt v Minister of Finance* (1918) 39 NPD 47 at 50. Other causes of a partnership's dissolution are:

a. *Completion of business or undertaking:* A partnership that was formed for the purpose of carrying out a particular business or undertaking is dissolved by the completion of such business or undertaking. See Ramdhin et al ibid; Benade et al ibid at para 6.07; Bamford ibid at 75.
b. *Effluxion of time:* A partnership entered into for a fixed term will be dissolved by the expiration of its agreed time of duration. See Ramdhin et al ibid at para 312; Benade et al ibid at para 6.05; Bamford ibid at 75).
c. *Partner declared mentally ill*: A court may dissolve a partnership if one of its members is declared mentally ill by a court. See Ramdhin et al ibid; Bamford ibid at 81.
d. *Frustration*: A partnership is dissolved if, due to circumstances beyond the control of the partners, the business purpose of the partnership becomes objectively impossible to achieve. See Ramdhin et al ibid; Bamford ibid at 76, 77.
e. *Notice of dissolution*: A partnership, formed for an indefinite duration, will be dissolved if any one of the partners gives notice that he no longer intends to continue the partnership. See Ramdhin et al ibid; Benade et al ibid at para 6.13; Bamford ibid at 81.
f. *Just or lawful cause*: A partner, if justified and reasonable, may obtain a court order dissolving the partnership. See Ramdhin et al ibid; Bamford ibid at 82.

4.3 The formation of a new partnership

After dissolution, a partner has a right to demand that the partnership be liquidated, unless the partners have agreed otherwise.[763] In the case of the retirement or death of a partner, a new partnership is created if the remaining partners agree to continue with the business of the partnership.[764] A new partnership also comes into existence by the admission of a new partner.[765] The admission of new members into a partnership can only be effected by a contract between them and each and all of the old members.[766]

When the new partnership is created, the partnership's business is transferred from the old partnership to the new partnership.[767] In *Berman v Brest and Another*,[768] the court held that where a new partnership is formed by the addition of another partner to the old partnership, all movable assets will, by process of law and without any act on the part of the partner, pass to the new partners.[769] The court held further that immovable property and incorporeal rights belonging to the old partnership can only be acquired by the new partnership by formal transfer and cession, respectively.[770] The partnership property of the old partnership is, therefore, transferred to the new partnership, whether by operation of law or by an act of the partners of the old partnership.

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[763] Ramdhin et al ibid at para 314. According to Bamford ibid at 97, on dissolution the partners have a right to wind up the partnership affairs. In *Kaplan v Turner* 1941 SWA 29 at 32, the court stated that in the absence of any agreement to the contrary the partners have an equal right in a liquidation of the partnership estate. See also *Meissner v Joubert* 1946 CPD 618 at 621, where reference is made to every partner's claim for the liquidation of the partnership assets, and *Ellery v Imhof* 1904 TH 170 at 172.

[764] *Executors of Paterson v Webster, Steel & Co* (1881) 1 SC 350 at 355; *Divine Gates & Co v African Clothing Factory* 1930 CPD 238 at 240; *Van der Merwe v Sekretaris na Binnelandse Inkomste* [1977] 1 All SA 591 (A); Ramdhin et al ibid at para 312. See also Bamford ibid at 110.

[765] *Executors of Paterson v Webster, Steel &* Co (1881) 1 SC 350 at 355; *Standard Bank v Wentzel and Lombard* 1904 TS 828 at 833. See also *Whitelock v Rolfes, Nebel & Co* 1911 WLD 35 at 38 where the court stated that, "the original partnership terminated in 1909, on the admission of Taylor, and, if he subsequently left the partnership, another new partnership came into existence." A partner who seeks to enforce a succession agreement does so not as a partner or former partner, however, but independently as a newly-contracting partner. See Bamford ibid at 112. Furthermore, the new partnership does not necessarily have the same rights and obligations as the old partnership. See Benade et al *Ondernemingsreg* para 6.18.

[766] *Wagstaff and Elston v Carter & Talbot* 1909 TS 121 at 123. See also Bamford ibid.

[767] In *Standard Bank v Wentzel & Lombard* 1904 TS 828 at 834 the court stated that, "[w]hen a new partner enters the firm, and the new partnership takes possession of the movable assets of the old, those assets cease to belong jointly to the original partners, and they become the joint property, for the purposes of the partnership and subject to its conditions, of the three new partners." In *Essakow v Gundelfinger and Another* 1928 TPD 308 the court stated at 315 that, "there is a dissolution between two partners, and in terms of the dissolution the whole business is transferred to the partner who continues to carry on the business." See also *Sacks v Commissioner for Inland Revenue* 1946 AD 31; Ramdhin et al "Partnership" para 312.

[768] *Berman v Brest and Another* 1934 WLD 135.

[769] See also *Standard Bank v Wentzel & Lombard* 1904 TS 828 at 834.

[770] *Berman v Brest and Another* 1934 WLD 135 at 139. See Ramdhin et al "Partnership" at para 312 and Bamford *Law of Partnership* at 111, 112.

4.4 The transfer and acquisition of a partner's share

A number of questions arise relating to the transfer of partners' shares. For example, does a retiring partner or the deceased estate of a deceased partner (or 'the decedent's estate') dispose of the partner's share upon retirement or death? Also, when disposing of the share, what exactly is disposed of? On the admission of a new partner, what is the nature of the rights he acquires on admission, and how does he acquire those rights? As stated above,[771] a partner's share denotes both his undivided share in jointly-owned partnership property, and his right to claim a specific portion of the partnership assets, such as profits, when this portion is due.[772] There are, accordingly, two distinct rights which a partner or his deceased estate can potentially dispose of upon retirement or death, or which a new partner can acquire upon his admission to the partnership.

A partner's undivided share in jointly owned partnership property

In *Rane Investment Trust v CSARS,*[773] the appellant (Rane) was an investment trust. It became a partner in an *en commandite* partnership formed for the purpose of investing in film ventures. This appeal concerned, inter alia, a deduction claimed by Rane for expenditure incurred from income under section 24F of the IT Act.

A commanditarian partnership was formed between Compass Films (Pty) Ltd (Filmco) and Movie Ventures (Pty) Ltd (Movie Ventures). Filmco bought a film named *Final Cut* from a production company. Rane subsequently became a partner. It acquired its interest from Movie Ventures, and paid a capital contribution of R90 000. Rane claimed its share of the cost of acquiring the film as a deduction under section 24F(2)(*a*) of the IT Act. Section 24F(2)(*a*) permits as a deduction from the income of a film owner, an allowance in respect of the production cost he incurred in respect of a film used by him in the production of his income. Production cost is defined in section 24F(1), and includes expenditure incurred by a film owner in the acquisition of a film. The Commissioner for the SARS disallowed the deduction.

The Commissioner argued that Rane's expenditure was in respect of its acquisition of its partnership share, not the acquisition of the film. The court, dismissing the Commissioner's argument, stated that, that argument loses sight of the principle that in acquiring the share, Rane was also acquiring, as part of the business of the former partnership, a share in the film, which was an asset. The court held that it was the expenditure on the film as an asset taken over by the new partnership which was deductible,

[771] See para 2.6.3 above.
[772] The latter right is hereafter referred to as the 'right to profit'.
[773] *Rane Investment Trust v CSARS* [2003] 3 All SA 39 (SCA), 65 SATC 333.

and not the amount of R90 000 paid by Rane to become a partner.[774]

Therefore, in acquiring a partner's share a partner also acquires an undivided share in the jointly-owned partnership property. It follows, logically, that when a partner disposes of his partner's share, he is also disposing of his ownership right in the jointly-owned partnership property. This was confirmed in *Chipkin (Natal) (Pty) Ltd v CSARS,*[775] where the court referred with approval to the principle in *Rane* – ie, that in acquiring the share Rane was also acquiring a share in the film.

In *Chipkin*, the appellant and others entered into a partnership. Its contribution to the partnership was a cash amount, for which it acquired a 30 per cent interest in the partnership. The appellant subsequently transferred 99,9 per cent of its 30 per cent interest in the partnership to one of the partners.[776]

The court held that when it made the capital contribution to the partnership, the appellant simultaneously obtained a 30 per cent interest in the partnership and an undivided share in the aircraft. The court held, further, that when the appellant disposed of 99 per cent of its 30 per cent interest in the partnership, it disposed of a corresponding percentage of its undivided share in the aircraft.[777] I am of the view, therefore, that when a partner disposes of his partner's share when retiring from a partnership, he disposes of his undivided interest in all jointly-held partnership property, including his interest in partnership profits which form part of the partnership property.[778] This should also apply in the case of the death of a partner, where the remaining partners purchase the deceased partner's undivided interest in jointly- owned partnership property. In *Van der Merwe v Sekretaris van Binnelandse Inkomste*,[779] for example, which is discussed below,[780] the remaining partners purchased the decedent's share of the partnership's goodwill. It should also be possible for a partner to dispose of his interest in jointly-owned partnership property even after dissolution, as property contributed *quoad dominium* remains the joint property of the partners until liquidation.[781]

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[774] Ibid at 345.
[775] [2005] 3 All SA 26 (SCA).
[776] Ibid at 28.
[777] Ibid at 29.
[778] I stated in para 2.6.3 above, that a partner's share consists of a partner's right to claim a specific portion of the partnership assets, as well as his share in jointly-owned partnership property, including partnership profits.
[779] *Van der Merwe v Sekretaris van Binnelandse Inkomste* [1977] 1 All SA 591 (A).
[780] That is, under this sub-heading.
[781] Ramdhin et al "Partnership" para 315. In *Brighton v Clift* [1970] 4 All SA 243 (R) 246, the court referred to the respondent's "right as a partner to remain in possession of the partnership assets until a liquidator is appointed" According to Pothier *A Treatise* 122, para 160, dissolution does not prevent the things which the partners have put into the partnership for the purpose of being common between them, from continuing common among the former partners until a distribution or division takes place.

A partner's right to profit

As regards a partner's right to profit, there could be a distribution of profits after the partnership is dissolved but before its liquidation and termination. Former partners are entitled to their share of the profits and losses arising from transactions which necessarily result from transactions commenced or concluded prior to dissolution.[782]

In *Sacks v Commissioner for Inland Revenue,*[783] the appellant was a former member of a partnership. The accounts of the partnership's business were drawn up annually for the period 1 July to 30 June. One of the terms of the partnership agreement was that the profits should be divided in specific proportions between the three partners. The appellant was entitled to 43 and one-third per cent of the profits. It was agreed that he would retire from the partnership with effect from 1 January 1941, and that his partner's interest would be sold to the two remaining partners. In terms of the deed of dissolution, the partners agreed that the appellant would be paid £5 351 as his agreed share of the profits for the period 1 July 1940 to 31 December 1940. This sum was an agreed estimate of the amount of the appellant's profit share for the stated period. The Commissioner for Inland Revenue, acting on the assumption, amongst others, that the year's profits had been earned at a uniform rate throughout the year, calculated the appellant's share of the profits at £14 297 and issued tax assessments on that basis. The appellant objected to the assessments arguing that his taxable income was £5 351. De Villiers J for the Cape Provincial Division, ruled in favour of the Commissioner. This decision was overturned on appeal, the Appellate Division holding that the sum of £5 351 was profit to which the appellant was entitled for the relevant period.[784] Although the appeal court disagreed with De Villiers J's decision, it agreed with the following noteworthy statements made by him during the course of his judgment:

> The right to profit is a valuable right, which he may sell, cede or otherwise dispose of. The value of the right may turn out, when the accounting period ends, to be very great or worthless, but it is a right vested in the retired or deceased partner which the retired partner or the executor of a deceased partner may sell, cede, or otherwise dispose of. In other words, it is a right to which he has become entitled on dissolution.[785]

And further:

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[782] Ramdhin et al "Partnership" para 315; Williams *Concise Corporate and Partnership Law* 53. In *Nash v Muirhead* (1909) 26 SC 26, a partnership transaction had not been concluded before the dissolution of a two-person partnership. The court found that the transaction was carried on by one of the partners in his capacity as a partner and for the benefit of the partnership (at 31, 32). The court held, therefore, that the other partner was interested in this transaction and that he never gave up his interest in it by any agreement at the dissolution (at 34).

[783] *Sacks v Commissioner for Inland Revenue* 1946 AD 31.

[784] Ibid at 43.

[785] Ibid.

> The right to profit is quite distinct from the actual profits earned. The actual profits simply mean the excess of receipts over expenditure over a given period. The right, however, exists throughout. It is merely the value of the right which remains uncertain until eventually ascertained.
> A partner's right to share in the profit and his liability to share in losses accrues at the inception of partnership. The value of that right or the extent of that liability varies as the year goes on.[786]

The court held that the appellant, importantly, "did not cede a portion of his share of profits to anyone after dissolution." What the appellant and his partners instead agreed to, as a condition of dissolution, was to amend the existing agreement as to the division of profits. They agreed that the appellant's share should not be 43 and one-third per cent of the profits made during the half-year ending 31 December 1940, but the fixed sum of £5 351.[787] The court held further that the right to profit arose from the partnership agreement and was a right of a capital nature. The amount of £5 351 "accrued to [the appellant] by virtue of that right" to profits.[788]

Important lessons can be drawn from the *Sacks* case concerning a partner's right to profit on dissolution. Firstly, the right to profit is a valuable right that vests in the retired or deceased partner, which the retired partner or the executor of a deceased partner may sell. The court also implied that such a sale is possible as it disagreed that the appellant had ceded his right, in this case. This is confirmed in *Van der Merwe v Sekretaris van Binnelandse Inkomste*.[789] Secondly, a partner need not sell or cede his right to profit as in the *Sacks* case, where the appellant received an agreed amount based on his right, in the same way that a dividend accrues to a shareholder by virtue of his shareholding.[790]

In *Van der Merwe v Sekretaris van Binnelandse Inkomste,*[791] the issue was whether, for purposes of income tax, certain partnership income relating to uncompleted assignments, accrued either to the two remaining partners or to the widow of a deceased partner. The court accepted that in the absence of a contrary agreement, the decedent's estate could claim the decedent's share in the profits from assignments which were uncompleted at the time of dissolution, but which were subsequently completed by the surviving partners. The court held that in the partnership agreement the partners intended that upon dissolution of the partnership resulting from the death of a partner, the surviving partners could continue with the partnership business for their own benefit. The partners further agreed that they would, in the manner determined in the partnership agreement, pay compensation to the

[786] Ibid.
[787] Ibid at 42.
[788] Ibid at 43.
[789] *Van der Merwe v Sekretaris van Binnelandse Inkomste* [1977] 1 All SA 591 (A).
[790] In *Nash v Muirhead* (1909) 26 SC 26, the plaintiff and the defendant were partners of a dissolved partnership. The plaintiff sued the defendant for his share of the profits from a transaction that was uncompleted at the date of dissolution. The court, granting judgment for the plaintiff, held that he "was interested in this transaction, and that he never gave up his interest in it by any agreement at the dissolution" (at 34). As in the *Sacks* case, the plaintiff in this case also did not give up or sell his right to profit on dissolution of the partnership.
[791] [1977] 1 All SA 591 (A).

widow of the deceased partner for the goodwill attached to the name of the decedent and for his share in uncompleted assignments.[792] The same applied when a partner retired.[793] The court held that the relevant amounts paid to the widow formed part of the surviving partners' gross income and were, therefore, subject to income tax in their hands.[794]

It is clear that the deceased partner's right to profit relating to the uncompleted assignments at the time of his death, as well as his share in the goodwill – which is partnership property – were purchased by the surviving partners.[795] It is for this reason that the profits flowing from these assignments accrued to the surviving partners and not to the deceased partner's widow.

I argue, based on the *Sacks, Nash,* and *van der Merwe* cases above, that a retiring or deceased partner's right to profit in the dissolved partnership can, on dissolution, either be retained by the retiring partner or by the decedent's estate, depending on the agreement between the partners. In this case, the retiring partner or the decedent's estate will receive the share of the profits by virtue of holding the right to profit. Alternatively, a retiring partner or the decedent's estate, can sell the partner's right to profit to the remaining partners who will then receive that partner's profit share.

A retiring partner (or a decedent's estate) cannot sell a partner's share, including a right to profit in the new partnership, simply because he is not a member of, and therefore does not own any rights in, the new partnership. He can only dispose of his partner's share in the dissolved partnership. The remaining partners acquire their partners' shares in the new partnership when they enter into a partnership agreement regulating the affairs of the new partnership.

4.5 The admission of a new partner

In my view, any number of the existing partners of a dissolved partnership can sell a portion of their ownership interest in the jointly-owned (dissolved) partnership's property to a newly admitted or incoming partner. The partnership property of the dissolved partnership is then transferred to the new partnership.[796] The new partner and existing partners thereafter each has an ownership interest in the partnership property of the new partnership.

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[792] Ibid at 596, 597.

[793] Ibid at 597. That is, the retiring partner had to be compensated for his share in the goodwill of the partnership and for his share in the assignments that were uncompleted at the time of dissolution.

[794] Ibid at 601.

[795] This is also Ramdhin et al's understanding that the surviving partners purchased the decedent's interest upon his death. See Ramdhin et al "Partnership" para 312.

[796] See para 4.3 above. I am of the opinion that the contribution of the dissolved partnership's property to the new partnership would be made in terms of the partnership agreement, referred to in para 4.3, between the new member(s) and the old members.

I suggest that, alternatively, rather than purchasing ownership interests in the partnership property of the dissolved partnership, the incoming partner can simply make a contribution to the new partnership in terms of the new partnership agreement. The VAT implications of a capital contribution upon the formation of a partnership have been dealt with above.[797]

The new partner owns a partner's share in the new partnership in the terms of the partnership agreement with the existing partners. I argue[798] that partners' shares are not supplied to the partners when the partnership is formed, because at that moment no partners' shares exist. The existing partners, therefore, do not supply a partner's share in the new partnership, including a right to profit, to the new partner.

4.6 The dissolved partnership ceasing to be a 'person'

As explained,[799] the reasons for the dissolution of a partnership are various. The question arising is when would a dissolved partnership cease to be a person for VAT purposes? In *Goldberg and Another v Di Meo,*[800] the appellant argued that as a partnership has no identity separate from its members, it changes its identity and ceases to exist whenever there is a change in its membership. The old partnership in this case, the appellant argued, had ceased to exist because the original partners had been replaced.[801] The court, rejected this argument and held that if a change occurs in the constitution of a partnership – eg, a partner retires or a new partner joins – a new partnership comes into being, but the old partnership continues to exist until its affairs have been liquidated.[802] In *Kaplan v Turner,*[803] the court stated that the partnership continues after dissolution solely for purposes of liquidation. Despite the dissolution event, the old partnership continues to exist in terms of the common law and, therefore, to be a person for VAT purposes, until its liquidation. Until the liquidation of the old partnership it, therefore, exists concurrently with the new partnership.[804]

As the partnership's business is transferred from the old to the new partnership, the old partnership is no longer carrying on an enterprise, and its continued VAT registration is no longer justified.[805]

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[797] See para 2.6 above.
[798] See para 2.8 above.
[799] See para 4.2 above.
[800] [1960] 2 All SA 459 (N).
[801] Ibid at 465.
[802] Ibid at 468.
[803] *Kaplan v Turner*1941 SWA 29 at 31, 32.
[804] See also *Van der Merwe v Sekretaris na Binnelandse Inkomste* [1977] 1 All SA 591 (A) at 596.
[805] Section 24(3) provides that a vendor who ceases to carry on all enterprises must notify the Commissioner for SARS of that fact, whereupon the Commissioner must cancel the vendor's registration.

4.7 The dissolved and new partnership deemed to be one person

Section 51(2) provides, subject to certain requirements, that where a partnership is dissolved and a new partnership which continues to carry on the enterprise of the dissolved partnership as a going concern comes into being, the dissolved partnership and the new partnership are deemed to be one and the same partnership, and therefore the same 'person'. This provision requires that the partnership be dissolved in consequence of the retirement or withdrawal of one or more (but not all) of its members, or the admission of a new member.[806] Furthermore, the new partnership must consist of the remaining members of the dissolved partnership, or such remaining members and one or more new members. As the dissolved and the new partnerships are deemed to be the same person, the dissolved partnership is not required to deregister for VAT. The new partnership need not apply for VAT registration but simply continues to account for VAT under the VAT registration number of the dissolved partnership.

The purpose of section 51(2), like section 57(2)(e) of the New Zealand GST Act, is simply to ensure the continuity of a body of persons.[807] This effectively does away with the administrative burden, inflated compliance costs, and VAT recovery issues,[808] on the basis of the section 8(2) deemed supply which arises when a person ceases to be a vendor, which would otherwise result from the frequent deregistration and registration of partnerships. This is especially so, considering that "the remaining partners more often than not take over the business of the partnership."[809] The legislature achieved this by deeming the two persons, ie the dissolved and the new partnership, to be one person.

Where the enterprise of the dissolved partnership is not continued by a new partnership, the provisions of section 51(2) do not apply and the dissolved partnership is required to deregister for VAT. This would occur, for example, where a partner in a two-person partnership retires, leaving the remaining 'partner' to continue with the partnership's enterprise alone. The remaining 'partner' cannot on his own, constitute a partnership in that a partnership arises out of a contract between two or more persons.[810]

I have previously stated that when a partnership dissolves and a new partnership is created, immovable property belonging to the members of the old partnership must be formally transferred into the names of the members of the new partnership.[811] This transfer could give rise to liability for transfer duty under

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[806] Note that in terms of s 25(*e*), a partnership that is a vendor, must within 21 days notify the Commissioner in writing of any change in the composition of the members of the partnership.
[807] NZIR available at http://www.ird.govt.nz/resources/3/7/3716fa51-a2ec-42ac-b692-083ecb04679c/QB1604. pdf 8 para 45 (date of use: 8 December 2016).
[808] See NZIR ibid at 8 para 47 (date of use: 8 December 2016).
[809] *Berco Sameday Express v McNeil and others* [1996] 4 All SA 100 (W) at 105.
[810] Ramdhin et al "Partnership" para 254; Benade et al *Ondernemingsreg* para 3.02; Bamford *Law of Partnership* 1; Williams *Concise Corporate and Partnership Law* 10.
[811] See para 4.3 above.

section 2(1) of the Transfer Duty Act.[812] This section provides for the imposition of transfer duty on the value of 'property' acquired by a person.[813] However, section 9(15) of the Transfer Duty Act provides that no duty is payable in respect of the acquisition of a property under a transaction which, for purposes of the VAT Act, is a taxable supply of goods to the person acquiring the property. In short, transfer duty is not payable if VAT is payable. Therefore, if the dissolved partnership and the new partnership are deemed to be one and the same partnership, there can be no supply of the immovable property for VAT purposes, as a person can obviously not make a supply to himself.[814] As a result, there can be no VAT liability on the transfer of the immovable property if section 51(2) applies. However, if section 51(2) applies, the members of the new partnership could be burdened with a transfer duty liability as transfer duty is payable by the person who acquires the property.[815]

Both an obligation to pay VAT at fifteen per cent, and a transfer duty liability can be avoided if section 51(2) does not apply, and if the supply of the immovable property forms part of the supply of an enterprise, as envisaged in section 11(1)(*e*).[816] The possible zero rating of the supply of the dissolved partnership's enterprise to the new partnership, or to a sole remaining partner who continues with the partnership's business, is discussed below.[817] Section 51(2) affords the Commissioner for the SARS a discretion, having regard to the circumstances of the case, to direct otherwise – ie, to direct that the old and the new partnership are not to be regarded as the same partnership.[818]

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[812] 40 of 1949.

[813] 'Property' is defined, in s 1 of the Transfer Duty Act, as meaning land in the Republic and any fixtures thereon, and includes any real right in land.

[814] Note, however, that the VAT Act allows for a supply that can be construed as a self-supply, to be a deemed supply for VAT purposes. An example is s 8(9), read with paragraph (ii) of the proviso to the definition of 'enterprise' in s 1(1), which provides that the supply of goods or services by a vendor to an independent branch or main business of that vendor located outside the Republic, is a deemed supply of goods or services in the course of furtherance of the vendor's enterprise. The vendor and its branch or main business are, in terms of the general law, part of a single 'person'.

[815] Section 3 of the Transfer Duty Act. Note that the definition of 'person' in s 1(1) of the Transfer Duty Act does not include a partnership. The individual partners of the new partnership, instead of the new partnership as a separate person, are therefore liable for the transfer duty.

[816] See Cross *New Zealand Master Tax Guide* 974 para 23-110.

[817] See para 4.9 above.

[818] The decision of the Commissioner is, however, not subject to objection and appeal. Section 104(1) of the Tax Administration Act 28 of 2011 (the TA Act) provides that a taxpayer who is aggrieved by an assessment made in respect of the taxpayer may object to the assessment. In terms of s 104(2) of the TA Act certain decisions may be objected to and appealed against in the same manner as an assessment. Section 104(2)(*c*) of the TA Act provides that a taxpayer may object and appeal against "any other decision that may be objected to or appealed against under a tax Act." Section 32(1) of the VAT Act lists the decisions that may be objected to or appealed against under the VAT Act. A decision made by the Commissioner for the SARS in terms of s 51(2) is not listed in s 32(1). As it is a discretionary decision, it is subject to review by the court. Section 5(1) provides that powers conferred and the duties imposed upon the Commissioner for the SARS by or in terms of the provisions of the VAT Act, may be exercised or performed by the Commissioner, or by any SARS official. In *Metcash Trading Ltd v Commissioner for SARS* 2001 (1) SA 1109 (CC), 2001 (2) JTLR 37, (2001) 63 SATC 13 at para 40, the court stated that it has long been accepted that when the Commissioner exercises discretionary powers conferred upon him by statute, the exercise of the discretion constitutes administrative action which is reviewable in terms of the principles of administrative law. See Botes *Juta's Value Added Tax* 5-2.

As section 51(2) deems the dissolved and the new partnerships to be one and the same partnership, a question arises as to whether, in the case of a change in membership, the sale of a partner's share and other related transactions, should be disregarded from the point of view of the outgoing and remaining partners. An argument can possibly be made that if the fact of the termination of a person and the formation of a new person are ignored for VAT purposes, the legislature may well have intended that all transactions related to, or which brought about this termination and formation, should likewise be ignored and, therefore, not hold any VAT implications.

Where a new partnership is created on the retirement or withdrawal of a partner, some of the following transactions will probably occur. The retiring partner or the decedent's estate could sell the partner's share in the dissolved partnership to the remaining partners. This would be a sale of the retiring (or deceased) partner's undivided interest in the jointly-owned partnership property and the retiring partner's right to profit in the dissolved partnership. The remaining partners would receive any profit distributions made by the dissolved partnership by virtue of their owning a right to profit in the dissolved partnership. This would include the retiring partner's right to profit which they had acquired. The remaining partners would enter into a new partnership agreement and each would own a partner's share in the new partnership. The remaining partners would contribute the jointly-owned partnership property of the dissolved partnership to the new partnership.

Section 57(2)(e) of the New Zealand GST Act provides that "any change of members of that body shall have no effect for the purposes of this Act." The Commissioner of the NZIR disagrees that this wording means that a supply of a partner's share has no GST effect. The Commissioner argues that section 57(2)(e) refers to a change of members of a body, and that it is possible to have a transfer of a partner's share without having a change of members. That will be the case when an existing partner transfers some, but not all, of his interest in a partnership to one or more of the other partners. In that case, the Commissioner submits, the partnership interests have changed, but the members of the partnership have not. In the Commissioner's view, reference to a change of members, rather than to changes of membership interests, indicates the intended scope of the provision.[819]

According to Cross, the scope of section 57(2)(e) is unclear, although she does concede that it is generally accepted that the minimum effect of the provision is that the retirement, admission, or variation of existing partners' interests has no effect on the partnership's registration. This means that the 'new' partnership need not apply for a new GST registration number.[820]

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[819] NZIR "Questions We've Been Asked QB 14/03, – GST – Transfer Of Interest In A Partnership" para 13 available at http://www.ird.govt.nz/resources/7/2/72537cec-da81-407d-ad4f-e490c9f2213d/qb1403.pdf (date of use: 8 December 2016).

[820] Cross *New Zealand Master Tax Guide* 974.

In *Whiteaway's Estate v CIR,*[821] the court referred to changes in the proportion in which partners share in the profits and losses of the business, and in their rights in the partnership assets, without there being a change in membership.[822] Batistich et al, commenting on Australian partnership law, distinguish between changes of partnership interests which effect a change in the membership of a partnership, on the basis that such changes operate to dissolve the partnership; and intra-partnership changes, such as an assignment of part of one partner's interest to another partner, which merely change the extent of interests held by existing partners. This type of change does not dissolve the partnership.[823]

It is possible, therefore, for there to be a change in partners' shares without the partnership being dissolved and a new partnership created because of a change in membership, which is the premise on which an application of section 51(2) is based. Adopting the argument of the Commissioner of the NZIR, I argue that a change in partners' shares is not necessarily equal to a change in membership causing the partnership to dissolve. Therefore, the reference to a change in membership in section 51(2) is not, *per se*, a reference to a change in partners' shares.

There is no evidence of a legislative intent to ignore not only the membership change, but also the mechanism used to achieve that change – ie, the supply of a partner's share and related transactions.[824] Moreover, the fact that supplies between the old and the new partnership are disregarded, clearly does not mean that supplies between other persons should also not be recognised. For example, the supplies between the remaining partners and an outgoing partner, and between the partners and the dissolved and the new partnership can be subject to VAT.

The Commissioner for the NZIR submits that not all partnership contributions will necessarily involve the supply of a partnership interest. To illustrate this he gives the example where two existing partners make contemporaneous capital contributions in proportion to their existing partnership interests (eg, two partners, each holding a 50 per cent partnership interest, each contributes an additional $10 000). The partnership interest of each partner does not change.[825]

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[821] *Whiteaway's Estate v CIR* 1938 TPD 482.
[822] Ibid at 491.
[823] Batistich M, Stuk J & Stuk J "GST and the Sale of a Partnership Interest" available at http://www.tved.net.au/index.cfm?SimpleDisplay=PaperDisplay.cfm&PaperDisplay=http://www.tved.net.au/PublicPapers/July_2000,_Lawyers_Education_Channel,_GST_and_the_Sale_of_a_Partnership_Interest.html (date of use: 31 December 2018).
[824] See NZIR 7 para 43 available at http://www.ird.govt.nz/resources/3/7/3716fa51-a2ec-42ac-b692-083ecb04679c/QB1604.pdf (date of use: 8 December 2016).
[825] Ibid at 4 para 20.

This argument – that a change in partners' shares does not necessarily mean a change in membership – applies equally to partners who make additional capital contributions. The same arguments in favour of recognising the supply of partners' shares in the context of the continuation of a dissolved partnership's business by a new partnership, apply to capital contributions in the same circumstances. This is further support for the view that section 51(2) does not prevent contributions made by the partners to the new partnership from being recognised as supplies, and therefore potentially subject to VAT.

Section 272.1(7) of Canada's ETA provides that where a partnership would, but for this section, be regarded as having ceased to exist, "the other partnership is deemed to be a continuation of and the same person as the predecessor partnership", subject to certain requirements.[826] The CRA's position is that where section 272.1(7) of the ETA applies, the supplies of property from the predecessor partnership to the partners, and from the partners to the new partnership, are subject to the normal GST rules in Canada's ETA.[827]

Arsenault and Kreklewetz disagree with the CRA. They contend that if ownership of the partnership property is in the hands of the partnership for GST purposes, and if under section 272.1(7) nothing has changed (ie, the new partnership is deemed to be the same person as the old partnership), the CRA's position is blatantly incorrect. They reason that the underlying commercial and legal realities should not matter, as a partnership is a legal person for GST purposes.[828]

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[826] Section 272.1(7) provides as follows:

> Continuation of predecessor partnership by new partnership
> Where
> (a) a partnership (in this subsection referred to as the 'predecessor partnership') would, but for this section, be regarded as having ceased at any time to exist,
> (b) a majority of the members of the predecessor partnership that together had, at or immediately before that time, more than a 50% interest in the capital of the predecessor partnership become members of another partnership of which they comprise more than half of the members, and
> (c) the members of the predecessor partnership who become members of the other partnership transfer to the other partnership all or substantially all of the property distributed to them in settlement of their capital interests in the predecessor partnership, except where the other partnership is registered or applies for registration under s 240, the other partnership is deemed to be a continuation of and the same person as the predecessor partnership.

[827] Government of Canada *Draft Policy Statement on the GST/HST implications of the transfers of property referred to in paragraph 272.1(7)(c) of the Excise Tax Act* GST/HST Notices – Notice 166 14 April 1996 at 2 available at https://www.canada.ca/en/revenue-agency/services/forms-publications/publications/notice166/ draft-policy-statement-on-gst-hst-implications-transfers-property-referred-paragraph-272-1-7-excise-tax-act.html (date of use: 31 December 2018).

[828] Arsenault & Kreklewetz "Partnerships" 51.

Considering the impact of section 51(2), supplies between the dissolved and the new partnership are ignored for VAT purposes because one entity cannot make supplies to itself. Furthermore, as the jointly-owned partnership property is deemed to belong to the partnership, and the dissolved and the new partnerships are deemed to be the same person, the various transfers of the ownership in such property in terms of the general law, are not regarded as supplies and, consequently, hold no any VAT implications.

The Australian GST Act does not have a provision dealing specifically with the situation where a dissolved partnership's enterprise is continued by a newly-created partnership, which corresponds to section 51(2). A written partnership agreement may, however, either expressly by a continuity or non-dissolution clause, or by implication, provide for the continuation of the partnership in the event of a change in its membership.[829] It is Taxpayers Australia Inc's view that a reconstituted partnership retains its GST registration despite the change in its membership. Furthermore, as there is no winding up of the partnership, the change in membership does not give rise to any supplies or acquisitions from one partnership to another. It also argues, importantly, that even though the acquisition or sale of an interest in the partnership may require a change in legal title to partnership assets, where such property remains in the partnership, there is no supply. This is because any supply of partnership property would be by the partnership as, for GST purposes, legal title in the partnership property vests in the partnership.[830]

In terms of section 45(1) of the UK VAT Act, no account is to be taken of any change in the partnership in determining, for the purposes of the VAT Act, whether goods or services are supplied to, or by, such persons.[831] According to HMRC, the purpose of section 45(1) is to ensure continuity by providing that changes in the composition of a partnership do not create the need for a partnership to deregister and re-register for VAT every time the partners change. It contends that, "it makes unnecessary to take account of any changes in the composition of the partnership when determining what supplies have been made or received by the partnership business." I understand HMRC to argue that where section 45(1) is applicable, supplies by the partnership resulting from changes in the composition of the partnership are not recognised for VAT purposes. HMRC further holds the view that section 45(1) has no effect on any supply that one of the partners may be making as a taxable person in his own right.[832]

[829] GSTR 2003/13 para 150. The ATO argues that the view that there can be continuity of a partnership for GST purposes, means that the partnership is dissolved only as far as a retiring or deceased partner is concerned. Moreover, the reconstituted partnership continues as far as the continuing partners are concerned. See GSTR 2003/13 para 167.
[830] Taxpayers Australia Inc *Taxpayers Guide* para 24.323.
[831] Hemmingsley & Rudling *Tolley's Value Added Tax* para 50.2.
[832] HMRC Business Brief 30/04 "VAT and Partnership 'Shares'" available at https://www.wired-gov.net/wg/wg-news-1.nsf/54e6de9e0c383719802572b9005141ed/5b231f3c7401364e802572ab004ba603?OpenDocument (date of use: 23 August 2018).

4.8 The supply of a partner's share

4.8.1 The identities of the supplier and the recipient of a partner's share

The NZIR is of the opinion that the transfer of partnership interests is made by the partners because the partnership is not a legal entity separate from the partners which could itself supply partnership interests.[833] The NZIR's view, that the partnership interests are supplied by the partners, is in my opinion correct. Its reason for holding that view is incorrect. I argue that the reason why the partnership does not supply partnership interests is not because it is not a legal entity separate from the partners. The partnership is indeed, for South African VAT and New Zealand GST purposes, deemed to be a person separate from its members, and on that basis it is capable of making supplies, including supplies to its own members.[834] As stated above,[835] whatever is supplied or acquired by the body of persons making up the partnership, within the course and scope of its common purpose, is supplied or acquired by the partnership as a separate person for VAT purposes. I argue that the partnership cannot supply the partners' shares simply because such shares are not jointly owned by all the partners, and therefore, for VAT purposes, owned by the partnership. It does not have the same status as, for example, jointly-owned partnership property that is owned in common by all the partners. Partnership interests are owned by the partners,[836] and it is for that reason that they can only be supplied by the partners.[837]

The ATO argues that a sale of an interest in a partnership by a continuing partner to an incoming partner, or by an outgoing partner to either a continuing or an incoming partner, is a partner-to-partner transaction because it does not involve the creation or supply of any new interest by the partnership.[838]

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[833] NZIR "Questions We've Been Asked QB 16/04, Goods And Services Tax – GST Treatment Of Partnership Capital Contributions" available at http://www.ird.govt.nz/resources/3/7/3716fa51-a2ec-42ac-b692-083ecb04679c/ QB1604.pdf 3 para 17 (date of use: 8 December 2016).

[834] See paras 2.2.2, 2.2.3 and 2.3 above.

[835] See para 2.3 above.

[836] Williams states, for example, that when we speak of a partner's 'share in the partnership' we mean two things: First, we mean *his* proportionate interest in the partnership property, while the partnership is a going concern. Second, we mean *his* proportionate share in the partnership property after it has been realised and all the partnership creditors have been paid. See Williams *Concise Corporate and Partnership Law* 31. See also Ramdhin et al "Partnership" para 289; Benade et al *Ondernemingsreg* paras 4.14 and 4.21: and Bamford *Law of Partnership* 29, 37.

[837] I argue (para 2.8 above) that for the purposes of the VAT Act, the partners' shares are not supplied by the partnership to the partners when the partnership is formed.

[838] GSTR 2003/13 para 174. Commenting on Australia's GST, Batistich et al state that in circumstances involving the retirement of a partner, it would appear that the individual partner is the entity making the supply. See Batistich M, Stuk J & Stuk J "GST and the Sale of a Partnership Interest" available at http://www.tved.net.au/index.cfm?SimpleDisplay=PaperDisplay.cfm&PaperDisplay=http://www.tved.net.au/PublicPapers/July_2000,_Lawyers_Education_Channel,_GST_and_the_Sale_of_a_Partnership_Interest.html (date of use: 31 December 2018).

In Canada and the UK, the consensus is that, for GST purposes, a partner disposes of his share in the partnership.[839]

The NZIR also submits that the supply of a partnership interest in return for a capital contribution is, for GST purposes, not deemed to be made by the partnership because the supply of the partnership interest is not made in the course of the partnership's taxable activity.[840] Again, the conclusion is correct, but the reasoning is flawed. It is correct that the supply of the partnership interest is not made in the course or furtherance of the partnership's enterprise in that the partnership interest is not used or applied in the partnership's enterprise. This is, however, not the reason why the partner, as opposed to the partnership, is the supplier of the partnership interest. Only the partner can supply the ownership of the partnership interest because only he owns it. Reference is made above[841] to the New Zealand case of *Case S83*[842] where the court stated that a person or partnership cannot supply what that person or partnership does not own.[843]

As regards the recipient of the supply of a partnership interest, the NZIR submits that any supply of a partnership interest will necessarily be a supply made by a partner to another partner (either existing or new).[844] I am in agreement with this view as partnership interests are owned by partners.

4.8.2 The partnership property and the right to profit

When a partner disposes of his partner's share, he disposes of both his undivided interest in the jointly-owned partnership property, and his right to profit.[845] I argue[846] that for VAT purposes, the jointly-owned partnership property, including property contributed *quoad dominium* and partnership profits, is owned by the partnership. Considering once more the common-law and VAT dichotomy, whilst in terms of the common law a partner disposes of his undivided interest in the jointly-owned partnership property when supplying his partner's share, this is not true for VAT purposes. Only the partnership, which is the deemed owner, is capable of supplying ownership of partnership property. When a partner disposes of

[839] Hemmingsley & Rudling *Tolley's Value Added Tax* para 50.8; HMRC Business Brief 30/04 "VAT and Partnership 'Shares'" available at https://www.wired-gov.net/wg/wg-news-1.nsf/54e6de9e0c383719802572b9005141ed/5b231f3c7401364e802572ab004ba603?OpenDocument (date of use: 23 August 2018); Arsenault & Kreklewetz "Partnerships" 34; Chabot et al *EY's Complete Guide to GST/HST* para 10,010.
[840] NZIR 1 para 6 available at http://www.ird.govt.nz/resources/3/7/3716fa51-a2ec-42ac-b692-083ecb04679c/ QB1604.pdf (date of use: 8 December 2016).
[841] See para 3.3.1 above.
[842] (1996) 17 NZTC 7,515.
[843] See also *Case S84* (1996) 17 NZTC 7,526 and *Commissioner of Inland Revenue v Dormer and Anor* (1997) 18 NZTC 13,446 at para 3.3.1.
[844] NZIR 3 para 17available at http://www.ird.govt.nz/resources/3/7/3716fa51-a2ec-42ac-b692-083ecb04679c/ QB1604.pdf (date of use: 8 December 2016).
[845] See para 4.4 above.
[846] See para 2.7 above.

all or a portion of his partner's share, therefore, the component of the supply made up by his interest in the jointly-owned partnership property, should not be recognised as a supply for VAT purposes.

Whilst the property contributed *quoad dominium* is deemed to be owned by the partnership, the property contributed *quoad usum* can, on dissolution of the partnership, immediately be reclaimed in whole by the contributing partner. It is not subject to sale and division between the partners.[847] If the goods were deemed to have been supplied to the partnership in terms of section 18(4), then the partnership could be liable for VAT on the supply of the goods to the partner.[848]

Instead of disposing of the ownership of property contributed *quoad dominium* to the remaining partners on dissolution, the new partnership could be given the use thereof. In *Monhaupt v Minister of Finance,*[849] the partnership was dissolved by operation of law on the outbreak of war. The court held that if, on the dissolution of a partnership, the business is continued without any realisation and distribution by one or more of the partners as trustees for the others, they are liable to account to the outgoing partners for that portion of the profits fairly attributable to the use of the capital they contributed.[850] I argue that if a new partnership is formed by the continuing partners, the partnership property of the dissolved partnership is transferred to the new partnership. The former partners are, however, the rightful owners of their capital that is used by the new partnership. If the former partners are vendors, then they could incur a VAT liability in relation to the supply of such use to the new partnership. As the former partners are not partners in the new partnership, they would not receive a share in the profits of the new partnership by virtue of owning any partners' shares. Such share in the profits would in fact be payments made for the use of their capital and, therefore, constitute consideration for a supply.[851]

Unlike the partnership property jointly owned by the partners, in my view a partner enjoys an 'individual entitlement' to his share in the partnership profits.[852] In other words, his right is separate from the other partners who have the same right, and is also distinct from the partnership property. A partner's right to profit is not deemed to be owned by the partnership as is the case with jointly-owned partnership property. As a result, the partner, rather than the partnership, can supply ownership of the right to profit.

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[847] Ramdhin et al "Partnership" para 315; Williams *Concise Corporate and Partnership Law* 26, 27. According to Beinart, the partner who has contributed the use of property, in effect takes such property back before any division takes place. See Beinart 1961 *Acta Juridica* 146.

[848] See para 3.3.1 above.

[849] (1918) 39 NPD 47.

[850] Ibid at 51, 52.

[851] If the capital constitutes an amount of money, and the amounts paid to the former partners are consideration for the use of such money, the supply of such use could be exempt under s 12(*a*), read with s 2(1)(*f*).

[852] See Williams *Concise Corporate and Partnership Law* 31; Ramdhin et al "Partnership" para 289; Benade et al *Ondernemingsreg* para 4.14; and Bamford *Law of Partnership* 37.

Arsenault and Kreklewetz's argument that for GST purposes the transfer of a partner's share is no different from the transfer of any other equity interest,[853] is, in my view, also applicable to the VAT Act. The legal status of companies is dealt with in section 19 of the Companies Act.[854] From the date and time of its incorporation, a company is a juristic person and it has all the legal powers and capacity of an individual.[855] As a company is a separate entity distinct from its shareholders or members, the property vested in the company cannot be regarded as vested in all or any of its shareholders.[856] Instead, the shareholders own shares in the company. A share in a company consists of a bundle or conglomerate of personal rights which entitle the holder to a certain interest in the company, its assets, and its dividends.[857] Before company property can be owned by a shareholder, it must be transferred to the shareholder – eg, by means of a cash dividend.[858] The VAT Act, moreover, defines 'equity security' to mean, amongst others, "any interest in or right to share in the capital of a juristic person".[859]

Based on the above, I argue that in the case of a company, the company's property may well belong to the company, but a shareholder is still regarded as owning an interest in that property by virtue of his share(s). Similarly, for VAT purposes the partnership property is deemed to belong to the partnership, but a partner owns an interest in that property in the form of, amongst others, a right to profit.

Because the partnership property is deemed to belong to the partnership, and a partner would only be disposing of his right to profit and not his undivided interest in the jointly owned partnership property, the nature of the assets cannot influence the VAT rate to be applied to the supply of a partner's share. The supply of a partner's share cannot be zero rated, for example, based on a disposal of a partner's undivided interest in jointly-owned gold coins as envisaged in section 11(1)(*k*). Moreover, a partner's supply of his right to profit is a supply of a 'service', which includes anything done or to be done, and the surrender of a right.

In both the *Rane Investment Trust* and *Chipkin* cases there was a change in the membership of the partnership. The court's reference in *Whiteaway's Estate v CIR*[860] to changes in partners' shares without there being changes in membership, implies that it is possible for a partner to sell a portion of his interest in the jointly-held partnership property, and a portion of his right to profit, to a co-partner. My view is that the above arguments also apply to such an intra-partnership change. I argue that the

[853] Arsenault & Kreklewetz "Partnerships" 35.
[854] Act 71 of 2008 (the Companies Act).
[855] Section 19(1)(a) and (b) of the Companies Act.
[856] *Dadoo Ltd v Krugersdorp Municipal Council* 1920 AD 530at 550, 551; Delport et al *Henochsberg* 84.
[857] *Standard Bank of South Africa Ltd v Ocean Commodities Inc* [1983] 1 All SA 145 at 151; Delport et al ibid at 158.
[858] See s 46 of the Companies Act; Delport et al *Henochsberg* 198.
[859] Section 2(2)(iv).
[860] 1938 TPD 482.

partner selling a portion of his partner's share would, legally, be supplying a portion of his joint ownership interest in the partnership property to the purchasing partner. For VAT purposes, however, and based on the above arguments, the partner does not make a supply of the partnership property, the ownership of which remains with the partnership. Furthermore, the partner's supply of a portion of his right to profit, would be recognised for VAT purposes.

In *Sacks v Commissioner for Inland Revenue,*[861] the remaining partners paid the retiring partner separate amounts for his share of the partnership profits, and for his interest in the jointly-owned partnership property.[862] It is envisaged that a single consideration could be paid for a partner's share. Section 10(22) provides that where a taxable supply is not the only matter to which a consideration relates, the supply shall be deemed to be for such part of the consideration as can properly be attributed to it. Whether the supply of a partner's share is taxable – albeit that only the partner's right to profit can be supplied by the partner – is considered below.[863] If the supply of the right to profit is taxable in the circumstances, then the single consideration paid could be apportioned between the amount of the consideration that relates to the taxable component of the supply, and that part which is a non-supply for VAT purposes.[864] As a result, only that part of the consideration which relates to the right to profit, would be subject to tax at either the standard or zero rate.

According to Arsenault and Kreklewetz, while Canada's ETA clearly deems a partnership to be a separate person, it is not clear on deeming a partner's interest in the underlying capital of a partnership to be a 'nothing' for GST purposes.[865] They maintain that although this is likely the intended result, it is not as certain as it could be because it appears to rely solely on the partnership's status as a 'person'.[866] They also point out that while Canada's ETA has defined an 'interest in a partnership' as a 'financial instrument',[867] it does not clarify what is meant by an 'interest in a partnership' – an issue which is not self-evident.[868]

In Australia, the supply by a partner of an interest in a partnership is a financial supply.[869] Australia's GST Act provides that a 'financial supply' is input taxed,[870] and that the term 'financial supply' has the

[861] 1946 AD 31.
[862] Ibid at 36.
[863] See para. 4.8.3 above.
[864] See Botes *Juta's Value Added Tax* 10-29; SARS Rulings - 52.
[865] Arsenault & Kreklewetz "Partnerships" 35.
[866] Ibid at 26.
[867] In s 123(1) of Canada's ETA.
[868] Arsenault & Kreklewetz "Partnerships" 35, 36.
[869] GSTR 2003/13 para 174.
[870] Section 40-5(1). If a supply is 'input taxed', no GST is payable on it, but the supplier normally cannot claim input tax credits for the GST payable on its business inputs that relate to that supply. See McCouat *Australian Master GST Guide* [E-book] Location 19.

meaning it is accorded in the regulations.[871] In terms of these regulations,[872] the disposal of an interest in 'the capital of a partnership' is a financial supply.[873] Reference is also made in the regulations to 'interests in a partnership'.[874] As with Canada, the Australian GST Act and regulations do not clarify the meaning of 'the capital of a partnership' and 'interests in a partnership'. It is, therefore, not clear whether these phrases include jointly-owned partnership property.

The ATO acknowledges that a supply of an interest in the partnership by a partner may require the outgoing partner to effect a change in legal title or interest in partnership assets. Furthermore, the acquiring partner acquires the beneficial and legal interests under the supply of the interests in the partnership. The ATO argues that for GST purposes, however, the transfer of the legal interest does not involve a separate supply by the outgoing partner.[875] It reasons that any supply of partnership property would be by the partnership. Therefore, where property remains in the partnership, there is no supply as the supply and acquisition would be by the partnership.[876]

The UK VAT Act and the New Zealand GST Act, do not define the terms 'partner's share', 'interest in a partnership', or comparable terms. However, the NZIR argues that a partnership interest is a chose in action, and therefore, a service. It contends that the supply of a partnership interest is not the supply of a portion of the underlying assets held by the partnership.[877]

Regarding the position in the UK, HMRC argues that a share in the partnership is distinct from the assets contributed by the partner on joining the partnership. It maintains, therefore, that even if the selling price of the share is determined by the value of those assets, they are not the subject of the sale. The supply of the assets would, accordingly, attract its own liability for VAT purposes.[878] HMRC agrees with my argument that a single consideration for a partner's share may have to be split between the portion that relates to the partner's undivided share in the jointly-owned partnership property, and the balance of his interest in the partnership.

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[871] Section 40-5(2).
[872] A New Tax System (Goods and Services Tax) Regulations 1999 Statutory Rules 245, 1999 made under the A New Tax System (Goods and Services Tax) Act, 1999.
[873] Item 10 in the table in regulation 40-5.09.
[874] Part 8 of Schedule 7 to the regulations includes 'interests in a partnership' as an example for item 10.
[875] GSTR 2003/13 para 182.
[876] Ibid para 183.
[877] NZIR 3 para 17 available at http://www.ird.govt.nz/resources/7/2/72537cec-da81-407d-ad4f-e490c9f2213d/qb1403.pdf (date of use: 8 December 2016).
[878] HMRC Business Brief 30/04 "VAT and Partnership 'Shares'" available at https://www.wired-gov.net/wg/wg-news-1.nsf/54e6de9e0c383719802572b9005141ed/5b231f3c7401364e802572ab004ba603?OpenDocument (date of use: 23 August 2018). See also Hemmingsley & Rudling *Tolley's Value Added Tax* para 50.8.

4.8.3 Whether the supply of a partner's share is subject to VAT

The supply of a partner's share is subject to VAT if the requirements of section 7(1)(*a*), read with the definition of 'enterprise', are met. Importantly,

a. the partner must be a vendor;
b. the partner must make the supply of the partner's share in the course or furtherance of carrying on an enterprise; and
c. the supply must be for a consideration.

As I argue above,[879] a partner cannot be registered for VAT on the basis of the partnership's enterprise, given the partnership's status as a separate person, and section 51(1)(*a*) which deems the partnership to be carrying on its enterprise separate from its members. A partner could, however, be registered for VAT on the basis of, for example, taxable capital contributions made to the partnership, or an enterprise carried on by the partner independently of the partnership.

For a partner's supply of his partner's share to be subject to VAT, the supply must be made in the course or furtherance of an enterprise he carries on. According to the NZIR, this would be possible but uncommon,[880] as the supply will not be made by a partner who is a vendor or, if the partner is a vendor, will not be a supply made in the course or furtherance of a taxable activity carried on by him.[881] I stated that the mere holding of a partner's share does not constitute an enterprise activity.[882] Its subsequent sale would, therefore, not attract VAT.

There are situations, however, where the supply of a partner's share could be part of a separate enterprise carried on by the partner, and consequently, be subject to VAT. An exceptional case mentioned previously,[883] is where a partner conducts an enterprise of buying and selling partners' shares.[884]

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[879] See paras 2.3 and 2.4 above.
[880] NZIR 8 para 17 available at http://www.ird.govt.nz/resources/3/7/3716fa51-a2ec-42ac-b692-083ecb04679c/QB1604.pdf (date of use: 8 December 2016)
[881] Ibid at 1.
[882] See para 2.6.3.
[883] Ibid.
[884] The NZIR 3 is in agreement with this view. See NZIR available at http://www.ird.govt.nz/resources/7/2/ 72537cec-da81-407d-ad4f-e490c9f2213d/qb1403.pdf (date of use: 8 December 2016). Batistich M, Stuk J & Stuk J "GST and the Sale of a Partnership Interest" available at http://www.tved.net.au/index.cfm?SimpleDisplay=PaperDisplay.cfm&PaperDisplay=http://www.tved.net.au/PublicPapers/July_2000,_Lawyers_Education_Channel,_GST_and_the_Sale_of_a_Partnership_Interest.html (date of use: 31 December 2018). I argue on the contrary, that any supply made by the individual partner is not made in the course or furtherance of an enterprise, even if the partner often swaps between partnerships. I disagree, because one can conceive of a partner swapping so often between partnerships that his acquisition and sale of partners' shares and the

Although the ECJ has not considered the disposal of shares in a partnership, it has considered transactions involving shares in companies.[885] The point was made earlier[886] that both 'economic activities' in the Sixth Directive, and 'enterprise' in the VAT Act, envisage on-going activities. In the *EDM* case,[887] one of the points at issue before the ECJ was whether a holding company's sale of shares and other negotiable securities, constitutes 'economic activities' within the meaning of article 4(2) of the Sixth Directive.[888] The court held that transactions relating to securities that would constitute economic activities are those from which revenue is earned on a continuous basis. Such transactions go beyond the simple acquisition and sale of securities, such as transactions carried out in the course of a business trading in securities.[889] The court held further that an undertaking which performs activities consisting of the simple sale of shares and other negotiable securities, is to be regarded as confining itself to managing an investment portfolio in the same way as a private investor.[890] HMRC considers that the principles applicable to transactions involving shares in companies, also apply to transactions involving partnership shares, even though the ECJ, as stated above, has not considered the disposal of shares in a partnership.[891]

Reference was made to the *De Beers* case[892] where the court held that unless one conducts business as an investment company, the investments one holds cannot be regarded on their own as constituting an enterprise.[893] Therefore, both the ECJ and the court in *De Beers*, regarded the 'business' of trading or dealing in shares as an economic or enterprise activity, respectively.

In *CIR v Nussbaum,*[894] the issue was whether the proceeds of the taxpayer's sales of shares should be included in his gross income, and so be subject to income tax, on the basis that he was engaged in a scheme of profit-making employing shares as stock-in-trade. Although this is an income tax case, in my view it nonetheless sheds light on the type of share-dealing activity which a court is likely to regard as an enterprise activity for purposes of the VAT Act. The court stated that the broad question to be answered was whether the relevant sales effected by the respondent, being an individual, amounted to

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accompanying activities, are sufficiently continuous or regular to constitute a 'taxable activity' as defined in s 6(1)(a) of the New Zealand GST Act.

[885] Hemmingsley & Rudling *Tolley's Value Added Tax* para 50.8.

[886] See paras 2.6.3 and 2.8 above.

[887] Case C-77/01 29 April 2004.

[888] Ibid at para 29.

[889] Ibid at para 59.

[890] Ibid at para 60.

[891] Hemmingsley & Rudling *Tolley's Value Added Tax* para 50.8; HMRC Business Brief 30/04 "VAT and Partnership 'Shares'" available at https://www.wired-gov.net/wg/wg-news-1.nsf/54e6de9e0c383719802572b9005141ed/5b231f3c7401364e802572ab004ba603?OpenDocument (date of use: 23 August 2018).

[892] See para 2.6.3 above.

[893] The *De Beers* case at para 34.

[894] 1996 (4) SA 1156 (A), 58 SATC 283.

the realisation of capital assets or the disposal of trading stock in the course of carrying on a business.[895] The court held that continuity is a necessary element in the carrying on of a business in the case of an individual.[896]

The court's enquiry was specifically directed to whether the respondent, contemporaneously with his main investment purpose, had a secondary profit-making purpose.[897] The following factors, in my view, provided evidence of the continuity of the taxpayer's share-dealing activity:

a. the considerable number and frequency of the taxpayer's sale of shares held for only five years or less;
b. the close watch which the taxpayer kept on his portfolio and on every shareholding within it;[898] and
c. the reasons why the taxpayer sold so many shares held for only comparatively few years. Not only was profit inherent in the sale of shares whose dividend yield had dropped, but the taxpayer manifestly worked for it.[899]

The court held that an investor buys shares 'for keeps' and, generally, adds to his portfolio using surplus existing income.[900]

Based on the above, I argue that a frequent purchase and sale of partner's shares may well be indicative of an enterprise which is dealing in such shares.[901] It should be noted that the definition of 'enterprise' requires that the activity, in the course or furtherance of which the supply is made, instead of the supply itself, be carried on continuously or regularly.[902] A partner would, therefore, be carrying on an enterprise should he continuously or regularly perform an activity in the course or furtherance of which partners'

[895] Ibid at 1162.
[896] Ibid at 1164. This is not so in the case of a company, the court explained, whose declared objects and its manifestly being in business to make profit, will generally make it easier to infer a secondary profit-making purpose than would be in the case of an individual.
[897] Ibid at 1162.
[898] Ibid at 1165.
[899] Ibid.
[900] Ibid at 1166.
[901] Although VAT and income tax are vastly different, the reasoning applied in *Nussbaum* may equally apply for VAT purposes. In *Nussbaum* the court listed the factors that illustrated the "continuity" of the sale of the shares, whereas "enterprise" is a continuous or regular activity (see "enterprise" as defined in s 1 of the VAT Act).
[902] See Botes *Juta's Value Added Tax* 1 enterprise 5. See also De Koker & Kruger *Value-Added Tax* para 3.6. According to the NZIR, a subdivision of land into two allotments, involving no development work, will not in itself amount to a taxable activity. The NZIR argues, though, that the greater the number of allotments created and sold, the more extensive the development work, the more time and effort involved, and the higher the financial commitment to the project, the more likely that the activity is carried on continuously. Therefore, it is more likely that there is a taxable activity. See NZIR Tax Information Bulletin Vol 7 No 3 (September 1995) 9 available at https://www.ird.govt.nz/resources/7/5/7548757f5-4e9a-b3e5-27074f8b2493/tib-vol07-no03.pdf (date of use: 21 March 2018).

shares are supplied for a consideration. The partners' purchase and sale of partner's shares would form part of this enterprise, and the supply of those shares would potentially be subject to VAT. The factors listed above could be indicative of the partner's status as either a dealer in partners' shares, or as a 'passive' investor.

The fact that a partner is a vendor does not necessarily mean that the supply of his partner's share is taxable in that the supply of the share may be unrelated to that enterprise. The definition of 'enterprise' specifies the nature of the *nexus* required between the taxable activity and the supply, for the supply to be taxable: the supply must either be 'in the course', or in the 'furtherance' of the taxable activity.

In the ECJ case of *Régie Dauphinoise*,[903] an issue was whether certain treasury placements fell within the scope of VAT in terms of the Sixth Directive.[904] The facts were that the taxable person (Régie) was involved principally in the management of property. It received advances from the co-owners and lessees for whom it managed the properties. With the agreement of its clients, it invested those sums for its own account with financial institutions. Régie became the owner of the sums advanced with effect from their payment into its account. It remained under an obligation to repay, but was entitled to retain the interest on the investments.

The court held that the receipt by a manager of interest resulting from the investment of monies received from clients in the course of managing their properties, constitutes the direct, permanent, and necessary extension of the taxable activity, with the result that the manager is acting as a taxable person in making such an investment.[905]

In New Zealand *Case K55*,[906] the objector purchased a car, which he traded in on the purchase of a new car. The old car was used for both business and private purposes. The question was whether the objector should have to pay GST on the sale of his old car. This depended on whether the supply was in the course of a taxable activity carried on by the objector.[907] The TRA decided this case on an application of section 8(1), read with section 6(1)(a), of the New Zealand GST Act.[908]

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[903] *Régie Dauphinoise – Cabinet A Forest SARL and Ministre du Budget* Case C-306/94 11 July 1996 (hereafter *Régie Dauphinois*).

[904] The scope of VAT is defined in art 2 of the Sixth Directive, which provides that only activities of an economic nature are subject to tax (*Régie Dauphinois* para 15). The concept of 'economic activities' is defined in art 4(2) of the Sixth Directive. See para 2.6.3 above.

[905] *Régie Dauphinois* para 18.

[906](1988) 10 NZTC 453. See para 2.6.1 above.

[907] I stated above (para 2.6.1) that in this case the TRA held that if capital assets are used to carrying on a taxable activity, the sale of those assets can readily be in the course or furtherance of that activity. See *Case K55* at 4.

[908] Section 8(1) provides that GST is charged on the supply of goods and services by a registered person 'in the course or furtherance of a taxable activity' carried on by that person. 'Taxable activity' is defined in s 6(1)(a) as any activity which is

The TRA reasoned that for a supply to be in the course or furtherance of a taxable activity, some discernible *nexus*[909] or relationship should be apparent between that activity and the supply. It is, moreover, a question of fact and degree whether there is such a relationship. In the present case, the TRA held, there was clearly a *nexus* between the objector's farming activities and the sale of his car, the principal use of which was for those activities. The objector was, therefore, liable to pay output tax on the sale of the car.[910]

In *CIR v Dormer and Anor,*[911] the New Zealand High Court held that the phrase "in the course or furtherance of a taxable activity" in section 8(1) is to be given a sufficiently wide meaning to include supplies made in connection with that activity.[912]

In a New Zealand case, *Case M129*[913] the question for determination by the TRA was whether payments received by the objector pursuant to the Department of Labour's Job Opportunities Scheme (JOS) constituted consideration for a taxable supply in the form of the provision by the objector of employment under the JOS. The TRA held that there was no taxable supply between the objector and the Department of Labour because the department was not involved in the employment in any way. The TRA considered, however, that the engagement of the employee must have been effected in the course or furtherance of a taxable activity. The objector's taxable activity was that of a drapery retailer and it engaged the employee to assist in that business. That engagement, the TRA held, was "a normal incident of running such a business."[914]

In another New Zealand case, *Case N43*,[915] the TRA held that an act performed for the purpose or object of furthering the taxable activity, or achieving its goal, can be to help, achieve, or advance, and is thus the 'furtherance' of a taxable activity.[916] The TRA found that the purchase, subdivision of the building, and the placement of the dwellings on the land by the objector, were in the furtherance of a taxable activity, namely, the subdivision and sale of the lots of a farm as part of the broader taxable activity of the sale of land. The TRA held that the whole purpose of erecting the dwellings on the two lots was to achieve the desired result of the sale of the land. It agreed that the Commissioner's amended

carried on continuously or regularly by a person, and involves the supply of goods and services to another person for a consideration.

[909] A '*nexus*' is a link or connection.

[910] *Case K55* at 5.

[911] *CIR v Dormer and Anor* (1997) 18 NZTC 13,446.

[912] Ibid at 11.

[913] (1990) 12 NZTC 2,839.

[914] Ibid at 7.

[915] (1991) 13 NZTC 3,361.

[916] Ibid at 6.

assessments were correct when the value of the dwellings was included as part of the land sold and, therefore, part of the taxable supplies made by the objector.[917]

In my view, the definitions of 'taxable supply' in Canada's ETA, and 'enterprise' in the VAT Act, are not sufficiently comparable. Canada's ETA defines a 'taxable supply' as "a supply made in the course of a commercial activity."[918]

The definition of a 'taxable supply' in the Australian GST Act is similar to that of an 'enterprise'. In terms of the Australian GST Act,[919] a taxable supply is made if "the supply is made in the course or furtherance of an enterprise" that the supplier is carrying on. In support of its argument that a partnership's supply of an interest in the partnership, upon its formation, is made in the course or furtherance of the partnership's enterprise, the ATO referred to the above reasoning in *Case N43*[920] with approval.[921]

In my view, the New Zealand case law, as opposed to that of the ECJ, should serve as guidance on the link required between a supply and a taxable activity for that supply to be taxable. The definition of 'taxable activity', and section 8(1) of the New Zealand GST Act, are similarly worded to the definition of 'enterprise'[922] and section 7(1)(*a*) of the VAT Act, both provisions incorporating the concept "in the course or furtherance of". Moreover, the *Régie Dauphinoise* case set the requirement of a "direct, permanent and necessary extension of the taxable activity" for an activity to be part of a taxable activity. There is no such requirement in the definition of 'enterprise', or any justification for reading it in. The ECJ's test is demonstrably more specific and restrictive than the New Zealand test, and it is merely an example of a connection between the activity and the supply.

According to HMRC, which is clearly applying the reasoning in *Régie Dauphinoise*, a partner's share would be acquired and disposed of as a direct extension of the partner's economic activities, if that share was acquired in the course or furtherance of his own economic activities. If so, it reasons, the

[917] Ibid at 7. See also McKenzie *GST: A Practical Guide* [E-book] Location 9.
[918] In s 123(1). In Canada no GST will apply to the purchase of a new or additional interest in a partnership or to a person transferring his partnership interest to another entity as the supply of a partnership interest is an exempt financial service. See Chabot et al *EY's Complete Guide to GST/HST* para 10,010; Arsenault & Kreklewetz "Partnerships*"* 35. In my view, that a supply of a partnership interest could be subject to GST in appropriate circumstances, had it not been specifically been exempted.
[919] In s 9-5(b).
[920] That is, that an act done for the purpose or object of furthering the taxable activity, or achieving its goal, can be to help, achieve, or advance, and thus a 'furtherance' of a taxable activity.
[921] GSTR 2003/13 para 59. The reasoning in *Case N43* is replicated in the Australian EM to a New Tax System (Goods and Services Tax) Bill, 1999, para 3.10, where it is stated that, "[a]n act done for the purpose or object of furthering an enterprise, or achieving its goals, is a furtherance of an enterprise although it may not always be in the course of that enterprise." Note that in terms of the Australian GST Act the provision, acquisition, or disposal of a partnership interest is input taxed. See para 6.4 below.
[922] See the definition of 'enterprise' in s 1(1).

subsequent transfer of that share for a consideration will also be an economic activity. An example given by the HMRC, is of a partner who has a business asset for sale and, rather than selling it directly, contributes the asset to a partnership and thereafter sells the resulting partnership share.[923] Applying the New Zealand case law to this example, there is in my view clearly a *nexus* between the initial application of the asset in the partner's separate enterprise, and the activities that followed, namely the contribution of the asset to the partnership and the sale of the partner's share. Those subsequent activities were undertaken with the object of furthering the taxable activity in that they were aimed at helping, achieving, or advancing the taxable activity.

The New Zealand case law can also be applied to the facts in the *Régie Dauphinoise* case. There is, undoubtedly, a *nexus* between the property management and investment activities, as the lessees' advances – as the common denominator in the two activities – were used to make the investments. Furthermore, I argue that if it is 'normal', meaning usual or typical in this type of business, for a property manager to invest lessees' advances for own account, then such investment activity is in the course or furtherance of the property manager's enterprise.[924]

Another example of a partner holding his partner's share providing a *nexus* with a separate enterprise carried on by that partner, is where he enters into what is known as a 'sell-with' partnership. The partners carry on their separate enterprises, selling some of their products separately, but they also collaborate with their partners to market and sell certain of their products together in an effort to extend their market reach.[925]

As I have argued above,[926] holding a partner's share constitutes an enterprise activity where the partner makes taxable contributions to the partnership. The subsequent sale of such a share could be subject to VAT. In my view, where a partner makes taxable supplies to the partnership as a third-party supplier, as opposed to making taxable contributions, the holding of the partner's share will not be part of the partner's enterprise. The fact that the partner owns a partner's share is irrelevant to his acting as a third-party supplier. A person's status as a partner and his ownership of a partner's share, are not required for the rendering of the third-party supplies as he acts independently of the partnership. A partner's obligation to make a contribution, however, and the payment of any consideration therefor, are regulated by the partnership agreement. It is, therefore, because of the partner's status as a partner

[923] HMRC Business Brief 30/04 "VAT and Partnership 'Shares'" available at https://www.wired-gov.net/wg/wg-news-1.nsf/54e6de9e0c383719802572b9005141ed/5b231f3c7401364e802572ab004ba603?OpenDocument (date of use: 23 August 2018). See also Hemmingsley & Rudling *Tolley's Value Added Tax* para 50.8.
[924] See *Case M129* (1990) 12 NZTC 2,839.
[925] IT Services Marketing Association "Making Partnerships Work: How to 'Sell-With,' Not 'Sell-Through'" available at https://www.itsma.com/making-partnerships-work/ (date of use: 3 March 2018).
[926] See para 2.6.3 above.

that the contributions are made. The NZIR supports this view. It gives as an example, a partner who, acting as a third-party supplier, makes taxable supplies by renting commercial premises to his partnership. The NZIR submits that, that partner's sale of his share to one of the partners would not be taxable because he does not make the supply of the partner's share in the course or furtherance of his taxable rental activity.[927]

The supply of a mere partner's share will not qualify for zero rating under section 11(1)(*e*). A partner's share is not on its own capable of constituting an enterprise, or part of an enterprise which is capable of separate operation.[928] However, where the holding of the partner's share is part of an enterprise (eg, an enterprise of making taxable contributions to the partnership), then the supply of that enterprise, including the partner's share, could be zero rated. All the assets necessary for carrying on such enterprise (or part of it) must be supplied by the partner to the recipient.[929] Furthermore, the supply of a partner's share, although it does not on its own constitute the supply of an enterprise, has the effect that the partnership's enterprise is transferred from the dissolved to the new partnership.[930]

4.9 The supply of the partnership's enterprise as a going concern

The dissolved and the new partnership will not be deemed to be one and the same partnership if section 51(2) does not apply. In my view, the ATO's argument that a dissolved partnership can make a supply to the new partnership comprising some of the same partners as the dissolved partnership making the supply,[931] is also true for the VAT Act. The fact that the two partnerships are persons and, therefore, different entities for VAT purposes, makes it irrelevant that they share some of the same partners.[932]

As the partnership property, including the partnership's business, is, in terms of the common law, transferred by process of law from the dissolved to the new partnership,[933] it is possible for the key requirements in section 11(1)(*e*) to be met, namely, that the supply must be of an enterprise, or of a part of an enterprise, which is capable of separate operation, and is disposed of as a going concern.

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[927] NZIR "Questions We've Been Asked QB 14/03, – GST – Transfer Of Interest In A Partnership" para 36 available at http://www.ird.govt.nz/resources/7/2/72537cec-da81-407d-ad4f-e490c9f2213d/qb1403.pdf (date of use: 8 December 2016).
[928] See Cross *New Zealand Master Tax Guide* 974 para 23-110.
[929] See proviso (i)(*bb*) to s 11(1)(*e*).
[930] GSTR 2003/13 para 124.
[931] GSTR 2003/13 para 123.
[932] See the discussion on *Nelson v Commissioner of Inland Revenue* in para 2.3 above.
[933] See para 4.3 above.

Section 7(1)(*a*) levies VAT on the supply of goods or services by a 'vendor'. As a result, only a 'vendor' can make a supply which is zero rated under section 11(1)(*e*).[934] The dissolved partnership must, therefore, be a 'vendor' to qualify for zero rating. Section 11(1)(*e*) also requires that the supply be made to a 'registered vendor'. In terms of section 24(3), the old partnership would only be required to notify the Commissioner that it has ceased to carry on all enterprises, within 21 days of the date of such cessation; whilst the Commissioner must cancel the registration with effect from the last day of the tax period during which all such enterprises ceased. The old partnership, whilst existing concurrently with the new partnership,[935] and before its liquidation and deregistration for VAT, can, therefore, supply the partnership's enterprise to the new partnership as a vendor.[936] Furthermore, if section 51(2) is not applicable, the new partnership is, as a person separate from the old partnership, entitled to apply to be registered for VAT under its own VAT registration number.

Section 7(1)(*a*) requires that a supply be made in the course or furtherance of an 'enterprise'. The definition of 'enterprise',[937] in turn, requires that the supply be made for a consideration. In my opinion, although for VAT purposes the dissolved partnership supplies the partnership property, including the partnership's enterprise, to the new partnership, the new partnership does not pay the dissolved partnership a consideration for the supply. Instead, the remaining partners pay the retiring partner (or the decedent's estate) for his interest in the jointly-owned partnership property. For a payment to constitute 'consideration', however, it need not be made by the recipient of the supply, but can equally be made by a third party, provided the payment is "in respect of, in response to, or for the inducement of" the supply.[938] The payment made to the departing partner is, however, not for the 'entire' partnership enterprise, but only for his undivided interest in the enterprise. There is no payment made by anyone which is intended to be a payment in exchange for the supply of the enterprise. This makes sense because the dissolved partnership does not 'sell' the enterprise to the new partnership. The enterprise is, instead, transferred by process of law to the new partnership. The enterprise is, therefore, supplied for no consideration and the value of the supply is deemed, by section 10(23), to be nil.

As the value of the supply of the enterprise is deemed to be nil, a question arising is whether the requirement in proviso (i)(*cc*) to section 11(1)(*e*), that the parties must have agreed in writing "that the consideration agreed upon for that supply is inclusive of tax at the rate of zero per cent", is complied with. I argue that this requirement is met because section 10(23) deems there to be a 'consideration',

[934] See SARS Interpretation Note 57 – 31 March 2010 "Sale of an enterprise or part thereof as a going concern" available at http://www.sars.gov.za/AllDocs/LegalDoclib/Notes/LAPD-IntR-IN-2012-57%20-%20Sale%20Enterprise%20Part%20Going%20Concern.pdf (date of use: 1 December 2019) para 4.2.
[935] See the discussion under para 4.6 above.
[936] Note that a 'vendor' is defined in s 1(1) as a person who is or is required to be registered for VAT.
[937] In s 1(1).
[938] See 'consideration' in s 1(1).

albeit of nil value. Nothing prevents the parties from agreeing that this deemed consideration is inclusive of tax at the rate of zero per cent.

In my view, section 7(1)(*a*), read with the definition of 'enterprise' and section 10(23), envisages the possibility of a supply being a taxable supply, including at zero rate, even though it is made for no consideration.[939] The requirement for a taxable supply in terms of section 7(1)(*a*), is that the supply must be made "in the course or furtherance of any enterprise". There is no requirement in section 7(1)(*a*) that the supply has to be made for a consideration. As long as the supply for no consideration is made in the course or furtherance of an enterprise it would be taxable.[940] That the definition of 'enterprise' requires that supplies be made for a consideration, does not mean that this is also a requirement for section 7(1)(*a*). I argue that the supply of the enterprise by the dissolved partnership to the new partnership is taxable because it is an act performed by the dissolved partnership in connection with the termination of its enterprise. In terms of proviso (i) to the definition of 'enterprise', anything done in connection with the commencement or termination of an enterprise is deemed to be done in the course or furtherance of that enterprise.

The Australian GST Act similarly provides that the supply of a going concern is GST-free if certain requirements are met. These include that: the recipient is registered for GST; the supplier and the recipient have agreed that the supply is of a going concern; and the supplier supplies to the recipient all the things necessary for the continued operation of the enterprise.[941] The ATO contends that if an existing partnership is dissolved, the transfer of the entire enterprise to the new partnership could constitute the supply of a going concern, which may be GST-free in terms of section 38-325(1).[942]

Cross, commenting on the position in New Zealand, submits that in the case of a two-person partnership where one partner buys the other out, the dissolved partnership could sell its taxable activity to the purchasing partner as a going concern.[943] I agree that this is true for VAT purposes, but I argue that in

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[939] See the discussion on the *KCM* case in paras 2.6.6 and 3.6 above.

[940] See Interpretation Note 70 para 5.3.

[941] Section 38-325(1) provides that the supply of a going concern is *GST-free* if

(a) the supply is for consideration; and
(b) the recipient is registered or required to be registered; and
(c) the supplier and the recipient have agreed in writing that the supply is of a going concern.

In terms of s 38-325(1) a *supply of a going concern* is a supply under an arrangement under which:

(a) the supplier supplies to the recipient all of the things that are necessary for the continued operation of an enterprise; and
(b) the supplier carries on, or will carry on, the enterprise until the day of the supply (whether or not as a part of a larger enterprise carried on by the supplier).

[942] GSTR 2003/13 para 124.

[943] Cross *New Zealand Master Tax Guide* 974 para 23-110. In terms of s 11(1)(m) of the New Zealand GST Act GST at the zero per cent can be charged on the supply of a taxable activity as a going concern, subject to meeting certain requirements. See McKenzie *GST: A Practical Guide* [E-book] Locations 18 and 19. In my view, if s 57(2)(e) of the New Zealand GST Act is

terms of the common law, the dissolved partnership does not sell the partnership's enterprise to the purchasing partner. The purchasing partner, instead, purchases the other partner's undivided interest in the partnership property thereby acquiring full ownership interest in the partnership's enterprise. The common law provides for a transfer of the partnership's business from the dissolved partnership to a partner who continues with the business on his own.[944] Before the purchase of the retiring partner's undivided ownership interest, the partnership property is deemed to belong to the dissolved partnership. After the purchase, ownership of the partnership property vests in the purchasing partner. In my view, the ownership of the partnership property is, for VAT purposes, supplied by the dissolved partnership to the purchasing partner by operation of law. The supply of the partnership's enterprise, which is part of the partnership property, can likewise be zero rated if the requirements of section 11(1)(*e*) are met.

Reference was made to section 272.1(7) of Canada's ETA[945] which deems the new partnership to be a continuation of, and the same partnership as the predecessor partnership. Canada's ETA, however, does not have a provision that could zero rate the supply of the partnership enterprise from the predecessor to the new partnership in the event that section 272.1(7) does not apply.

The UK provisions on this point, are not comparable to the VAT Act. In the UK, the sale of the assets of a VAT-registered business are normally subject to VAT at the appropriate rate. Where certain conditions are met, however, the transfer of a business as a going concern must be treated as neither a supply of goods, nor a supply of services, and is, therefore, outside the scope of VAT.[946] HMRC remains of the view that there is no transfer of a business as a going concern through changes in the constitution of a partnership.[947]

4.10 The transfer of liabilities to the new partnership

In terms of section 22(1), where a partnership, which is a vendor:

a. has made a taxable supply for consideration in money;

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not applicable, and the dissolved partnership's taxable activity is continued by a new partnership, the transfer of the taxable activity to the new partnership should qualify for zero rating under s 11(1)(m).

[944] *Essakow v Gundelfinger and Another* 1928 TPD 308 at 315. See para 4.4 above.

[945] See para 4.7 above.

[946] HMRC "Transfer a business as a going concern (VAT Notice 700/9)" para 1.2 available at https://www.gov.uk/guidance/transfer-a-business-as-a-going-concern-and-vat-notice-7009 (date of use: 23 August 2018); Hemmingsley & Rudling *Tolley's Value Added Tax* para 8.9.

[947] HMRC "Transfer a business as a going concern (VAT Notice 700/9)" para. 1.3 available at https://www.gov.uk/guidance/transfer-a-business-as-a-going-concern-and-vat-notice-7009 (date of use: 23 August 2018). The justification for the ATO's view appears to be s 45(1) of the UK VAT Act, which provides that no account is to be taken of any change in the partnership. See para 4.7 above.

b. has furnished a return in respect of the tax period for which the output tax on the supply was payable, and has properly accounted for the output tax on that supply; and

c. has written off so much of the consideration as has become irrecoverable,

the partnership may make a deduction. The deduction is equal to a portion of the amount of tax charged, bearing the same ratio as the amount written off as irrecoverable to the total consideration.

In my view, if section 51(2) is applicable and the dissolved and the new partnership are deemed to be one and the same partnership, then the new partnership would be entitled to the section 22(1) deduction if a transferred debt becomes irrecoverable and the other requirements of this provision have been met. Even though the dissolved partnership is the person who made the taxable supply, the new partnership would be entitled to the deduction because the two entities are deemed to be the same person.

In the event that section 51(2) does not apply – eg, on the basis of a directive granted by the Commissioner – the new partnership would not meet the requirements in section 22(1)(*a*) and (*b*), ie, of having made the relevant taxable supply, submitted the return, and accounted for the output tax on the supply. The new partnership would potentially be entitled to a deduction under section 22(1A), instead. This provision permits a deduction where the dissolved partnership has transferred the account receivable, relating to the taxable supply, at face value to the new partnership on a non-recourse basis, and any amount of that face value has been written off as irrecoverable. The dissolved partnership will in all likelihood transfer debts to the new partnership on a non-recourse basis in view of its imminent termination. As a general principle, debtors cannot object to the transfer of claims which the dissolved partnership has against them to the new partnership.[948]

There are no legislative provisions in Australia, Canada, New Zealand, or the UK, which specifically provide for the VAT/ GST implications of the transfer of liabilities from a predecessor partnership to a successor partnership. In these VAT/GST jurisdictions it is possible for the dissolved partnership's business to be continued by a new or reconstituted partnership under the same VAT/ GST registration number.[949] This should have the effect that the dissolved and the new partnership are considered to be the same entity. Furthermore, all these jurisdictions permit a deduction of the VAT/ GST component of a bad debt written off, subject to meeting certain requirements.[950] In my view, such a new or

[948] *Executors of Paterson v Webster, Steel & Co and Others* (1881) 1 SC 350 at 355; Ramdhin et al "Partnership" para 312.
[949] See para 4.7 above.
[950] See McCouat *Australian Master GST Guide* [E-book] Location 156; ATO Goods and Services Tax Ruling: GSTR 2000/2 "Goods and services tax: Adjustments for bad debts" available at https://www.ato.gov.au/law/view/document?docid=GST/GSTR20002/NAT/ATO/00001 (date of use: 31 December 2018); Chabot et al *EY's Complete Guide to GST/HST* para 8,170; Crowe Soberman LLP "Canada: How Do I Manage The GST/HST On A Bad Debt" available at

reconstituted partnership should be permitted a bad-debt deduction, which the old partnership would otherwise have qualified for had it not dissolved.

In terms of section 22(3), where a partnership which accounts for tax payable on an invoice basis has:

a. made a deduction of input tax in respect of a taxable supply of goods or services made to it; and
b. within a period of twelve months after the expiry of the tax period within which that deduction was made, not paid the full consideration in respect of such supply,

an amount equal to the tax fraction of that portion of the consideration which has not been paid, is deemed to be tax charged in respect of a taxable supply.

The dissolved partnership remains in existence in so far as creditors are concerned, until their claims have been discharged.[951] The dissolved partnership may, however, transfer all the rights and liabilities of the partnership enterprise to the new partnership, and that transfer will be binding between the outgoing and incoming partners. As regards the transfer of liabilities, the creditors are not bound to accept the new partnership in substitution for the members of the old partnership with whom they had contracted.[952]

If section 51(2) applies, the new partnership could incur a tax liability in terms of section 22(3) if the debt is not settled within the twelve months. The dissolved and new partnerships are deemed to be one and the same partnership, and the new partnership would, therefore, be deemed to have made the input tax deduction contemplated in section 22(3), although the relevant supply had been made to the dissolved partnership. Conversely, if section 51(2) does not apply, a potential tax liability would rest with the old partnership as the new partnership had not made the deduction of input tax on the relevant supply as contemplated in section 22(3). In my view, whether or not the creditors accept the substitution,

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http://www.mondaq.com/canada/x/607584/sales+taxes+VAT+GST/How+Do+I +Manage+The+GSTHST+On+A+Bad+Debt (date of use: 24 August 2018); McKenzie *GST: A Practical Guide* [E-book] Locations 97 and 98. See NZIR Public Ruling -BR Pub 05/01 "Bad Debts – Writing off debts as bad for GST and Income Tax purposes" available at https://www.ird.govt.nz/resources/0/1/01b2c8004ba383c0b079bd9ef8e4b077/ pu05001.pdf (date of use: 24 August 2018); Hemmingsley & Rudling *Tolley's Value Added Tax* para 7.1; HMRC "Relief from VAT on bad debts (VAT Notice 700/18)" available at https://www.gov.uk/guidance/relief-from-vat-on-bad-debts-notice-70018 (date of use: 24 August 2018).

[951] *Essakow v Gundelfinger and Another* 1928 TPD 308 at 312; Ramdhin et al "Partnership" para 316. According to Williams, the dissolution of a partnership does not extinguish its debts to third parties, who remain entitled to sue the partnership or the individual partners, and judgment can be given against the partnership even though it has been dissolved. See Williams *Concise Corporate and Partnership Law* 54.

[952] *Executors of Paterson v Webster, Steel & Co and Others* (1881) 1 SC 350 at 355; Ramdhin et al "Partnership" para 312; Williams *Concise Corporate and Partnership Law* 54.

the new partnership's failure to make timeous payment would render the dissolved or the new partnership liable for the section 22(3) tax depending on whether or not section 51(2) applies.

4.11 The deductibility of VAT on costs incurred relating to the transition from the dissolved to the new partnership

The following are typical costs that could be incurred on the dissolution of a partnership because of the transition from the old to the new partnership (the transition expenses):[953]

a. Legal costs related to the transfer of jointly owned partnership property, for example immovable property and incorporeal rights, from the dissolved to the new partnership.
b. Legal costs related to the drafting of a new partnership agreement.[954]
c. Accounting fees related to the adjustment of the partnership's accounting records resulting from the change in the composition of the partnership.[955]

The issue is whether any VAT incurred on such transition costs is deductible by the partnership as input tax. Should the dissolved and the new partnership be deemed to be one partnership in terms of section 51(2), then the costs incurred by the old partnership would also be deemed to have been incurred by the new partnership. The VAT is deductible if the relevant goods or services were acquired by the partnership for the purpose of consumption, use, or supply in the course of making taxable supplies.[956]

In the *De Beers*-case a consortium approached De Beers Consolidated Mines Ltd (DBCM) and proposed a transaction in terms of which a new company would become the holding company of DBCM. In considering the proposal of the consortium, DBCM employed the services of NM Rothschild and Sons Ltd (NMR), a London-based company, as independent financial advisers to advise its board on whether the consortium's offer was fair and reasonable. DBCM also appointed a range of South African service providers to assist in finalising the proposed transaction.

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[953] See, for example, Mack R & Chapman J "Partnership Structural Changes: Deductibility of Expenses" available at https://www.thetaxadviser.com/issues/2009/sep/partnershipstructuralchangesdeductibilityofexpenses. html (date of use: 6 March 2018).
[954] See, eg, the *KapHag*-case where a lawyer invoiced the partnership for providing legal advice and drafting the partnership agreement when a new partner was admitted to the new partnership.
[955] Flynn & Koornhof *Fundamental Accounting* 23-8. The authors also submit at 23-8, that changing the composition of the partnership can result in some complex areas that need to be dealt with.
[956] See 'input tax' as defined in s 1(1).

In an assessment, the Commissioner for the SARS determined that NMR's services were 'imported services' and that VAT was, therefore, payable on such services by DBCM in terms of section 7(1)(*c*).[957] 'Imported services' are defined[958] to mean "a supply of services that is made by a supplier who is resident or carries on business outside the Republic to a recipient who is a resident of the Republic to the extent that such services are utilised or consumed in the Republic otherwise than for the purpose of making taxable supplies". Furthermore, the Commissioner determined that the VAT charged by local service providers did not qualify as input tax. Considering 'the purpose' referred to in the definitions of 'imported services' and 'input tax', the primary question was whether the services of NMR's and the South African service providers' had been acquired for the purpose of making taxable supplies.

The Commissioner contended that NMR's services were unrelated to DBCM's core activities, which were the mining and sale of diamonds. NMR was not providing services directed at making any of DBCM's businesses better or more valuable. It was the interests of DBCM's departing shareholders and investors, rather than the interests of DBCM itself, which formed the focus of NMR's services.[959]

The court held that in the case of a public company there is a clear distinction between:

a. the enterprise with its attendant overhead expenses; and
b. the special duties which are imposed on the company in the interest of its shareholders as individuals in consequence of the fact that a choice has been made to conduct an enterprise in a corporate form.[960]

The court held further, that the duty imposed on a public company is too far removed from the advancement of the VAT enterprise to justify characterising services acquired in the discharge of that duty, services acquired for purposes of making taxable supplies. The court agreed with the submissions on behalf of the Commissioner,[961] and upheld its appeal.[962]

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[957] Section 7(1)(*c*) levies VAT on the supply of imported services by a person at fifteen per cent on the value of the importation. Section 7(2) provides that the tax payable in terms of s 7(1)(*c*) must be paid by the recipient of the imported services.
[958] In s 1(1).
[959] At para 26. It was contended on behalf of DBCM that as it had chosen to conduct its business as a public company, it had certain statutory obligations (para 23). Its board had a duty to report to the shareholders as to whether the consortium's offer was fair and reasonable and to obtain independent financial advice in that regard (para 25). DBCM could not realistically continue to operate its enterprise without complying with its legal obligation to acquire NMR's services (para 24). The services of NMR were, therefore, directly linked to its making of on-going supplies (para 23).
[960] At para 27.
[961] At paras 27, 28.
[962] At para 43.

In *ITC 1744,*[963] the appellant was incorporated to exploit a patent for the manufacture of steel shipping containers suitable for road freight. The appellant required capital to manufacture the containers. It employed the services of A, a company who undertook share placings for the appellant. The question was whether the VAT levied by A on its services was deductible as input tax.

The court applied the ECJ's 'direct and immediate link' test and referred, inter alia, to the case of *BLP Group plc v Commissioner of Customs and Excise*.[964] It held that the appellant was not entitled to deduct the VAT levied on the services supplied by A, because those services were directly and immediately linked to the issue of shares, which is exempt in terms of section 12(*a*), read with section 2(1). The principle is, so the court explained, that where goods or services are used for an exempt supply, it is not legitimate for the taxpayer to look through that supply to an ultimate purpose of making taxable supplies – in this case the manufacture and sale of steel shipping containers.[965]

In the *BLP* case, BLP claimed to deduct the VAT paid on professional services supplied to it in connection with the sale of shares in another company, which was an exempt transaction. BLP sold the shares for the purpose of raising the funds necessary to pay its debts, which derived from the taxable transactions it had effected. The court held, in effect, that the VAT was not deductible because the acquired services were directly and immediately linked to the sale of shares, which was an exempt transaction. It was irrelevant that the ultimate purpose of the transaction was the carrying out of a taxable transaction.[966]

The *BLP*-case was decided on the basis of article 17(2) of the Sixth Directive, which provides that:

> [I]n so far as the goods and services are used for the purposes of his taxable transactions, the taxable person shall be entitled to deduct from the tax which he is liable to pay:
>
> (a) value added tax due or paid in respect of goods or services supplied or to be supplied to him by another taxable person.

Article 2(1) of the Sixth Directive levies VAT on the supply of goods or services effected for consideration by a taxable person acting as such. A taxable person may, therefore, deduct VAT on

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[963] *ITC 1744* 65 SATC 154.

[964] *BLP Group plc and Commissioners of Customs and Excise* Case C-4/94 6 April 1995 (hereafter the *BLP* case).

[965] *ITC 1744* 65 SATC 154 at 157, 158; In *Sub-Nigel Ltd v CIR* 1948(4) SA 580 (A), 15 SATC 381, the question was whether certain expenses were deductible under s 11(*a*) of the IT Act. The court, per Centlivres JA, stated that it is not concerned with deductions which may be considered proper from an accountant's point of view or from the point of view of a prudent trader, but merely with the deductions which are permissible according to the language of the IT Act. (at p 238) Accounting and business principles are, therefore, irrelevant when considering whether an expense is deductible in terms of the IT Act., When determining whether the VAT on an expense is deductible as input tax, this principle applies equally. Whether a transaction entitles the taxpayer to an "input tax" deduction depends on whether the requirements in terms of the Act are met, irrespective of whether the transaction might, from an accounting or business perspective, be considered to have been incurred for business purposes.

[966] *BLP* case para 27.

goods or services, but only in so far as those goods or services are used to make supplies that are subject to VAT in terms of article 2(1). Articles 2(1) and 168 of the Council Directive, which replaced the Sixth Directive, are phrased similarly to articles 2(1) and 17 of the Sixth Directive.[967]

Section 7(1)(*a*) levies VAT on the supply by a vendor of goods or services supplied by him in the course of carrying on an enterprise. The definition of 'input tax',[968] read with section 17(1), permits the deduction of VAT levied on acquired goods or services, but only to the extent that those goods or services are consumed, used, or supplied in the course of making taxable supplies.

The court stated in *ITC 1744*, that despite the difference in wording between article 17 of the Sixth Directive and section 7, it considered the *BLP* case helpful.[969] I agree with van der Zwan and Stiglingh who submit that because there is no significant difference between the requirements, respectively imposed on input tax deductions in South Africa and in the European Union, the decisions of the ECJ can serve as guidance on this particular topic.[970]

There is a contradiction between *ITC 1744* and the ECJ, though, on whether the transfer of shares is an on-going activity as envisaged in 'enterprise' in the VAT Act and 'economic activity' in the Sixth Directive.[971] The court in *ITC 1744* simply accepted, without considering the circumstances, that the issue of shares in that case was exempt in terms of section 12(*a*), and that such issue was, therefore, made in the course or furtherance of an enterprise as contemplated in section 7(1)(*a*). Reference was made above[972] to the ECJ cases of *Wellcome Trust* and *EDM*, where it was held that whilst the concept 'economic activity' does not involve the simple transfer of shares, it does include, for example, the business of trading in shares.[973]

In the *KapHag* case[974] a new partner was admitted to a partnership. The partnership was intended to take the form of a closed property fund.[975] A lawyer charged the partnership a fee plus VAT for providing

[967] Article 2(1) provides that: "[T]he following transactions shall be subject to VAT: (a) the supply of goods for consideration within the territory of the Member State by a taxable person acting as such … (c) the supply of services for consideration within the territory of a Member State by a taxable person acting as such …". Article 168 provides that: "[I]n so far as the goods and services are used for the purpose of the taxed transactions of a taxable person, the taxable person shall be entitled, in the Member State in which he carries out these transactions, to deduct the following from the VAT which he is liable to pay: (a) The VAT due or paid in that Member State in respect of supplies to him of goods or services, carried out or to be carried out by another taxable person…".
[968] See s 1(1).
[969] *ITC 1744* 65 SATC 154 at 157.
[970] Van der Zwan & Stiglingh 2011 *De Jure* 337.
[971] Or in the Council Directive.
[972] See para 2.8 above.
[973] The *Wellcome Trust* case para 33; the *EDM* case para 59.
[974] *KapHag* case.
[975] Ibid at para 13.

legal advice and drafting the partnership agreement. The legal advice related to the 'closed property fund' concept and the formation of the partnership.[976] The issue was whether the partnership was entitled to deduct the VAT on the lawyer's fee. The ECJ concluded that a partnership which admits a partner in consideration of payment of a contribution in cash does not effect a supply of services to that person for consideration within the meaning of article 2(1) of the Sixth Directive.[977] This case is not helpful, even though the issue before the court is relevant to the current discussion. I argue[978] that it is unlikely that a South African court will agree with the ECJ's reasons for holding that a partnership is not making a supply when admitting a partner to the partnership, based on the analysis that in substance the partnership is increasing its assets by acquiring capital. I further argue that the partners, as opposed to the partnership, supply partners' shares.[979]

Section 3A(1) of the New Zealand GST Act previously defined input tax to mean "tax charged under section 8(1) on the supply of goods and services made to that person, being goods and services acquired for the principal purpose of making taxable supplies." The reference to 'principle purpose' has now been removed. I agree with van der Zwan and Stiglingh that the cases decided on the basis of this former wording, may not be helpful as the definition of 'input tax' in the VAT Act does not contain a similar reference to a 'principal purpose'.[980] It is apparent from the New Zealand High Court case of *Mangaheia Trust,*[981] that the New Zealand courts have not applied the ECJ's direct and immediate link test, when determining whether goods or services were acquired 'for the principal purpose of making taxable supplies'. The court confirmed that the 'sufficient *nexus'* approach to ascertaining the 'principal purpose' has been used on a number of occasions.[982] The court further stated that there is no requirement that the specific expenditures on which input tax credits are claimed need in any way to be directly and demonstrably linked to the specific resulting products.[983] The court either rejected, or at least applied a test other than the direct and immediate link test.

As the partnership does not supply the partners' shares to the partners upon the admission of a new partner (or at any other stage, including at the formation of the partnership), the transition expenses incurred when a new partner is admitted are not directly and immediately linked to any specific supply. The ECJ has decided a number of cases dealing with the deduction of the VAT on acquisitions that have no direct and immediate link to a specific supply.

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[976] Ibid at para 15.
[977] Ibid at para 43.
[978] See para 2.8 above.
[979] See para 4.8.1 above.
[980] Van der Zwan & Stiglingh 2011 *De Jure* 337.
[981] *Commissioner of Inland Revenue v Trustees in the Mangaheia Trust and Trustees in the Te Mata Property* (2009) 24 NZTC 23,711
[982] Ibid at 23,718.
[983] Ibid at 23,720.

In the *Cibo-case*,[984] for example, one of the issues was whether Cibo Participations SA (Cibo), a holding company, was entitled to deduct VAT in respect of the supply of various services by third parties for the acquisition of shares in its subsidiaries. The services in question included the auditing of the companies, assistance with the negotiation of the purchase price of the shares, organising the take-over of the companies, and legal and tax services.

The court confirmed the view of the ECJ that to give rise to the right to deduct, the goods or services purchased must have a direct and immediate link with the output transactions in respect of which VAT is deductible. The court clarified that the reason why there is a right to deduct in the case of such a direct and immediate link, is because the VAT on the acquired goods or services is a component of the cost of the output transactions. The expenditure must, therefore, form part of the costs of the output transactions in respect of which VAT is deductible, which use the acquired goods and services.[985] This ensures complete tax neutrality for all economic activities, provided they are themselves subject to VAT.[986] The court found that there was no direct link between the various services purchased by a holding company in connection with its acquisition of a shareholding in a subsidiary, and any output transaction in respect of which VAT is deductible. The amount of VAT paid by the holding company on the expenditure incurred for those services, does not directly burden the various cost components of its output transactions in respect of which VAT is deductible. The expenditure does not form part of the costs of the output transactions which use the service.[987]

In the *Kretztechnik* case, where the court held that a share issue does not constitute a supply of goods or services for consideration within the meaning of article 2(1) of the Sixth Directive, it also considered whether there was a right to deduct input VAT paid on supplies linked to a share issue. As the share issue was considered not to be a supply, there was no direct link between the relevant purchases and an output transaction in respect of which VAT was deductible.

In both the *Cibo* and *Kretztechnik* cases, the court held that the costs of the supplies acquired were part of the taxable person's general costs and cost components of an undertaking's products. Such services do, therefore, in principle have a direct and immediate link to the taxable person's business as a whole.[988]

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[984] See *Cibo Participations SA and Directeur regional des impôts du Nord-Pas-de-Calais* Case C-16/00, 27 September 2001 (herafter the *Cibo* case).
[985] Ibid at para 31.
[986] Ibid at para 27.
[987] Ibid at para 32.
[988] Ibid at para 33 and the *Kretztechnik* case para 36.

In both cases, the company was entitled to deduct all the VAT charged on the expenses it incurred for the various supplies it acquired in the context of the share acquisition and the share issue carried out, respectively, provided however, that all the transactions carried out by that company constituted taxed transactions.Thus, if the company carried out both transactions in respect of which VAT is deductible, and transactions in respect of which it is not, it may deduct only that proportion of the VAT which is attributable to the former.[989]

As argued above,[990] a share issue is considered to be a supply in terms of the VAT Act. The court's ruling in *Kretztechnik* on this particular point – that a share issue does not constitute a supply – is therefore not true for the VAT Act. The *Kretztechnik* case nonetheless remains relevant to the issue of the deductibility of the VAT on transition expenses on the basis that a partnership does not supply the partners' shares.

In the *Securenta* case,[991] where the taxpayer simultaneously carried out economic activities, taxed and exempt, and non-economic activities outside the scope of the Sixth Directive, the ECJ held that deduction of the VAT relating to expenditure connected with the issue of shares and a-typical silent partnerships is allowed only to the extent that the expenditure is attributable to the taxpayer's economic activity within the meaning of article 2(1) of the Sixth Directive, and provided they are themselves subject to VAT.[992] The *Securenta* case serves to illustrate how the 'direct and immediate link' test is applied to share issue costs which are considered to be general costs.

In *Skatteverket v AB SKF,*[993] one of the issues before the ECJ was whether there is a right to deduct input VAT in terms of the Sixth Directive on services required for a disposal of shares, on the ground that the costs of those services form part of the taxable person's general costs.[994] Confirming earlier decisions, the court stated that whether there is a direct and immediate link will depend on whether the cost of the input services is incorporated either in the cost of particular output transactions, or in the cost of goods or services supplied by the taxable person as part of his economic activities.[995] The court held that to establish whether there is such a direct and immediate link, it is necessary to establish

[989] The *Cibo* case at para 34 and the *Kretztechnik* case at para 37; Heber points out that this approach, that was introduced by the ECJ, is often referred to as the 'look-through approach', which ignores the causal link between one particular input transaction which is subject to VAT and one particular output transaction which is outside the scope of VAT. (Heber 2013 World Journal of VAT/GST Law 24) The court thus 'looks through' the transactions which are causally linked to the input transaction (Ibid at 33)

[990] See para 2.8 above.

[991] *Securenta Göttinger Immobilienanlagen und Vermögensmanagement AG v Finanzamt Göttingen* Case C-437/06, 17 March 2008 (hereafter the *Securenta* case).

[992] Ibid at para 31 read with para 28.

[993] *Skatteverket v AB SKF* Case C-29/08 29 October 2009.

[994] Ibid at para 54.

[995] Ibid at para 60.

whether the costs incurred are likely to be incorporated in the price of the shares which the taxable person, AB SKF, intends to sell, or whether they are only among the cost components of AB SKF's products.[996]

Regarding the deductibility of the VAT on transfer costs, the transfer of ownership of the partnership property from the members of the dissolved partnership to the members of the new partnership, is, in terms of the common law, a transaction between such individual members. It could be argued, therefore, that because the transaction is between the individual partners, the partnership should not be permitted a deduction of the VAT. This argument is questionable, however, in that both the dissolved and the new partnership are deemed persons, who are also deemed to own the jointly-held partnership property. Furthermore, if section 51(2) applies, then this provision deems the dissolved and the new partnership to be one person.[997] I argue that there can be no supply of the immovable property for VAT purposes, as a person cannot make a supply to himself in terms of this specific matrix of facts.[998] The transfer costs are, therefore, not linked to any specific supply. As a result, the partnership will not have a right to deduct the VAT based on the transfer costs having a direct and immediate link with any specific taxable supply.[999] The transfer costs, instead, have a direct and immediate link with the partnership's business as a whole.[1000] Should the partnership make taxable supplies only, then the VAT will be fully deductible. If not, then the VAT will be deductible only to the extent that the partnership makes taxable supplies.[1001]

If section 51(2) does not apply, deeming the dissolved and the new partnership to be one and the same partnership, the supply of the partnership property by the dissolved partnership to the new partnership could be taxable, whether at fifteen per cent or the zero rate.[1002] The dissolved partnership should be

[996] Ibid at para 62; Ramsdahl Jensen and Stensgaard in summarising the position in the EU, accordingly, distinguish between two overall categories of expenses, namely, direct and overhead costs. If a direct and immediate link between the relevant input and output transactions exists, the cost will be a direct cost and the VAT thereon will either be fully deductible or not deductible, depending on the character of the output transaction. If that is not the case, then it must be established whether the cost is directly and immediately linked to the person's overall economic activity and, therefore, forms part of the overhead costs. If so, then the VAT on such overhead costs will either be fully, partially or not deductible, depending on the character of the person's overall economic activity. (Ramsdahl Jensen & Stensgaard 2014 World Journal of VAT/GST Law 24)

[997] See para 4.7 above.

[998] Ibid; A self-supply is indeed possible in terms of the VAT Act. S 8(9) of the VAT Act (as one example) provides that the supply of goods or services by a vendor to an independent branch or main business of the vendor located outside the Republic, is deemed to be a supply of goods or services in the course or furtherance of the vendor's enterprise. Proviso (ii) of the definition of "enterprise" in s 1, deems a branch or main business to be independent if it is separately identifiable, has a separate system of accounting and is permanently located at premises outside the Republic. As a result, a vendor can make a supply to such a branch or main business even though, in reality, they form part of the same entity, but are deemed to be separate for VAT purposes.

[999] See the *Cibo* case at para 31.

[1000] See the *Cibo* and *Kretztechnik* cases at paras 33 and 36 respectively.

[1001] See the *Cibo*, *Kretztechnik*, and *Securenta* cases at paras 34, 37, and 31 respectively.

[1002] See para 4.7 above.

entitled to deduct the VAT on the transfer costs based on such costs having a direct and immediate link with a specific taxable supply.[1003]

The next issue concerns the deductibility of the VAT incurred on the cost of drafting a partnership agreement for the new partnership. In the *De Beers* case the court implied that the mutual relationship between DBCM and its shareholders was not part of its enterprise and, hence, its agreement with the Commissioner's argument that because the focus of the relevant services "was the interest of DBCM's departing shareholders and investors, rather than the interest of DBCM itself",[1004] the services were not acquired for a taxable purpose. If the relationship between a company and its shareholders is not part of its enterprise then, logically, the relationship between its shareholders should be even further removed from its enterprise because it is a relationship that the company is not party to. It can hardly be contended that the VAT on the cost of drafting a shareholders' agreement is deductible by the company. The same reasoning should also be applicable to the members of a partnership. A partnership agreement gives rise to the legal rights and obligations between the partners.[1005] Although the partnership comes into existence because of the partners entering into a partnership agreement, the fact is that the partnership agreement regulates the affairs between the individual partners. I therefore argue, that the VAT on the cost of drafting a new partnership agreement is not deductible as input tax because the relationship between the members of a partnership is not part of its enterprise.

The next issue concerns the deductibility of VAT on accounting fees related to the adjustment of the partnership's accounting. In the *De Beers* case, the court implied that the VAT on an enterprise's overhead expenses is deductible because of its distinction between a public company's enterprise with its attendant overhead expenses, and the special duties which are imposed on the company in the interest of its shareholders, which, according to the court, is too far removed from the advancement of its enterprise.[1006] The SARS moreover considers administrative overheads, such as audit and accounting fees, typical examples of expenses incurred for the purpose of making taxable supplies on which input tax may be deductible by a vendor.[1007]

In my view, the nature of the accountancy services should be considered to determine whether they are incurred for the purpose of making taxable supplies. According to Flynn and Koornhof, there are a few fundamental accounting procedures that must be followed when a change in the composition of a

[1003] See the *Cibo* case at para 31.
[1004] The *De Beers* case at para 26.
[1005] See Williams *Concise Corporate and Partnership Law* 7.
[1006] The *De Beers* case at para. 27.
[1007] SARS Legal Counsel *VAT 404 Guide for Vendors* available at http://www.sars.gov.za/AllDocs/OpsDocs/Guides/LAPD-VAT-G02%20-%20VAT%20404%20Guide%20for%20Vendors.pdf (date of use: 1 January 2019) 55.

partnership occurs.[1008] It is, for example, essential to determine the amounts due to each partner on the date when the partnership dissolves. To make this determination it may be necessary to revalue some or all of the partnership's assets.[1009] The accounting procedure is done for the benefit of the individual partners. As the Commissioner argued in the *De Beers* case, this particular procedure is not to be directed at making the partnership's enterprise better or more valuable. It is the interest of the members of the partnership, rather than the interest of the partnership itself, that forms the focus of the service.[1010]

Flynn and Koornhof further submit that once the change in composition has been effected, it is useful to draft a Statement of Financial Position reflecting the opening financial position of the new partnership.[1011] This accounting procedure has a closer connection with the new partnership's enterprise because it is an overhead expense that is required for managing the business of the partnership. The accounting procedure is, however, not linked to any specific supply, but instead has a direct and immediate link with the partnership's business as a whole. Should the partnership only make taxable supplies, the VAT will be fully deductible. If not, the VAT is deductible only to the extent that the partnership makes taxable supplies.

As in the case of South Africa and New Zealand, Australia, Canada, and the UK also have general provisions regulating the deductibility of input tax credits, but no specific provisions aimed at partnerships.[1012]

[1008] Flynn & Koornhof *Fundamental Accounting* 23-8.
[1009] Ibid.
[1010] The *De Beers* case at para 26.
[1011] Flynn & Koornhof *Fundamental Accounting* 23-9.
[1012] In terms of the Australian GST Act, you are entitled to an input tax credit in relation to 'creditable acquisitions'. A 'creditable acquisition' is a thing which is acquired solely or partly for a 'creditable purpose' (s 11-5; ATO Goods and Services Tax Ruling: GSTR 2008/1 "Goods and services tax: When do you acquire anything or import goods solely or partly for a creditable purpose" available at https://www.ato.gov.au/law/view/pdf?DocID=GST%2FGSTR20081%2FNAT%2FATO%2F00001&filename=law/view/pdf/pbr/gstr2008-001c3.pdf&PiT=99991231235958 (date of use: 22 December 2018) para 1 (hereafter GSTR 2008/1); McCouat *Australian Master GST Guide* [E-book] Locations 120 and 121) which is not defined in the Act. The ATO explains some factors that provide guidance in determining whether an acquisition or importation is for a creditable purpose (GSTR 2008/1 para 70). Based on the ATO's factors, GST levied on transition costs would be deductible as input tax in Australia if such costs are incidental or relevant to the continuance of the partnership's enterprise, or are used in the enterprise, and the costs do not meet the personal needs of the partners as individuals. See GSTR 2008/1 para 70. In terms of Canada's ETA registrants are normally entitled to an input tax credit on purchases that relate to a 'commercial activity'. See s 169(1); CRA "Input tax credits (ITCs)" https://www.canada.ca/ en/revenue-agency/services/tax/businesses/topics/payroll/benefits-allowances/remitting-gst-hst-on-employee-benefits/input-tax-credits-itcs.html (date of use: 19 August 2018); Chabot et al *EY's Complete Guide to GST/HST* para 3,010, which is also not defined in Canada's ETA. According to Chabot et al, the CRA has traditionally interpreted 'commercial activity' to mean the activities of running the day-to-day business of an entity. They state, however, that it was concluded in cases that the relevant expenses were incurred in the course of commercial activities, even though there was no direct link between the expenses and the goods and services produced. In all cases the judgments were, furthermore, consistent in finding that a taxpayer engaged exclusively in commercial activities, cannot incur expenses for any other activity. Therefore, if a taxpayer is only engaged in commercial activities, the GST on expenses incurred in connection with initial public offerings, takeovers, and other activities, is deductible as input tax. See Chabot et al ibid at 208. Section 120(1) of Canada's ETA

4.12 Group relief measures

Section 8(25) provides that where goods or services are supplied by a vendor to another vendor, those vendors must, for purposes of that supply or subsequent supplies of those goods or services, be deemed to be one and the same person. This is subject to the condition that the provisions of sections 42,[1013] 44,[1014] 45,[1015] or 47[1016] of the IT Act are met.[1017]

It is stated in an EM that section 8(25) ensures that the transactions entered into between group companies, as envisaged by the relevant sections of the IT Act, have no VAT consequences for either vendor where the vendors are partially taxable entities.[1018] As section 8(25) deems the supplier and the

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excludes from the definition of 'commercial activity', the making of exempt supplies. In my view, the GST incurred on transition costs would be fully deductible in Canada if the partnership is solely engaged in commercial activities. In the UK, in order for VAT incurred to be treated as deductible input tax, the supplies must have been incurred for the 'purpose of the business' (Hemmingsley & Rudling *Tolley's Value Added Tax* para 34.2) which is not defined the UK VAT Act. HMRC suggests, on the basis of UK case law, that input tax incurred on a cost can be claimed if it relates directly to the function and carrying on of the business. If it merely provides an incidental benefit to the business, it is unlikely that input tax can be claimed. See HMRC "VAT Input Tax basics: how to determine business use" available at https://www.gov.uk/hmrc-internal-manuals/vat-input-tax/ vit10600 (date of use: 24 August 2018). In the UK the VAT on transition costs would, therefore, be deductible as input tax if such costs relate directly to the function and carrying on of the partnership business, and not if they merely provide an incidental benefit to the business. In New Zealand, the GST on such costs would be deductible as input tax if the costs have a 'sufficient nexus' with the making of taxable supplies. See the reference to *Commissioner of Inland Revenue v Trustees in the Mangaheia Trust and Trustees in the Te Mata Property* at para 4.11).

[1013] Section 42 applies to an 'asset-for-share transaction', meaning a transaction in terms of which a person disposes of an asset to a resident company, in exchange for the issuing of an equity share in that company (s 41(1)(*a*)).

[1014] Section 44 applies to an 'amalgamation transaction', meaning a transaction in terms of which a resident company (the 'amalgamated company') disposes of all of its assets to another resident company by means of an amalgamation, conversion, or merger, and as a result of which the existence of the amalgamated company will be terminated (s 44(1)(*a*)).

[1015] Section 45 applies to an 'intra-group transaction', meaning a transaction in terms of which an asset is disposed of by one company (the 'transferor company') to a resident company (the 'transferee company') and both companies form part of the same group of companies at the end of the day of the transaction and as a result of which the transferee company acquires that asset from the transferor company (s 45(1)(*a*)).

[1016] Section 47 applies to a 'liquidation distribution', meaning a transaction in terms of which a resident company (the 'liquidating company') disposes of all of its assets to its shareholders in anticipation of or in the course of the liquidation, winding up or deregistration of that company, but only to the extent to which those assets are so disposed of to another resident company and which on the date of the disposal forms part of the same group of companies as the liquidating company (s 47(1)(*a*)).

[1017] Section 8(25) will, however, not apply to a supply contemplated in s 42 or 45 of the IT Act unless:

a. That supply is of an enterprise (or part of an enterprise which is capable of separate operation) where the supplier and the recipient have agreed in writing that such enterprise (or part) is disposed of as a going concern; or
b. The enterprise (or part) disposed of as a going concern has been carried on in relation to goods or services applied mainly for the purposes of such enterprise (or part) and partly for other purposes. Such goods or services will be deemed to form part of such enterprise (or part) notwithstanding paragraph (v) of the proviso to the definition of 'enterprise' in s 1 (provisos (i) and (ii) to s 8(25)).

In terms of para (v) of the proviso to 'enterprise', an activity will not be deemed to be the carrying on of an enterprise to the extent to which it involves the making of exempt supplies.

[1018] EM on the Revenue Laws Amendment Bill 40 of 2005, at 69. It is further stated that where a partially-taxable business is transferred, or where business assets that were used in a partially-taxable business are transferred or declared as a

recipient to be one and the same person "for purposes of that supply or subsequent supplies of those goods or services", the supply by the supplier to the recipient is deemed to be a non-event for VAT purposes and, therefore, has no VAT consequences.[1019] Should the recipient on-supply such goods or services, then the normal VAT provisions will apply.[1020]

In the 2015 Budget Tax Proposals, the view is expressed that the corporate restructuring provisions referred to in section 8(25) apply only to groups of companies that are incorporated, and not to unincorporated entities such as joint ventures and partnerships.[1021] It was, therefore, proposed that because the VAT Act recognises unincorporated persons as vendors, the VAT Act be amended "to remove the unintended anomalies and allow for reorganisation relief for all vendors".[1022] The VAT Act is yet to be amended to give effect to this proposal. In my view, a partnership desiring the kind of relief envisaged in section 8(25), may in the interim apply for a VAT ruling[1023] requesting a special dispensation in terms of section 72 from the Commissioner for the SARS.[1024]

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dividend *in specie*, an unintended VAT cost is generally created for the parties involved by the possible applications of ss 16(3)(*h*) and 18A. The supplying vendor is not required to make an adjustment in terms of s 16(3)(*h*), whilst the purchasing vendor is not required to make a s 18A adjustment (EM bid). In my opinion, and from the perspective of the supplying vendor, an unintended VAT cost is not created by an application of s 16(3)(*h*). The provision which gives rise to the VAT liability is s 8(16), which provides that the supply by a vendor of goods or services he acquired partly for the purpose of making taxable supplies and were held by him partly for that purpose immediately before such supply, is deemed to be made wholly in the course or furtherance of his enterprise. This means that the supply is fully taxable notwithstanding that the vendor was not permitted a full input-tax deduction on the acquisition of the goods or services due to their earlier, partial non-taxable use. Section 16(3)(*h*) provides relief in the circumstances, permitting the vendor to make an input tax adjustment to recover the portion of the VAT, which he has not deducted as input tax. The deduction is based on the percentage that the non-taxable use of the goods or services is of their total use. Section 18A(1) provides that where the supply of an enterprise (or part of an enterprise) to a vendor has been zero-rated in terms of s 11(1)(*e*), and that enterprise (or part) was acquired by the vendor wholly or partly for a purpose other than making taxable supplies, the enterprise (or part) will be deemed to have been supplied by the vendor by way of a taxable supply in the course of his enterprise. The vendor is required to account for output tax on the portion of the cost of the enterprise used for a non-taxable purpose.

[1019] See EM on the Taxation Laws Amendment Bill 10 of 2009 at 92.

[1020] Botes *Juta's Value Added Tax* 8-37.

[1021] National Treasury Republic of South Africa *Budget Review 2015* 25 February 2015 Annexure C: Additional Tax Amendments 148. This view is correct because the entity making the disposal or the distribution as contemplated, respectively, in ss 44, 45 and 47 of the IT Act, is a 'company' whose definition in the IT Act does not include an unincorporated body. Section 42 of the IT Act can apply to a 'person' as defined in the IT Act, and includes an individual, but not an unincorporated body. Furthermore, outside of the VAT Act a partnership is incapable of making an acquisition, which is a requirement of, for example, s 42 of the IT Act. In terms of s 42(1)(*a*), the person who disposes of an asset must be issued with, and therefore acquire, an equity share in exchange. As a partnership is not a person in terms of the common law, it cannot in any event conclude any contractual agreement envisaged in the IT Act's restructuring provisions.

[1022] Ibid at Annexure C: Additional Tax Amendments 148.

[1023] In terms of s 41B.

[1024] Section 72 provides that if the Commissioner is satisfied that in consequence of the manner in which a vendor conducts his business, difficulties, anomalies, or incongruities have arisen or may arise in regard to the application of any of the provisions of the VAT Act, the Commissioner may make an arrangement or decision as to –

a. the manner in which such provisions shall be applied; or
b. the calculation or payment of tax,

in the case of such vendor or any person transacting with such vendor to overcome such difficulties, anomalies, or incongruities. In terms of the proviso to s 72, such decision or arrangement should not have the effect of substantially reducing or increasing the ultimate liability for tax levied under the VAT Act. In *Milner Street Properties (Pty) Ltd v Eckstein*

The notion of extending the reorganisation relief to partnerships is open to question because certain of the transactions contemplated in the provisions of the IT Act, mentioned in section 8(25), can simply not apply to partnerships. Section 45 of the IT Act, for example, is applicable to an 'intra-group transaction'.[1025] In South African partnership law there is no such phenomena as a group of partnerships. This also applies to section 47 of the IT Act which applies to a 'liquidation distribution', and which also refers to a group of companies. Furthermore, section 42 of the IT Act applies to an 'asset-for-share transaction'. Considering how a partnership is formed, assets cannot be disposed of to a partnership in exchange for a partner's share. As I have stated, when a partnership agreement is entered into, the partners' shares accrue to the partners.[1026]

The legislature has not indicated to which types of partnership-reorganisation transaction section 8(25) will apply. In my view, the 'reorganisation' of a partnership would typically occur in the case of the technical dissolution of a partnership, such as is envisaged in section 51(2). Making section 8(25) applicable to a technical dissolution of a partnership could be tautologous, however, as the effect of section 51(2) is in any case that supplies between the dissolved and the new partnership are ignored for VAT purposes. Section 8(25) similarly deems the supplying and the recipient vendors to be one and the same person.

According to Badenhorst, it can be argued that as a supply in terms of section 8(25) is not a taxable supply, the VAT on any costs relating to the supply, such as attorney transfer fees, may not be deducted as input tax.[1027] It is proposed in the EM, however, that VAT on services acquired for the purposes of a section 8(25) transaction, will qualify as input tax.[1028] Regrettably, no reasons are, given for this concession.

As a result of a reorganisation transaction in terms of sections 42 or 45 of the IT Act, where an enterprise is supplied to the recipient, the supplier's enterprise could be terminated. In terms of proviso (i) to the definition of 'enterprise', anything done in connection with the commencement or termination of an enterprise is deemed to be done in the course or furtherance of that enterprise. The section 8(25) transaction is, therefore, deemed to be done in the course or furtherance of the supplier's enterprise. It

Properties (Pty) Ltd [2000] JOL 7403 (N), the court stated that s 72 gives the Commissioner wide power to grant relief against anomalies and hardships which the application of the provisions of the VAT Act would cause in particular circumstances. The Commissioner would, therefore, be entitled, in an appropriate case, to waive strict compliance with a provision of the VAT Act where insistence on a strict application would lead to unnecessary hardship and unforeseen results (at 18).

[1025] Section 45(1)(*a*) of the IT Act.

[1026] See para 2.6.4 above.

[1027] Badenhorst "VAT on company reorganisations" (2009) March *Tax enSight* 10.

[1028] EM on the Revenue Laws Amendment Bill 40 of 2005 at 69.

is arguable that the VAT on related costs could be deducted on this basis as they are incurred for a taxable purpose.[1029]

There are no provisions similar to section 8(25), in the Australian GST Act, Canada's ETA, the UK VAT Act, and the New Zealand GST Act which deal with 'reorganisation' transactions.[1030]

4.13 Conclusion

In this chapter I have dealt with the VAT implications of transactions that typically arise during the technical dissolution of a partnership. This phase is characterised by the transfer of partners' shares based on a partner leaving due to death or retirement, for instance, or the admission of a new partner. The important question of whether the supply of partners' shares is subject to VAT, was explored. I argued that partners' shares are owned by, and supplied to, partners, and because partners are deemed not to carry on the enterprise of the partnership, the supply of partners' shares is subject to VAT in exceptional circumstances only.

The importance of distinguishing between the two main rights constituting a partner's share – his undivided interest in the jointly owned partnership property, and his right to profit – was highlighted. I argued that a partner does not supply his interest in the jointly-held property when he supplies a partner's share, as for VAT purposes, such property is deemed to be owned by the partnership. When a partner supplies a partner's share he is, therefore, only supplying his right to profit. If section 51(2) is not applicable, deeming the old and the new partnership to be one partnership, then the dissolved partnership supplies the jointly-held property, including the partnership's enterprise, to the new partnership. I argued that both an obligation to pay VAT at fifteen per cent, and a transfer duty liability can be avoided if the supply of the partnership's enterprise is zero rated under section 11(1)(*e*).

I considered the effect of section 51(2) on transactions between the dissolved and the new partnership, and between other persons, and concluded that this provision should not be interpreted so as to disregard the supply of partners' shares and the making of capital contributions to the new partnership for VAT purposes.

[1029] 'Taxable supply' is defined in s 1(1) to mean a supply which is chargeable with tax under s 7(1)(*a*), which levies VAT on a supply made in the course or furtherance of a vendor's enterprise.

[1030] Considering the partnership reorganisation provisions in s 272.1(7) of Canada's ETA, s 57(2)(e) of New Zealand's GST Act, and s 45(1) of the UK VAT Act, as well as a continuity clause in Australia that can provide for the continuation of a partnership in the event of a change of members, in my view, the introduction of a provision similar to s 8(25) which is made applicable to partnerships, would, as in the case of South Africa, be tautologous in these GST/VAT jurisdictions.

I discussed how the provisions dealing with irrecoverable debts and the non-payment of creditors apply, depending on whether the rights and liabilities of the dissolved partnership are transferred to the new partnership. I furthermore considered the deduction of VAT on typical transition expenses, and the application of the reorganisation provisions of section 8(25) to partnerships.

In the Chapter Five I discuss the VAT treatment of transactions that commonly occur during the general dissolution and liquidation of a partnership.

CHAPTER 5

GENERAL DISSOLUTION, LIQUIDATION AND DISTRIBUTION

5.1 Introduction

In this chapter, I consider the VAT implications of a general dissolution and liquidation of a partnership, as well as the distribution of partnership assets. After dissolution of the partnership, and unless the partners have agreed otherwise, a partner has a right to demand that the partnership be liquidated.[1031] Although the partnership has dissolved, it continues to exist for the purpose of liquidating the partnership business.[1032] Consequently, so long as there are partnership assets, the partnership remains in existence.[1033] I am therefore of the opinion, that a partnership which continues to be registered for VAT, will not cease to be a 'person' for VAT purposes any time prior to its liquidation. There are, however, important changes that take place upon dissolution relating to, for example, a partner's position as agent for the partnership, the nature of a partner's rights, debts between the partnership and the partners, and the partnership's indebtedness to creditors. I discuss the impact that these changes could have on the VAT liability of both the partnership and the partners. I further consider the VAT consequences of the death of a partner and the transfer of his partner's share to a legatee or heir.

5.2 General dissolution

5.2.1 The partners' agency powers

Although the partnership has dissolved, the relationship between the partners is finally terminated only once the liquidation of the partnership is complete.[1034] The partners, therefore, continue to have a relationship after dissolution, even though that relationship is not the same as before.[1035]

[1031] See para 4.3 above.

[1032] *Lee v Maraisdrif* [1976] 3 All SA 53 (A) 58; *Du Toit v African Dairies Ltd* 1922 TPD 245 at 247. See *Kaplan v Turner* 1941 SWA 29 where the court stated at 31, 32 that "…the partnership … continues after dissolution merely for the purposes of liquidation" See also *Goldberg v Di Meo* above at 468; Bamford *Law of Partnership* 85.

[1033] *Du Toit v African Dairies Ltd* ibid at 248.

[1034] Ramdhin et al "Partnership" para 324; Williams *Concise Corporate and Partnership Law* 53; Bamford ibid. According to Benade et al *Ondernemingsreg* para 6.29, the dissolution of a partnership does not terminate the relationship between the partners, but does change it fundamentally. In *Ferreira v Fouche* [1949] 1 All SA 130 (T) the court stated at 132, that although the partnership ended, it has not been liquidated. Partners can end their partnership agreement, but as far as accountability between them and the outside world is concerned, the partnership continues to exist until liquidated.

[1035] Although the partnership has dissolved and its members are technically no longer 'partners', in most instances I continue to refer to such members as 'partners' and not as 'former partners'.

I have discussed[1036] how a partner's power as an agent impacts on the partner's and the partnership's position for VAT purposes prior to dissolution. In the case of *In Re Paarl Bank in Liquidation*,[1037] the court held that upon dissolution the partners' agency powers cease to exist, save for the purpose of liquidating the affairs of the partnership. Any new obligations incurred by a partner's co-partners after dissolution, ought not to bind the partner.[1038] Subject to a number of exceptions, all new transactions entered into by a partner which are unconnected to the liquidation, or not necessarily consequential to transactions which occurred during the existence of the partnership, do not bind his partners but are for his own account alone.[1039] As a result, partners will be bound if a partner completes a transaction that is unfinished at the time of dissolution, but that was entered into prior to dissolution.[1040] Partners will also be bound if they acquiesce in or adopt a partner's acts,[1041] or if a partner, who for good reason is ignorant of the dissolution of the partnership, enters into transactions.[1042]

It is evident that, after dissolution, a contracting partner has the authority to bind the partnership in certain instances only. The partnership is not required to levy VAT on a supply, or be entitled to an input tax deduction, where in making the supply or acquisition, the partner acts without authority.[1043] The partner would, therefore, be acting as principal in his own name, as opposed to making the supply or acquisition as agent for the partnership.[1044]

[1036] In para 2.6.2 above.

[1037] (1890-1891) 8 SC 131.

[1038] Ibid at 134. In *Bosman v Registrar of Deeds and The Master* 1942 CPD 302 at 307, the court held that it is trite law that in the case of partnership each partner is an agent for the other partners, and when a partnership is dissolved by death, this agency ceases save for the purpose of liquidating the affairs of the partnership. See also Ramdhin et al "Partnership" para 315; Williams *Concise Corporate and Partnership Law* 53.

[1039] Ramdhin et al ibid; Williams ibid. According to Pothier *A Treatise* 116, 117 para 155, the effect of the dissolution of a partnership is that from that point onward all contracts which each of the former partners may enter into, will be for his own account only, unless they were necessary consequences of the affairs of the partnership. In *Birkenruth v Shaw, Hoole & Co* (1850-1852) 1 Searle 39 at 45, the court stated that retiring partners are not bound by any new contract, or by instruments negotiated in the name of the original firm after dissolution.

[1040] Ramdhin et al ibid at para 316; Williams ibid; Pothier ibid at 117 para 155. In *R v Levitan* 1958 1 SA 639 (T), for example, the court assuming that the partnership in this case had dissolved, held that it does not follow that a partner's authority to collect and receive a cheque in payment of a partnership debt had also terminated. This is because a partner's agency continues notwithstanding dissolution, to complete a transaction begun but unfinished at the time of the dissolution (at 147).

[1041] In *Birkenruth v Shaw, Hoole & Co* (1850-1852) 1 Searle 39, the court agreed with the principle that after dissolution no partner can bind the partnership and create new debts. The court found that the partnership in this case had access to the bank, and saw that Shaw, who was the partnership's managing partner, signed the bills in liquidation. The court held that the partnership had by its acquiescence, ratified Shaw's activities. It reasoned that if a party gives a limited authority, and after it has been exceeded, acquiesces, he cannot plead limited authority (at 46, 47).

[1042] Ramdhin et al "Partnership" para 316; Pothier *A Treatise* 117, 118, para 155. Former partners may, furthermore, be estopped from denying the validity of a transaction as against *bona fide* third parties who have not been warned of the dissolution.

[1043] However, if partners are bound by a supply or an acquisition made by a partner, the dissolved partnership, as a separate person for VAT purposes, is deemed to make that supply or acquisition. The partnership is, accordingly, liable for output tax or entitled to an input-tax deduction, subject to meeting the relevant requirements.

[1044] A partner who is a vendor, for instance, could be liable for VAT on services supplied in terms of a transaction concluded after dissolution and without the acquiescence of his former partners.

It should be noted, however, that a partner acting alone would not be capable of supplying property contributed *quoad dominium* as principal, in that legal ownership is the basis of accounting for output tax (and deducting input tax).[1045] Legal ownership of such property remains the joint property of all the partners after dissolution.[1046] In my view, the ownership of such property can only be supplied by all the partners acting together.

Australia and New Zealand's partnership law is similar to that of South Africa as regards the partners' limited authority to bind one another after dissolution and leading up to the winding up of the partnership.[1047] It is within the confines of this limited authority that the ATO contends that some or all of the partners may continue to carry on the enterprise of the partnership during its winding up.[1048]

In my view, considering section 272.1(6) of Canada's ETA, a partner retains his authority to bind the partnership, as envisaged in section 272.1(1),[1049] until after dissolution and until the moment that the partnership's GST registration is cancelled. Section 272.1(6) provides that where a partnership would, but for this provision, be regarded as having ceased to exist, the partnership is deemed not to have ceased to exist until its registration has been cancelled. The effect of section 272.1(6) is that the transfer of property on the dissolution of the partnership is no different from the transfer of partnership property while the partnership is in existence.[1050]

In terms of New Zealand partnership law, the entry or exit of a partner to or from a partnership results in the dissolution of the partnership.[1051] However, section 57(2)(e) provides that any change of members of the partnership has no effect for purposes of the New Zealand GST Act. The partnership continues

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[1045] See the discussion in para 3.4.1 on *Case T35* (1997) 18 NZTC 8,235.
[1046] See para 4.4 above.
[1047] According to Higgins, after the dissolution of a partnership the authority of each partner to bind the firm continues, notwithstanding the dissolution, insofar as is necessary to wind up the affairs of the partnership and to complete transactions begun but unfinished at the time of dissolution. See Higgins *Law of Partnership* 199; Williams *Corporations and Partnerships* para 804. In the case of Australia, in particular, see GSTR 2003/13 para 129.
[1048] GSTR 2003/13 para 131. See also Ward J "GST and the Formation & Dissolution of Partnerships" 5 available at http://www.tved.net.au/index.cfm?SimpleDisplay=PaperDisplay.cfm&PaperDisplay=http://www.tved.net.au/PublicPapers/June_2003,_Sound_Education_in_GST,_GST_and_The_Formation___Dissolution_of_Partnerships.html (date of use: 2 May 2017).
[1049] See para 2.6.2 above.
[1050] Arsenault & Kreklewetz "Partnerships" 36; Canadian Bar Association 'GST/HST Questions for Revenue Canada 2012' available at https://www.cba.org/Sections/Commodity-Tax-Customs-and-Trade/Resources/ Resources/2014/GST-HST-Questions-for-Revenue-Canada-2012#1 (date of use: 27 August 2018).
[1051] NZIR 3 para 5 "Questions We've Been Asked QB 14/02, – Income Tax – Entry Of A New Partner Into A Partnership – Effect On Continuing Partners" available at https://www.ird.govt.nz/resources/9/9/99a8ac84-d23e-4ae6-a3ed-7c87685d7654/qb1402.pdf (date of use: 12 June 2018). See also Higgins *Law of Partnership* 181, 182 where reference is made to dissolution because of the retirement of a partner; and Williams *Corporations and Partnerships in New Zealand* para 791.

to exist for GST purposes, therefore, notwithstanding a change in membership. In my view, partners also continue to bind the partnership after its dissolution, as contemplated in section 57(2)(b),[1052] based on the partnership's continued existence after dissolution.

This is also the position in the UK, ie, that the partners continue to bind the partnership after dissolution, in light of section 45(1) of the UK VAT Act which ensures the continuity of the partnership despite changes in its composition.[1053]

5.2.2 The rights of the partners

5.2.2.1 The fate of the partners' shares

I have stated previously that a partner owns a partner's share in terms of the partnership agreement.[1054] After dissolution, however, no provision of the partnership agreement is binding, unless a contrary intention appears from the agreement of partnership or the dissolution agreement.[1055]

There is perhaps an argument to be made that when the partnership dissolves, the partners lose their shares in the partnership because the partnership agreement, which is the source of the partners' rights and obligations, has terminated. As the loss of their partners' shares does not involve a positive act on the part of the partners, that loss would constitute the supply of the partners' shares 'by operation of law' as envisaged in the definition of 'supply'.[1056] Such a supply could give rise to an output tax liability for the partner if the partner's share was held as part of a separate enterprise carried on by him.

However, considering the nature of a partner's share – he has an undivided interest in partnership property and a right to profit – and that the partners continue to remain co-owners of the partnership property after dissolution[1057] and share in the profits, as will be seen from the discussion below,[1058] in

[1052] Section 57(2)(b) provides that any supply of goods or services made in the course of carrying on the partnership's taxable activity is deemed to be supplied by the partnership, and not by any of its members. See para 3.3.1 above.
[1053] See para 4.7 above.
[1054] In para 2.6.4 above.
[1055] Ramdhin et al "Partnership" para 315; Bamford *Law of Partnership* 87; Benade et al *Ondernemingsreg* para 6.33. In *Rogers v Mathews* 1926 TPD 21 at 22, for example, a deed of partnership included a clause providing for certain differences or disputes to be referred to arbitration. The court held that the arbitration clause ceased to operate when the partnership was dissolved by the agreement.
[1056] See the definition of 'supply' in s 1(1). 'Operation of law' is "a legal outcome that automatically occurs whether or not the affected party intends it to." See *Law Dictionary Featuring Black's Law Dictionary Free Online Legal Dictionary* available at https://thelawdictionary.org/operation-of-law/ (date of use: 13 April 2018).
[1057] See para 4.4 above.
[1058] In para 5.2.2.2 below.

my view the partners do not supply their partners' shares, consisting of the mentioned rights, when the partnership dissolves.

5.2.2.2 The nature of a partner's rights after dissolution

Although the partnership agreement is no longer binding after dissolution, the partners are not left without rights in relation to profits. During the course of the liquidation of the partnership, a partner is entitled to expect fairness and good faith from his former partners.[1059]

Accordingly, partners do not share in profits after dissolution on the basis of a right to profit in the partnership agreement which is no longer valid and, therefore, not binding on the partners. Instead, they share in the profits by reason of their right to fairness and good faith. This right, dictates that profits earned from the partnership business carried on – whether improperly or against the will of the other partners – using assets owned jointly by all the partners, must be fairly apportioned between the partners. This also applies to transactions that commenced before but were completed after dissolution.[1060]

In my view, any profit distributions made after dissolution would not be subject to VAT because the profit share is merely the result of the partners' entitlement to fairness and good faith, and not in exchange for any reciprocally connected supplies made by the partners to the partnership.

[1059] Ramdhin et al "Partnership" para 315; Williams *Concise Corporate and Partnership Law* 53; Bamford *Law of Partnership* 87. In *Sempff v Neubauer* 1903 TH 262 at 216, the court cited Lindley in his work on the *Law of Partnership* with approval where he stated that: "This obligation to perfect fairness and good faith is, moreover, not confined to persons who actually are partners. It extends to persons negotiating for a partnership but between whom no partnership yet exists, and also to persons who have dissolved partnership but who have not yet completely wound up and settled the partnership affairs." There are a number of cases which illustrate how the courts have given effect to this right to expect fairness and good faith. In *Wegner v Surgeson* 1910 TPD 571 at 584, for example, the plaintiff and the defendant were former partners. After dissolution, the partnership business was carried on by the defendant with assets which belonged partly to the plaintiff and partly to the defendant. The licence belonged to the defendant, and the lease to the plaintiff and defendant jointly. The court held that the profits were divisible in the proportion which the value of a half interest in the lease bore to the total value of the lease and the licence. In *Latham and Another v Sher and Another* [1974] 4 All SA 102 (W) at 106, the court held that where a partnership is dissolved, and one of the partners improperly appropriates and uses for his own benefit, property which was a partnership asset, he may be obliged to account to his former partners for their interest and for their share in the profits from such use. This is because the former partners own and are entitled to their proportionate share in such property. According to the court, this does not mean that the partnership agreement is regarded as extending beyond the dissolution to cover the period of such use. In *Ellery v Imhof* 1904 TH 170 at 175 the defendant, against the will of the plaintiff, continued to carry on the partnership business after the dissolution of the partnership. The court found that the defendant had, in fact, been trading with the plaintiff's capital, and held the plaintiff entitled to a half-share in any accrued profits. The court held that on dissolution, one partner is not entitled to take possession of the partnership assets and trade with them, and if he does so, he is liable to account for profits.

[1060] In *Nash v Muirhead* (1909) 26 SC 26 at 34, the court agreed that the plaintiff was entitled to his share of the profits from a transaction that was uncompleted at the date of dissolution.

There are no GST/VAT provisions in Australia, Canada, New Zealand, and the UK with regard to partners' shares and profit distributions at the time of the partnership's dissolution.[1061] I concluded[1062] that profit distributions in these jurisdictions are not subject to VAT/GST before the dissolution of the partnership. There is no reason why profit distributions would be taxable after dissolution, especially considering that no supplies are made by the partners in exchange for such distributions.

5.2.3 Irrecoverable debts

5.2.3.1 Debts between the partnership and the partners

A partner could be indebted to the partnership resulting from a taxable supply made by the partnership to the partner for consideration in money, and in respect of which the partnership has accounted for output tax. Should the partnership write off any irrecoverable portion of the consideration, the partnership would, in terms of section 22(1), be entitled to a deduction of the portion of the irrecoverable debt that represents the VAT charged. This would also apply where a partner who is a vendor carrying on a separate enterprise, made a taxable supply to the partnership. A question is how any debts between the partners and the partnership are affected by the dissolution of the partnership.

The debts of each of the partners to the partnership, or of those of the partnership to each of the partners, do not come to an end on dissolution.[1063] Section 22(1) is, therefore, not automatically triggered when a partnership dissolves.

In *McLeod and Shearsmith v Shearsmith,*[1064] the court held that the obligation to replace what had been drawn out to pay for certain land and buildings, in the partnership funds had to be borne in mind in calculating the value of the deceased partner's share. In this case the deceased partner's capital in the partnership greatly exceeded the amount of the indebtedness. Where this is so, the court reasoned, a partner's share is calculated by setting off the amount of the indebtedness against the amount standing

[1061] In Australia, New Zealand, the UK, and Canada all partners, including an outgoing partner, continue to share in the partnership profits after dissolution if the surviving or continuing partners carry on the partnership's business after dissolution. See Higgins *Law of Partnership in Australia and New Zealand* 221, 223; Scamell & I'anson Banks *Lindley on the Law of Partnerships* 719. Section 42(1) of the Partnerships Act RSO 1990 c P5 (Canada), applies where any member of a firm dies or otherwise ceases to be a partner and the surviving or continuing partners carry on the business of the firm with its capital or assets without any final settlement of accounts. In the absence of an agreement to the contrary, the outgoing partner or his estate is entitled to such share of the profits made since the dissolution as is attributable to the use of the outgoing partner's share of the partnership assets, or to interest at the rate of five per cent per annum on the amount of his share of the partnership assets.

[1062] In para 2.6.5 above.

[1063] Ramdhin et al "Partnership" para 315. See also Bamford *Law of Partnership* 100; and Williams *Concise Corporate and Partnership Law* 53.

[1064] *McLeod and Shearsmith v Shearsmith* 1938 TPD 87.

to his credit after paying off partnership liabilities and advances by partners to the partnership.[1065] The court held that payment into the partnership funds on a dissolution, is therefore necessary only where a partner's liability to the partnership exceeds what is due to him from the partnership fund, and then only to the extent of the excess. It furthermore does not matter how the liability arises, whether it is money overdrawn, or capital promised and not paid in, or, as was alleged in this case, capital drawn out under a promise to re-deposit it.[1066]

The liquidation, meaning the sale, of the partnership property is discussed below.[1067] It is clear from the *McLeod* case that from the proceeds of the sale of the partnership property, the partnership liabilities and advances by partners to the partnership are paid first. Thereafter, any indebtedness of a partner is set off against any amounts standing to his credit, for example, amounts debited to his capital and/or current account. This setting-off of the partner's debt constitutes payment.[1068] A partner would only be required to make payment into the partnership funds to the extent that his liability to the partnership exceeds what is due to him by the partnership.

It should be noted that a partner has no right of action against another partner for payment owed to him in connection with partnership affairs, unless and until there has been a final and binding settlement of the partnership's accounts and a credit balance remains due to him.[1069]

As regards a partnership's indebtedness to a partner, although the court in *McLeod* confirmed that partnership debts, which include advances by partners to the partnership, are repaid first, the process of recovery of a partnership's debt to a partner depends on whether a liquidator has been appointed. In *Van Tonder v Davids,*[1070] the court held that where the partners have agreed on a liquidator, the liquidator is the only, and the appropriate person to claim the partnership assets.[1071]

[1065] Ibid at 93.

[1066] Ibid at 91, 92. In this case the deceased was a member of a partnership. On his death, he and his co-partner held undivided shares in certain fixed property on which there were buildings in the process of completion. The property was not a partnership asset. The money expended in the purchase of the erf and on the improvements as they existed on the deceased's death, came out of the partnership funds, each partner having drawn £2 375 for that purpose. The appellants regarded the deceased as indebted to the partnership, on dissolution, in this sum. However, instead of setting it off against the capital standing to his credit in the partnership's books, they treated his capital as undiminished.

[1067] See para 5.3 above.

[1068] See para 3.5.2 above.

[1069] Ramdhin et al "Partnership" para 315; Bamford *Law of Partnership* 100.

[1070] [1975] 3 All SA 544 (C).

[1071] Ibid at 547; The applicant requested the court for an order that the respondent deliver a truck to the manager of a bank so that he could divide the partnership assets between the two parties who were the former partners of the dissolved partnership. The applicant alleged that the parties agreed to appoint the manager as liquidator. The court dismissed the applicant's request.

In *Kaplan v Turner,*[1072] the court held that a plaintiff is not entitled to arrogate to himself the sole right of liquidating the partnership estate. The court held further that if the partners cannot agree on the division of the assets or the payment of or responsibility for the partnership liabilities, they must either agree on the appointment of a liquidator, or ask the court to appoint a liquidator.[1073]

The partners will, therefore, either agree on how the partnership's indebtedness to a partner should be settled, or a liquidator will be appointed who will be responsible for liquidating the partnership, which would include paying debts owed by the partnership to a partner.[1074]

According to the SARS, a debt will be considered as irrecoverable if the vendor has complied with both the following requirements, namely:

a. the vendor must have done all the necessary entries in his accounting system to record that the amount has been written off; and
b. must have ceased any recovery action taken by himself and have decided to either not take any further action, or have handed the debt over to an attorney or debt collector.[1075]

Unlike an attorney and a debt collector, a liquidator is appointed to liquidate the dissolved partnership,[1076] and not necessarily because of complications in collecting debt. Therefore, only if the liquidator has ceased any recovery action he has taken and decided to either not take any further action, or has handed the debt over to an attorney or debt collector, can the partnership's debt to the partner potentially be considered not to be recoverable.[1077]

As regards a partner's indebtedness to the partnership, in my opinion, prior to the completion of the above process set by law, ie, the liquidation of the partnership assets, the settlement of the partnership's accounts, and the set-off of any mutual indebtedness between the partnership and the partner, a partner's debt to the partnership cannot be considered to have become irrecoverable. The SARS' requirements for a debt to be considered irrecoverable, can only potentially be met thereafter because the outcome of this process will confirm whether the partnership will be successful in recovering all or part of the partner's debt.

[1072] 1941 SWA 29.
[1073] Ibid at 32.
[1074] See Ramdhin et al "Partnership" para 321; Benade et al *Ondernemingsreg* paras 6.41, 6.42; Bamford *Law of Partnership* 106 - 108.
[1075] SARS *VATNews* No 9 - February 1997 available at http://www.sars.gov.za/AllDocs/Documents/VATNews-Archive/LAPD-IntR-VATN-Arc-2013-09%20-%20VATNews%209%20February%201997.pdf (date of use: 2 September 2018).
[1076] See Ramdhin et al "Partnership" para 321; Benade et al *Ondernemingsreg* para 6.42; and Bamford *Law of Partnership* 106 - 108.
[1077] See the above two requirements are set by the SARS for a debt to be considered irrecoverable.

Section 22(3) provides that where a vendor:

a. has made a deduction of input tax in respect of a taxable supply of goods or services made to him; and
b. has, within a period of twelve months, not paid the full consideration in respect of such supply,

an amount equal to the tax fraction of that portion of the consideration which has not been paid, is deemed to be tax charged in respect of a taxable supply.

A partnership or a partner could be faced with a tax liability if its debt to the other party remains unpaid for longer than the prescribed twelve-month period.

5.2.3.2 Partnership's indebtedness to creditors

The next issue concerns the impact which a partnership's dissolution has on its indebtedness to third-party creditors. In *Essakow v Gundelfinger,*[1078] the court held that the partnership remains in existence in so far as creditors are concerned, until their claims have been discharged despite a dissolution agreement having been entered into.[1079] As the partnership's indebtedness remains in existence, dissolution will not automatically trigger a section 22(1) deduction for a partnership's creditor.

There are no GST/VAT provisions in Australia, Canada, New Zealand, and the UK with respect to debts between a partnership and its partners, or between the partnership and creditors at the time of the partnership's dissolution.[1080]

[1078] 1928 TPD 308.
[1079] Ibid at 312.
[1080] Section 39 of the UK Partnership Act, 1890, provides that on the dissolution of a partnership every partner is entitled, as against the other partners in the firm, to have the property of the partnership applied in payment of the debts and liabilities of the firm, and to have the surplus assets after such payment applied in payment of what may be due to the partners, respectively, after deducting what may be due from them as partners to the firm. See Morse *Partnership Law* 252 para 7.32. The Partnership Acts applicable in Australia and New Zealand contain the identical provision. See Higgins *Law of Partnership in Australia and New Zealand* 203. The Partnership Acts in Canada contain similar, but not identical, provisions. See Haack R "Canada: What Happens To A Partnership's Assets And Liabilities Upon Dissolution?" available at http://www.mondaq.com/canada/x/718560/Corporate+Commercial+Law/What+Happens+to+a+Partnerships+Assets+and+Liabilities+upon+Dissolution (date of use: 28 August 2018). I stated in para 4.10 (above) that all these jurisdictions permit a deduction of the VAT/GST component of a bad debt written off. In my view, as a partnership's indebtedness to a partner, and vice versa, as well as a partnership's indebtedness to a creditor, clearly continue to exist on dissolution of the partnership, a claimant will only be entitled to a bad-debt deduction once it has been established that the debt is bad – as opposed to automatically on dissolution.

5.2.4 The status of a partnership's rights on dissolution

According to the court in *Baldinger v Broomberg*,[1081] there is no general principle that a right granted to a partnership ceases when the partnership is dissolved. As a result, the court held that there would appear to be no reason in principle why dissolution should terminate a lease to the partnership.[1082] In *Blumberg v Buys and Malkin & Margolis,*[1083] the court held that the granting of a trading right to a partnership for so long a period (nine years *in casu*), without any limitations, must be regarded as a property right of the firm which can be freely ceded to any of the partners upon the dissolution of the partnership.[1084] Consequently, a lease concluded in favour of a partnership does not automatically terminate, and a grant of exclusive trading rights does not lapse on dissolution of a partnership.[1085]

Considering that the partnership's rights do not cease on dissolution, there can be no argument that such rights are, on dissolution, surrendered by the partnership by operation of law, giving rise to a potential VAT liability under section 10(4).

There are no GST/VAT provisions in Australia, Canada, New Zealand, and the UK which address a partnership's rights at the time of its dissolution. Considering the manner in which partnership assets, which should include rights owned by the partnership, are required to be applied in these jurisdictions on the dissolution and liquidation of the partnership,[1086] it is clear that the rights of the partnership do not cease on dissolution. In my view, the position in these jurisdictions should correspond to that in South Africa, namely, that such rights are, on dissolution, not surrendered by the partnership so giving rise to a potential GST/VAT liability.

[1081] [1949] 3 All SA 219 (C).
[1082] Ibid at 229.
[1083] 1908 TS 1175.
[1084] Ibid at 1180. In this case the plaintiff alleged that the defendant gave a partnership a right, namely, an undertaking that he would not sell or lease any part of a certain property to others for trading purposes. The partnership subsequently dissolved. Thereafter, the partnership ceded this right to one of the partners – the plaintiff in the case. One of the arguments raised by the defendant, was that the plaintiff could avail himself of the right, because it was a purely personal grant to the partnership, and the partnership had been dissolved (at 1179). The court held that all rights which a person possesses can be freely ceded, and it is incumbent upon the person who challenges the capacity to cede a right, to show that the parties intended that the right granted should not be ceded (at 1180).
[1085] See Ramdhin et al "Partnership" para 316; Benade et al *Ondernemingsreg* paras 6.35, 6.36; and Bamford *Law of Partnership* 88.
[1086] See para. 5.2.3.2 above.

5.2.5 The death of a partner

The death of any partner dissolves the partnership, but the heirs or executor of the deceased partner do not become partners in his stead.[1087] The executor of the decedent's estate is, however, entitled to the deceased partner's share of the partnership assets.[1088] In terms of section 46(*g*), the executor acts only in a 'representative capacity'. The ownership of the partner's share is, therefore, not transferred to the executor. As a result, the executor's acquisition of the deceased partner's share holds no VAT consequences as the share is not supplied to the executor. The dissolved partnership would subsequently be liquidated. The deceased partner's share in the dissolved partnership can either be sold to the surviving partners, as stated above,[1089] or it can be transferred to the deceased partner's legatee or heir since the partner's share is an asset forming part of his estate.[1090]

If the deceased partner's share in the dissolved partnership formed part of a separate enterprise he carried on, the provisions of section 53 may be applicable. Only in exceptional cases would a partner's share form part of a separate enterprise carried on by him.[1091] In terms of section 53(1)(*a*), where, after the death of a partner who is a vendor, an enterprise previously carried on by him continues to be carried on by the executor of his estate, or anything is done in connection with the termination of the enterprise, the decedent's estate is deemed to be a vendor in respect of the enterprise. Section 53(1)(*a*) envisages two options available for an executor: he can continue with the deceased partner' enterprise and hold the deceased partner's share in the dissolved partnership as part of that enterprise; or he can terminate the enterprise.

In terms of section 53(1)(*b*), where section 53(1)(*a*) applies, the deceased partner and his estate are deemed, "as respects the enterprise in question", to be one and the same person. In my view, the deeming of the two entities to be the same 'person', has the effect that the decedent's estate continues to carry on the enterprise of the deceased partner under the same VAT registration number. I further argue that all goods and services forming part of the enterprise are not supplied by the deceased partner

[1087] Williams *Concise Corporate and Partnership Law* 49. According to Ramdhin et al "Partnership" para 312, where the partnership contract provides for the partnership to be continued for the benefit of the estate of the deceased partner, his executor, if so authorised in the will, concludes a new partnership on behalf of the estate with the remaining partners. See, for example. *McLeod and Shearsmith v Shearsmith* 1938 TPD 87 where, after the death of the deceased partner, the partnership business was carried on in partnership between the surviving partner, McLeod, and the executors as trustees. The court stated (at 89) that the latter partnership "is clearly not the same partnership as that between McLeod and the testator."

[1088] Bamford *Law of Partnership* 78.

[1089] In para 4.4 above. The sale of the deceased partner's share cannot be zero rated in terms of section 11(1)(*e*) as it cannot, on its own, constitute an enterprise or part of an enterprise which is capable of separate operation. The share can, however, be supplied as part of an enterprise, which can be zero rated subject the relevant requirements. See para. 4.8.3 above.

[1090] Ramdhin et al "Partnership" para 289; Williams *Concise Corporate and Partnership Law* 31.

[1091] See para 4.8.3 above.

to his estate, and their transfer to the estate is, consequently, not subject to VAT. The SARS agrees with this view.[1092]

Should the executor deregister the estate for VAT, section 8(2) applies and the goods or rights,[1093] including the partner's share forming part of the assets of the enterprise, are deemed to be supplied by the estate in the course of its enterprise immediately before it ceases to be a vendor. Such a deemed supply gives rise to an output tax liability for the estate, which in terms section 9(5) will be deemed to be made immediately before the decedent's estate ceases to be a vendor.

Where the decedent's estate which is a vendor, transfers the deceased partner's share for no consideration to an heir, who is a connected person in relation to the decedent's estate,[1094] section 10(4) may apply. This would be the case where the heir would not have been entitled to a full input tax deduction if he had paid a consideration for the supply equal to its open- market value. The heir will have been denied a full input tax deduction if, for example, he was not a vendor, or even if he was a vendor, he did not make the acquisition for a wholly taxable purpose. The executor would be required by section 7(*a*) to levy VAT at the standard rate, on the supply of the partner's share. Section 10(4) deems the supply to be made for consideration in money equal to the open-market value of the supply.

The next issue concerns the 'open-market value' of the supply of the deceased partner's share. The 'open-market value' of a supply of goods or services is defined in the VAT Act as the consideration in money which the supply of those goods or services would generally fetch if supplied in similar circumstances, at that date, in the Republic, and the supply is freely offered and made between persons who are not connected persons.[1095]

In this instance, the circumstances surrounding the supply of the partner's share are the transfer of the share to a legatee or heir on the death of the partner. In *CIR v Estate Whiteaway,*[1096] the court had to decide on the method of valuation of a deceased partner's share in the partnership. In my view, the court advanced a rational and unbiased method of valuation that meets the requirements of an 'open-

[1092] The SARS stated in the *Guide for Estates* VAT 413 para 4.3 available at http://www.sars.gov.za/AllDocs/OpsDocs/Guides/LAPD-VAT-G06%20-%20VAT%20413%20Guide%20for%20Estates.pdf (date of use: 1 January 2019) that an executor may decide temporarily to continue with the deceased vendor's enterprise if it is in the best interests of the estate. In that case, the transfer of goods or services from the deceased to that person's estate is not regarded as a supply as they are deemed to be one and the same person. See also Botes *Juta's Value Added Tax* 53-2.

[1093] Section 8(2) does not apply to goods in respect of the acquisition of which by the vendor, a deduction of input tax under s 16(3) was denied in terms of s 17(2). Section 8(2), furthermore, applies to rights which are capable of assignment, cession or surrender.

[1094] 'Connected persons' is defined in s 1(1) to mean a natural person, including the estate of a natural person if such person is deceased, and any relative of that natural person, who is a relative as defined in s 1 of the IT Act.

[1095] See the definition of 'open market value' in s 1(1) read with s 3(2).

[1096] 1933 TPD 486.

market value' for VAT purposes. It held that the following seems to be the proper method: First, the partnership's total liabilities are deducted from the value of the total gross assets of the partnership. Second, with this figure in hand, it must be decided what the deceased would be entitled to, which depends on what the rights of a partner are. The court held that the partners are co-owners each holding a lien over the partnership property. The purpose of the lien is to use the partnership property to discharge of the partnership's debts, with any surplus assets then used to pay what is due to the respective partners, after having deducted any amounts the partners owe the partnership.[1097] In *McLeod and Shearsmith v Shearsmith,*[1098] the court held that although what was said in *CIR v Estate Whiteaway* referred to English law, it is in principle no different from systems based on civil law – which would include the South African partnership law – on this specific point.[1099]

Where the deceased partner's share is transferred to an heir for no consideration and section 10(4) does not apply, section 10(23) provides that the value of the supply is nil. Section 10(4) does not apply if the heir is not a connected person in relation to the decedent's estate, or even if he is a connected person, he is a vendor who acquires the partner's share for a wholly taxable purpose. The supply of the partner's share can be zero rated in terms of section 11(1)(*e*), if it is supplied as part of an enterprise which is capable of separate operation – and, of course, the rest of the provision's requirements are met.

In the case of New Zealand, Cross claims that there is no clear guidance on the GST implications when a partner dies. She states, however, that it is arguable that the following GST treatment is justified. The partnership terminates on the death of the partner and the executor steps into the shoes of the deceased as specified agent of his estate. If the deceased partner was GST-registered in his own right, the transfer of the deceased partner's share to the continuing partner(s) is unlikely to be zero rated. In the case of a two-person partnership, if the surviving partner is GST-registered and intends to carry on the taxable activity, section 10(3) of the New Zealand GST Act[1100] – which would otherwise deem the supply to be for market value – does not apply. This is because the surviving partner acquires the share for the principal purpose of making taxable supplies, and is entitled to an input tax deduction.[1101]

As in the case of New Zealand, there are no specific GST/VAT provisions in Australia, Canada, and the UK as to the lot of a deceased partner's share upon the dissolution of a partnership. According to the

[1097] Ibid at 500.
[1098] 1938 TPD 87.
[1099] Ibid at 91.
[1100] See para 2.6.6 above.
[1101] Section 10(3AB) of the New Zealand GST Act provides that s 10(3A) does not apply to a supply if the recipient acquires the supply for no consideration and, from the time of supply, applies the goods or services for the purpose of making taxable supplies.

ATO, on the death of a partner the deceased partner's interest in the partnership crystallises as a debt due by the partnership to the partner. This crystallisation is of a right that the partner already has, the ATO reasons, and is not a new right that is acquired. The crystallisation of the interest in the partnership as a debt, results in the extinguishment of the deceased partner's interest in the partnership. Following this extinction, there is an increase in each of the continuing partners' fractional interest in the partnership. The ATO contends that this increase is a consequence of the extinction of the deceased partner's interest, and does not involve the supply of any new or additional interests in the partnership by the partnership.[1102] The crystallisation of a deceased partner's interest, therefore, does not involve a supply for the deceased partner's estate, the partnership, or the individual partners.

The positions in Canada and the UK are similar to that in South Africa. In Canada when a partner dies, his estate is generally deemed to continue with the partnership business "as if he had not died".[1103] In the UK the representative who takes control of a deceased person's assets merely acts in a representative capacity.[1104] In Canada and the UK, a deceased partner's share is, therefore, not supplied to his estate upon his death. I stated that in Canada and the UK the consensus is that, for GST purposes, a partner disposes of his share in the partnership.[1105] The supply of the deceased partner's share to his heirs or to the continuing partners could, likewise in my view, hold GST/VAT consequences.

5.3 Liquidation and distribution of assets

5.3.1 General

After dissolution the partnership must be liquidated. Thereafter, as stated above,[1106] the partnership's creditors must be paid. Any remaining assets must be distributed to the partners, after deducting what they owe the partnership.[1107]

[1102] See GSTR 2003/13 paras 176, 177.

[1103] See Pansieri F "Canada: Goods and Services Tax/ Harmonised Sales Tax (GST/HST) and Death" available at http://www.mondaq.com/canada/x/568038/wills+intestacy+estate+planning/Goods+And+Services+TaxHarmonized+Sales+Tax+GSTHST+And+Death (date of use: 28 August 2018).

[1104] See Hemmingsley & Rudling *Tolley's Value Added Tax* para 15.1.

[1105] Para 4.8.1 above.

[1106] In para 5.2.3.1 above.

[1107] *CIR v Estate Whiteaway*1933 TPD 486 at 500; *McLeod and Shearsmith v Shearsmith* 1938 TPD 87 at 91. In *Brighton v Clift (2)* [1971] 2 All SA 417 (R) at 419, the court held that since it was common cause that the partnership had, through the respondent's repudiation, ceased to exist, the applicant was entitled to have the partnership property applied in payment of its debts and to have the surplus assets, if any, applied in payment of what may be due to him after deducting what may be due by him to the firm. See Ramdhin et al "Partnership" para 318; Williams *Concise Corporate and Partnership Law* 55.

5.3.2 Liquidation

In *Robson v Theron*,[1108] the court held that where the partnership agreement provides for, or the partners subsequently agree upon, the dissolution of the partnership and how it is to be liquidated and wound-up, specific performance may be claimed under the *actio pro socio*. Generally, where there is no such agreement, this action may, subject to any stipulation for the duration of the partnership or any other relevant stipulations, be brought by a partner to have the partnership liquidated and wound-up. The court may then appoint a liquidator to realise the partnership assets for the purpose of liquidating partnership debts and to distribute the balance of the partnership assets or their proceeds among the partners.[1109] Upon dissolution of the partnership, a liquidator may also be appointed by the partners jointly.[1110]

5.3.2.1 Rights and duties of liquidator

In *Bockris v Bockris,*[1111] the court granted an order that a liquidator be appointed to: realise the partnership assets, including the goodwill, by public auction or by private agreement, and whether as a going concern or otherwise; to collect debts due to the partnership unless the debts are realised by sale; to pay the liabilities of the partnership; to prepare a final account between the parties; and to divide the assets of the partnership after payment of its liabilities in accordance with the account. In order to enable the business to continue, the liquidator is also appointed to act as its manager pending the final settlement of the partnership account.[1112] According to Ramdhin et al, a liquidator generally has the rights, and must perform the duties, as set out in the *Bockris* case.[1113]

In my opinion, considering the rights and duties of a liquidator of a partnership – particularly his appointment as manager of the partnership business – the liquidator is an agent because he has the power to create legal rights and obligations for the partners whom he represents.[1114] Section 54, therefore, applies to a liquidator in his dealings on behalf of the dissolved partnership. As a result, where

[1108] [1978] 2 All SA 264 (A).
[1109] Ibid at 275, 276; Ramdhin et al "Partnership" para 318; Williams *Concise Corporate and Partnership Law* 55, 56.
[1110] Ramdhin et al ibid at para 320; Williams ibid at 55; Bamford *Law of Partnership* 105; Benade et al *Ondernemingsreg* para 6.41.
[1111] 1910 WLD 182.
[1112] Ibid 184. See also *Sherry v Stewart* 1903 TH 13 at 15, where the court appointed a liquidator to the dissolved partnership with the same rights and duties.
[1113] Ramdhin et al "Partnership" para 321. See also Bamford *Law of Partnership* 107; Williams *Concise Corporate and Partnership Law* 49, 56; and Benade et al *Ondernemingsreg* para 6.42.
[1114] Silke *Law of Agency* 2.

the liquidator makes supplies or acquisitions as agent on behalf of the partnership as principal, those supplies or acquisitions are deemed to be made by the dissolved partnership.[1115]

5.3.2.2 The liquidation of the partnership property

According to the court in *Sherry v Stewart*,[1116] the general rule is that on dissolution the partnership property is converted into money by means of sale, and after payment of the partnership debts, the proceeds are divided between the partners.[1117] In *Young v Young,*[1118] the court confirmed that while it will lean to favouring partners who wish to purchase the jointly-owned partnership property, it must always have regard to the rights of the other co-owners. Considering the circumstances, the court held that the property in question must be sold by public auction.[1119]

In *Robson v Theron,*[1120] the court found that it was in the circumstances of that matter impossible, impracticable, or inequitable for a court, in exercising its equitable discretion, to divide the goodwill between the parties or to cause it to be auctioned and to have the proceeds divided between the parties. The court held that the practical and equitable solution in the circumstances is for the court to place *arbitrio judicis,*[1121] a valuation on the goodwill with due regard to the particular circumstances concerning its value at the date of dissolution of the partnership, and to order the one partner to pay the other partner half of this value.[1122]

In terms of the above case law, the jointly-owned partnership property will either be sold, whether by the liquidator or at public auction, or be awarded to a partner(s) who will be ordered to pay the other partner(s) his share. In terms of proviso (i) to the definition of 'enterprise',[1123] anything done by the liquidator in connection with the termination of the partnership's enterprise, is deemed to be done in the course or furtherance of that enterprise. In my view, as the task of the liquidator is to wind up the partnership's affairs,[1124] and his actions will result in the termination of the partnership's enterprise, the supplies he makes – including the liquidation of partnership assets and any *in specie* distributions made to the partners – will be deemed to be done in the course or furtherance of the partnership's enterprise.

[1115] See ss 54(1) and (2).
[1116] 1903 TH 13.
[1117] Ibid at 15. Ramdhin et al "Partnership" para 322; Williams *Concise Corporate and Partnership Law* 56.
[1118] *Young v Young and Others* (1918) 39 NPD 460.
[1119] Ibid at 464; Ramdhin et al "Partnership" para 322; Bamford *Law of Partnership* 99.
[1120] [1978] 2 All SA 264 (A).
[1121] That is, in the discretion of the judge.
[1122] *Robson v Theron* [1978] 2 All SA 264 (A) at 278; Ramdhin et al "Partnership" para 322; Bamford *Law of Partnership* 99.
[1123] Section 1(1).
[1124] Ramdhin et al "Partnership" para 321; Williams *Concise Corporate and Partnership Law* 55; Benade et al *Ondernemingsreg* para 6.42.

This accords with the view of the ATO, that realising business assets and *in specie* distributions to partners, as part of winding up a partnership, are made in 'carrying on an enterprise' and, therefore, potentially subject to GST.[1125] The Australian GST Act also specifically includes in the definition of 'carrying on an enterprise', anything done in the course of the commencement or termination of the enterprise.[1126]

The sale of the partnership property could be taxable at the standard rate, subject to compliance with section 7(1)(*a*). Should the liquidator dispose of the partnership's enterprise as a going concern, the supply may be zero rated provided that all the requirements of section 11(1)(*e*) are met. If the partnership property is awarded to one of the partners for no consideration, the value of the supply will, in terms of section 10(23), be deemed to be nil.[1127] This is, however, subject to section 10(4), which deems the supply to be made at open- market value if the property is not acquired by the partner for a wholly taxable purpose.

The partnership must, therefore, account for output tax and may deduct input tax on transactions concluded by the liquidator in connection with the termination of the partnership's enterprise, provided that the relevant requirements are met.[1128]

There are no specific legislative provisions in Australia, Canada, New Zealand, or the UK which regulate the GST/VAT implications of the liquidation of a dissolved partnership's assets. In terms of section 4(1) of the UK VAT Act, VAT is charged on a taxable supply of goods or services made in the UK by a taxable person in the course of furtherance of any business carried on by him. Section 94(5) of the UK VAT Act provides that anything done in connection with the termination of a business, is treated as being done in the course or furtherance of that business.[1129] The New Zealand GST Act and Canada's ETA have provisions similar to those in Australian and UK legislation regarding supplies made in the course of termination of a taxable or commercial activity.[1130] In my view, as in the case of South Africa, supplies made in the course of the liquidation of the partnership would potentially be subject to GST/VAT.

In the case of Canada, a supplier may, in terms of section 167(1) of the Canadian ETA, sell a business or part of a business, to a recipient and no GST will be payable on property or services supplied under

[1125] GSTR 2003/13 paras 131, 132 and 135.
[1126] Section 195-1. See McCouat *Australian Master GST Guide* [E-book] Location 49.
[1127] I mentioned in para 2.6.6 above, that a partnership and a member of that partnership are connected persons.
[1128] See 'input tax' as defined in s 1.
[1129] See Hemmingsley & Rudling *Tolley's Value Added Tax* para 8.1.
[1130] See s 6(2) of the New Zealand GST Act; McKenzie *GST: A Practical Guide* [E-book] Location 297; s 123(1) of Canada's ETA; and Chabot et al *EY's Complete Guide to GST/HST* para 7,035.

the agreement.[1131] The CRA takes the position that "the supply by a partnership of an undivided interest in the partnership property" to the partners "would not be considered to be a supply of a business or part of a business" and, accordingly, not eligible for relief under subsection 167(1).[1132] According to Chabot et al, the reason for the CRA's view is that the partner receiving the undivided interest in the assets cannot operate the property on his own, and as a result, one of the conditions under section 167 has not been met.[1133] They, therefore, argue that the election under section 167 does not generally apply to the dissolution of partnerships[1134] when the dissolved partnership supplies the partnership property to the partners. However, Arsenault and Krekelwetz argue that the CRA's current position may still leave the door open to the possibility that where a partnership is dissolved and everything (eg, physical property, intangible property, goodwill) is transferred to a single partner, subsection 167(1) could still apply.[1135] In other words, the single partner would be able to operate a business if all the property used to carry on the partnership business, is transferred to him.

5.3.3 Distribution

The partnership capital is a debt due to the partners by the partnership and must, therefore, be repaid to the partners after outside creditors and the advances made by partners have been paid.[1136] Depending on the remaining surplus,[1137] each partner is repaid pro-rate what he has contributed to the partnership capital.[1138] The capital is repaid to the partners without interest.[1139] The balance of the

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[1131] Chabot et al *EY's Complete Guide to GST/HST* paras 2,150 and 10,010; CRA "Sale of a Business or Part of a Business" GST/HST Memorandum 14-4 December 2010 available at https://www.canada.ca/en/revenue-agency/services/forms-publications/publications/14-4/sale-a-business-part-a-business.html (date of use: 28 August 2018). To qualify for this treatment, the supplier and the recipient must make a joint election, and certain conditions must be met. These conditions include the following:

a. the business should have been established or carried on by the supplier;
b. under the agreement for the supply, the recipient should acquire ownership, possession, or use of all or substantially all (at least 90%) of the property (based on the fair market value of the property) that can reasonably be regarded as being necessary for the recipient to be capable of carrying on the business (or part of the business) of the vendor;
c. if the supplier is registered, the purchaser should also be registered; and
the election needs to be filed by the purchaser.
See Chabot ibid.

[1132] CRA GST Headquarters Ruling 11950-3 *Transfer of Farmland Upon Dissolution of Partnership* (9 March 2004). I extracted the information regarding the latter ruling from Arsenault & Kreklewetz "Partnerships" 50.

[1133] Chabot et al *EY's Complete Guide to GST/HST* para 10,010. The condition that is not met is that the recipient should be capable of carrying on a business with the acquired property.

[1134] Ibid at 793.

[1135] Arsenault & Kreklewetz "Partnerships" 50.

[1136] *CIR v Estate Whiteaway* 1933 TPD 486 at 501; *Schlemmer v Viljoen* [1958] 2 All SA 309 (T) at 316; *McLeod and Shearsmith v Shearsmith* 1938 TPD 87 at 93; *Olivier v Stoop* [1978] 1 All SA 482 (T) at 489.

[1137] The surplus that remains after payment of the creditors.

[1138] Ramdhin et al "Partnership" para 323. It seems to Williams that where partners have so agreed, their contributions are repaid to them in full. In the absence of such agreement, the partners are not entitled to repayment in full, and the capital contributions must be divided between them. See Williams *Concise Corporate and Partnership Law* 56.

[1139] *Schlemmer v Viljoen* [1958] 2 All SA 309 (T) at 316.

partnership assets are then divided between the partners, in proportion to the amounts contributed by each, or in accordance with the special terms of the contract of partnership.[1140]

If there is a shortfall, the partners must contribute to the loss in the proportion in which losses are shared.[1141] In my opinion, the arguments of the ATO concerning the VAT implications of partners contributing to a loss, also apply to the VAT Act. A contribution in money would not be subject to VAT as money does not constitute 'goods' or 'services'.[1142] Should the partner, in contributing to the loss, make a supply of goods or services in the course or furtherance of an enterprise carried on by him independently of the partnership, the supply is subject to VAT if the requirements of section 7(1)(*a*) are met.[1143] The partnership would, in turn, be entitled to deduct the VAT as input tax as the acquisition is made for a taxable purpose. The transaction is concluded by the liquidator as part of the termination of the partnership enterprise and, therefore, is deemed to be done in the course or furtherance of that enterprise.[1144]

In my view, it is unlikely that the partnership will pay any consideration to the partner, in that the supply serves as a contribution to a loss. If no consideration is payable, then it is, moreover, unlikely that section 10(4), deeming the supply to be at the market value, would apply. The partnership would probably sell the goods or services and apply the proceeds to pay its debts. All these transactions, I argue, are part of the termination of the partnership enterprise and, therefore, part of the partnership's enterprise activities. Such acquisitions will, probably, be classified as 'made for a taxable purpose'.

After payment of the partnership's liabilities, any surplus assets are first applied to pay any amount due to the respective partners – ie before the repayment of capital. As the surplus assets and capital contributed *quoad dominium* form part of the partnership property, and are, therefore, deemed to belong to the partnership for VAT purposes, the distribution of the surplus assets and the repayment of capital to the partners constitutes supplies made by the partnership to the partners.

The settlement of the partnership's debt to a partner and the repayment of capital, could take the form of a cash payment as the partnership property is generally converted into money. From the partnership's perspective, the supply of the money would not be subject to VAT.

[1140] *Monhaupt v Minister of Finance* (1918) 39 NPD 47 at 50.

[1141] Ramdhin et al "Partnership" para 323; Williams *Concise Corporate and Partnership Law* 56; *McLeod and Shearsmith v Shearsmith* 1938 TPD 87 at 93.

[1142] Money is specifically excluded from the definitions of 'goods' and 'services' in s 1(1); see GSTR 2003/13 para 147.

[1143] Ibid.

[1144] See proviso (i) to the definition of 'enterprise' in s 1(1); GSTR 2003/13 para 147.

In my opinion, VAT should be levied on the settlement of a debt or the repayment of capital, if the payment takes the form of a supply of goods or services, and if that supply is made for consideration and in the course or furtherance of an enterprise. Arsenault and Kreklewetz's commentary on the Canadian GST – that the transfer of partnership property on dissolution of the partnership is no different from the transfer of partnership property while the partnership is in existence – also applies to the VAT Act. Accordingly, the supply of such property is subject to VAT at the standard rate, unless it is zero rated or exempt.[1145]

There should, furthermore, be no distinction between a distribution *in specie* to a partner during the partnership's operation and during its liquidation. The partner's indebtedness for the *in specie* distribution can be offset, respectively, against any amount due to him, and the amount of capital which he is entitled to have repaid to him. The payment for the *in specie* distribution can, alternatively, be structured in the form of a barter, where the partner supplies a service in the form of the surrender of his right, respectively, to the amount by which the partnership is indebted to him, and the amount of capital to be repaid to him. The nature of the partnership's VAT liability on the *in specie* distribution should, accordingly, be exactly the same as in the case of an *in specie* distribution during the partnership's operation.

The ATO also holds the view that an *in specie* distribution to the partners as part of the final distribution, is made by a partnership for consideration.[1146] According to the ATO such consideration may be represented by: (a) an amount debited to the capital account of the partner; (b) an amount debited to the current account of the partner; or (c) a combination of amounts debited to both the partner's capital and current accounts.[1147]

As stated above,[1148] any balance of partnership assets is divided between the partners. This distribution is, in my view, not made by the partnership in return for any payment by the partners.

As, after its dissolution, the partnership continues to exist only for the purpose of its liquidation,[1149] the relationship between the partners is terminated as soon as the liquidation of the partnership has been completed.[1150] In my view, the termination of the partners' relationship should bring an end to the limited agency powers which the former partners had after dissolution.

[1145] See Arsenault & Kreklewetz "Partnerships" 36.
[1146] GSTR 2003/13 para 135A.
[1147] Ibid para 135C.
[1148] In para 5.3.3 above.
[1149] See para 5.1 above.
[1150] Ramdhin et al "Partnership" para 324; Williams *Concise Corporate and Partnership Law* 57.

After the partnership's liquidation and, therefore, after all the partnership property has been distributed, the partnership will cease to carry on an enterprise. In terms of section 24(3), the partnership is required to notify the Commissioner of this fact within 21 days of the date of the cessation of the enterprise. The Commissioner then cancels the partnership's registration with effect from the last day of the tax period during which the enterprise ceased, or from such other date as he may determine.

The de-registration could trigger the application of section 8(2). It is unlikely, however, that after its liquidation the partnership will have any assets on hand as all its assets are distributed as part of the liquidation.

There are no specific legislative provisions in Australia, Canada, New Zealand, or the UK to regulate the GST/VAT implications of the distribution of a dissolved partnership's assets. I conclude,[1151] that *in specie* distributions made by the partnership to partners during the operation of the partnership are potentially subject to GST/VAT in these jurisdictions. In my view, there is no reason why *in specie* distributions made after dissolution, and as part of the liquidation of the partnership would not also be subject to GST/VAT.

5.4 Conclusion

In this chapter, I considered some of the important changes that take place when a partnership dissolves, and the VAT consequences occasioned by these changes notwithstanding the partnership's continued existence after dissolution. It was seen, for example, that only in limited circumstances does a partner have the authority to bind the partnership and, therefore, to make supplies and acquisitions on its behalf. The partners' rights in relation to partnership property also change, although their interests in such property are preserved.

Certain rights, however, continue undisturbed after dissolution. Rights granted to a partnership, debts between the partnership and the partners, and the partnership's indebtedness to creditors, for example, do not end when the partnership dissolves. Consequently, dissolution does not result in supplies by the partnership in the form of the surrendering of these rights. The irrecoverable, and unpaid, debt provisions in section 22 are, likewise, not automatically triggered.

I examined the VAT consequences that ensue when a partner dies and his share in the dissolved partnership is transferred to the executor of his estate, and thereafter, to a legatee or heir.

[1151] In para 3.5.1 above.

I further examined the liquidation of the partnership and the VAT treatment of the various transactions that take place during this process. This culminated in the consideration of provisions relevant to the cessation of the partnership enterprise and consequent deregistration for VAT.

That there are difficulties and uncertainties regarding the application of the provisions of the VAT Act to the various transactions encountered during the life of a partnership, should be clear from the discussion thus far. Consequently, in the next, and final, chapter I consider possible amendments that can be made to the VAT Act to create certainty, by simplifying the provisions that have a bearing on common partnership transactions, and by formulating provisions for transactions on which the VAT Act is currently silent. I also seek to align my proposed amendments with internationally accepted principles inherent in a sound VAT system.

CHAPTER 6

PROPOSED AMENDMENTS

6.1 Introduction

There is clearly a measure of confusion and uncertainty regarding the VAT implications of many of the common partnership transactions. In my view, several factors contribute to this. The VAT Act does not specifically provide for the VAT treatment of a number of partnership transactions. Furthermore, the current provisions applicable to partnerships, are, in certain respects, vague and therefore difficult to interpret and apply. These perplexities are due not solely to the lack and the vagueness of provisions, but also to the fact that the application of VAT in the area of partnerships is an inherently difficult exercise. As stated above,[1152] this is due to the South African legal system's incorporation of two distinct theories of partnership – the 'entity' and the 'aggregate' theories. The use of deeming rules, and importantly, the deeming of a partnership to be a separate person for VAT purposes, add to the complexity as it is generally difficult to determine their effect.[1153] The uncertainty can also be attributed to a lack of understanding of, at least, certain areas of partnership law.

In my view, much can be done to create greater certainty and simplicity. Judging from the comparative analyses above, different policy options are clearly available to the legislature. I consider these different options and propose amendments to the current provisions, and also propose additional provisions. My proposed amendments seek to align with the purpose of the VAT Act and the principles upon which it is based, and also to adhere to internationally accepted principles for a sound VAT system. The proposed provisions should be phrased simply and clearly to facilitate interpretation and application.

However, legislative provisions have limitations – it is simply not practicable to expect the law to cater for every eventuality that may arise during the lifetime of a partnership. Furthermore, the purpose of the VAT Act is not to explain the law of partnerships to ease the application of VAT provisions in this area. I argue, therefore, that apart from the need to improve the legislative provisions, the SARS should provide greater guidance by clarifying certain difficult areas of partnership law through interpretation statements, as is done in other jurisdictions, and by explaining how the VAT provisions apply to the more common partnership transactions.[1154]

[1152] In para 2.2 above

[1153] See para 2.2.3 above.

[1154] For example the ATO's GSTR 2003/13; the NZIR's "Questions We've Been Asked QB 14/03 – GST – Transfer of Interest In A Partnership" available at http://www.ird.govt.nz/resources/7/2/72537cec-da81-407d-ad4f-e490c9f2213d/qb1403.pdf (date of use: 8 December 2016), and "Questions We've Been Asked QB 16/04 – GST – GST

6.2 Guiding principles

The VATCOM Report sets out the principles upon which the VAT Act is based. The intention with the enactment of the VAT Act, was to introduce a broad-based, indirect tax on consumption in South Africa.[1155] A 'broad-based tax' is described as a general indirect tax on consumption imposed on most goods and certain services, as opposed to a selective tax on specific products.[1156] A consumption-type VAT was proposed.[1157] A 'consumption-type VAT' imposes tax on supplies to consumers, and supplies of capital to businesses, but grants businesses an input credit for the tax paid on capital, so that capital goods and inventories are held tax-free.[1158] The tax is collected at each stage in the production and distribution chain. It is non-cumulative in light of the credit allowed for tax paid in previous stages.[1159]

In order to judge the shift to a VAT system, it was necessary for VATCOM to evaluate General Sales Tax and VAT against the broad principles forming the basis of fiscal policy, including neutrality, and simplicity.[1160] In terms of the neutrality principle, indirect taxes should be neutral as regards the choice

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Treatment Of Partnership Capital Contributions" available at http://www.ird. govt.nz/resources/3/7/3716fa51-a2ec-42ac-b692-083ecb04679c/QB1604.pdf (date of use: 8 December 2016); the CRA Policy Statement P-244.

[1155] VATCOM Report at 3.

[1156] Ibid. See *CSARS v Marshall NO* (816/2015) [2016] ZASCA 158, where the court stated (para 16) that VAT is a broad-based indirect tax applicable in respect of a wide range of goods and services supplied by vendors within the Republic; Bird et al argue that on the whole, as world experience suggests, VAT is definitely the economically preferable way in which to impose a broad-based consumption tax. See Bird RM, Gendron P & Rotman JL "VAT Revisited A New Look at the Value Added Tax in Developing and Transitional Countries" 148 available at http://citeseerx. ist.psu. edu/viewdoc/summary?doi=10.1.1.627.8693 (date of use: 20 August 2018).

[1157] VATCOM Report at 3. In *CSARS v Marshall NO* ibid the court stated (para 16) that the liability to charge VAT arises each time a taxable transaction is carried out by a vendor and does not depend on the profitability or outcome of the transaction. This is because VAT is not a tax on business profits or turnover, but on consumption.

[1158] VATCOM Report at 4. In *CSARS v Marshall NO* ibid at para 17, the court stated that a registered vendor pays VAT, but the amount paid is ultimately passed on to the end consumer. Each time a vendor invoices a customer, the vendor claims a credit for the VAT previously invoiced to it. The VAT paid by the vendor is deducted from the amount of tax charged and, ultimately, the vendor is liable only for the difference between its output tax and the consumer's input tax. VAT is intended to tax "domestic consumption, in particular, including that from imports". See Bird RM, Gendron P & Rotman JL "VAT Revisited: A New Look at the Value Added Tax in Developing and Transitional Countries" 23 available at http://citeseerx.ist.psu.edu/viewdoc/summary?doi=10.1.1.627.8693 (date of use: 20 August 2018).

[1159] VATCOM Report at 4. See the EM on the Value-Added Tax Bill, 1991, where the same points are made with regard to VAT being levied at every point in the chain of production and distribution, and the system of tax credits which prevents escalation of the tax (para 1). According to Bird et al, a definitive statement defines a 'value added tax' as "a broad-based tax levied at multiple stages of production with—crucially—taxes on inputs credited against taxes on output. That is, while sellers are required to charge the tax on all their sales, they can also claim a credit for taxes that they have been charged on their inputs." See Bird RM, Gendron P & Rotman JL ibid at 8. By withholding VAT at each stage in the chain of production, it both achieves the goal of taxing only consumption and, if evaded at the final retail stage, forgoes only that part of the potential tax base consisting of the retail margin (ibid at 148).

[1160] Ibid at 7. Note that the Katz Commission of Inquiry into Taxation, and the Franzsen Commission of Inquiry into Monetary and Fiscal Policy in South Africa, failed to address the issue of VAT on partnership transactions. See the *Ninth Interim Report of the Commission of Inquiry into certain Aspects of the Tax Structure of South Africa* available at

of production and distribution channels. The same amount of tax should be paid irrespective of the channel used.[1161]

South Africa is not an OECD member state,[1162] but it is one of the countries that has endorsed the OECD guidelines on VAT, and, in the main, abides by these guidelines.[1163] These OECD guidelines describe the core features of VAT, but, it must be said, focus in particular on their application to international trade.[1164] VATCOM and the OECD agree on the purpose of, respectively, the VAT Act, and VAT/GST systems internationally.

According to the OECD, the overarching purpose of a VAT is to impose a broad-based tax on consumption,[1165] which corresponds to the proclaimed purpose of the VAT Act. In terms of a broad-based tax, according to the OECD, VAT is not targeted at specific forms of consumption[1166] and is a tax on final consumption by households. This means that the burden of VAT should not rest on business.[1167]

Although the Ottawa Taxation Framework Conditions[1168] were articulated in the context of taxation of electronic commerce, the generally accepted principles of tax policy applicable to consumption taxes that were welcomed, are broadly applicable to VAT systems in both domestic and international trade.[1169] These generally accepted principles of tax policy are the following.

a. **Neutrality:** Taxation should seek to be neutral and equitable between forms of commerce. Taxpayers in similar situations and carrying out similar transactions, should be subject to similar levels of taxation.[1170] Furthermore, the full right to deduct input tax through the supply chain, except

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http://www.treasury.gov.za/publications/other/katz/9.pdf (date of use: 2 September 2018), and *South Africa: Franzsen Commission of Inquiry into Monetary and Fiscal Policy in South Africa*.

[1161] VATCOM Report at 4.

[1162] Olivier & Honiball *International Tax* 311.

[1163] Malony M "OECD's Guidelines on VAT get extensive support" available at https://www.meridianglobal services.com/blog/2014/05/26/OECDs-guidelines-on-VAT-get-extensive-support (date of use: 18 March 2018). South Africa is one of five key partners to the OECD, along with Brazil, China, India and Indonesia. Key partners contribute to the OECD's work in a sustained and comprehensive manner. OECD "South Africa and the OCED" available at http://www.oecd.org/global-relations/keypartners/south-africa-and-oecd.htm (date of use: 8 January 2019).

[1164] Organisation for Economic Co-Operation and Development *International VAT/GST Guidelines* (OECD 2015) para 1.1.

[1165] Ibid at para 1.2.

[1166] Ibid at para 1.3.

[1167] Ibid at para 1.4. This is in line with the EM on the Value-Added Tax Bill, 1991, where it is stated (para 1) that the burden of VAT falls on the end-user or end-consumer.

[1168] Organisation for Economic Co-Operation and Development *Electronic Commerce: Taxation Framework Conditions* (OECD 1998).

[1169] OECD *International VAT/GST Guidelines* para 1.16.

[1170] Ibid.

by the final consumer, ensures the neutrality of the tax, whatever the nature of the product, the structure of the distribution chain, or the means used for its delivery.[1171]

b. **Efficiency:** Compliance costs for businesses, and administrative costs for the tax authorities, should as far as possible be minimised.[1172]

c. **Certainty and simplicity:** The tax rules should be clear and simple to understand so that taxpayers can anticipate the tax consequences in advance of a transaction, including knowing when, where, and how the tax is to be accounted.[1173]

d. **Flexibility:** The systems for taxation should be flexible and dynamic to ensure that they keep pace with technological and commercial developments.[1174]

When contemplating whether a provision in the VAT Act needs to be amended, or whether a new provision should be added, there are a number of issues to consider. It must be determined whether the current VAT treatment of the relevant transaction is ideal. If so, is the relevant provision sufficiently clear, or should improvements be made to the wording, or a new provision be added in order to clarify what was intended? If the current VAT treatment is not ideal, what should the VAT Act provide and how

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[1171] Ibid at para 1.7.

[1172] Ibid at para 1.16.

[1173] Ibid. The successful implementation of VAT requires the prior satisfaction of a number of conditions, including for example, simple, clear and stable tax laws. See Bird RM, Gendron P & Rotman JL "VAT Revisited: A New Look at the Value Added Tax in Developing and Transitional Countries" 120 available at http://citeseerx.ist.psu.edu/viewdoc/summary?doi=10.1.1.627.8693 (date of use: 20 August 2018). Gendron refers to a very important development in 2012 when Canada's Department of Finance examined the GST/ HST treatment of financial services. The examination was to follow the principle of broad revenue neutrality as well as the general tax policy principles of efficiency, fairness, and simplicity. See Gendron (2016) 64/2 *Canadian Tax Journal* 413.

[1174] OECD *International VAT/GST Guidelines* para 1.16. In my view, the OECD's generally accepted principles of tax policy are broadly in consonance with especially the following of Adam Smith's canons with regard to taxes in general, and those proposed by Johan Heinrich Gottlob von Justi, listed further below:

1. Canon of Equality
   The subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state.
2. Canons of Certainty and Simplicity
   The tax which each individual is bound to pay ought to be certain, and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor, and to every other person.
3. Canon of Economy
   Every tax ought to be so contrived as both to take out and to keep out of the pockets of the people as little as possible over and above what it brings into the public treasury of the state. (Smith A *Wealth of Nations* digital ed (MetaLibri 2007) [PDF file] at 640).

The Canon of Economy means that the cost of collection should be as small as possible. See Mundra N "Adam Smith's Canons of Taxation" available at https://tax-taxes.knoji.com/adam-smiths-canons-of-taxation/ (date of use: 2 September 2018). According to Wagner and Harris, a few years before Adam Smith, von Justi described six canons in his treatise on *Natur und Wesen der Staaten*. Justi's formulation of tax canons were as follows:

1. Taxes should be levied in proportion to property, while bearing equally upon all those who possess the same amount of property. 2. Tax obligations should be transparently clear to everyone. 3. Taxes should be convenient and economical, for both taxpayers and the state. 4. A tax should not deprive a taxpayer of necessaries or cause to reduce his capital to pay the tax. 5. A tax should neither harm the welfare of the state and its subjects nor violate the civil liberties of the subjects. 6. A tax should be compatible with the form of government. See Wagner & Harris *Fiscal Sociology* 140.

should the new provision ideally be phrased? Furthermore, if the application of VAT in certain areas is difficult or unclear for whatever reason, should clarification be sought through legislative amendment, or is it preferable for the SARS to issue an interpretation statement to explain the VAT implications? In my view, an interpretation statement is more desirable if there is uncertainty regarding the partnership law that bears upon the nature of the transaction.[1175]

6.3 The VAT consequences of partner contributions

6.3.1 The current VAT treatment

I have stated that the VAT Act does not specifically deal with the VAT treatment of partner contributions to a partnership[1176] which depend on a number of arguments – for example, that a partner can make supplies to the partnership and vice versa,[1177] and that a partner's contribution can be subject to VAT.[1178] In my view, although these conclusions are perhaps not obvious judging from the reasoning building up to each conclusion, no clarifying legislative amendments are required. The SARS can provide guidance, however, by means of an interpretation statement setting out its views, so that all these points are clear to users of the VAT Act.

As regards whether contributions are made for consideration, I have argued that the New Zealand requirement of 'enforceable reciprocal obligations' should be adopted for the VAT Act.[1179] There are a variety of views on the nature of the connection required in order for a payment to constitute 'consideration' for a supply.[1180] The SARS's view that a 'sufficient nexus' is required,[1181] is vague and the VAT jurisdictions I have considered have differently worded provisions and tests for the required link.[1182]

I also needed to consider when obligations are reciprocal under South African law, and this necessitated an investigation of the law of obligations, and contract law in particular.[1183] This also demanded a consideration of the relevant features of a contract of partnership and the meaning of a reciprocal

[1175] Note that the SARS Interpretation Notes are not binding on the courts, but carry persuasive value. See para 2.6.4.1 above.
[1176] See para 2.6 above.
[1177] See para 2.3 above.
[1178] See para 2.6.1 above.
[1179] See para 2.6.5 above.
[1180] See para 2.6.4 above.
[1181] Ibid.
[1182] Ibid.
[1183] See para 2.6.5 above.

contract.[1184] After considering all these matters, I concluded that a partner's share and any profit distributions, are not reciprocally connected and, therefore, not 'consideration' for a partner's contribution. As a result, a partner does not make his required contribution to the partnership in exchange for consideration, save where the partners agree that the partner is to receive a specific payment for his contribution.[1185]

This conclusion is, in my view, not obvious and even debatable, considering that the answer depends on the meaning ascribed to the phrase "in respect of, in response to, or for the inducement of", in the definition of 'consideration',[1186] which is not defined in the VAT Act. There is no guarantee that the South African courts will adopt the New Zealand courts' and the NZRA's requirement of 'enforceable reciprocal obligations' to determine whether a sufficient connection exists between a partner's contribution and a partner's share, in order for the one to constitute consideration for the other. Moreover, the answer to the question is dependent on a proper understanding of the nature of a partnership contract, which I concluded is not a reciprocal contract.[1187] In addition, some of the VAT/GST jurisdictions do not agree on whether capital contributions and partners' shares are given in exchange, although the relevant legislative provisions in the jurisdictions I have considered are different.[1188]

I concluded that when a partnership agreement is entered into, the partners' shares simply accrue to the partners.[1189] The partners' shares are, therefore, not supplied to the partners when the partnership is formed. I am of the opinion, however, that it is not unreasonable to hold the view that partner's shares are supplied to the partners on formation, because of a partnership's status as a person for VAT purposes, and, therefore, its ability to make supplies. The VAT Act should clarify the current status, unless the VAT Act is amended to provide for an alternative VAT treatment of partner contributions. I address this below.[1190]

In my view, this uncertainty constitutes a violation of the OECD's policy of certainty and simplicity, and needs to be tidied up by means of legislative reform. One option is to add a provision clarifying the current position. I therefore propose that the following provisions be inserted in the VAT Act:

[1184] Ibid.
[1185] Ibid.
[1186] See s 1(1).
[1187] See para 2.6.5 above.
[1188] See para 2.6.4 above.
[1189] See para 2.8 above.
[1190] See paras 6.3.4 and 6.3.5 above.

a. partners' shares that come into existence upon the formation of a partnership, are not received by the partners by means of a 'supply' as defined in section 1(1);[1191] and

b. a partner's share, and any profit distributions, do not constitute 'consideration', as defined in section 1(1), for a partner's capital contribution to the partnership, excluding a specific payment made for that contribution.[1192]

6.3.2 Whether partner contributions should be subject to VAT

I now consider whether the *status quo* should be maintained – ie, subjecting partner contributions that meet the requirements of section 7(1)(*a*), to VAT. I earlier referred to the ECJ case of *KapHag*,[1193] where it was held that the entry of a new partner into a partnership in consideration for a contribution in cash, does not constitute an economic activity on the part of the partner within the meaning of the Sixth Directive. According to van Doesum, although the ECJ has delivered various judgments on contributions in cash to partnerships, it remains unclear whether a contribution in kind is a taxable supply under current European VAT law.[1194] In van Doesum's view, there are compelling arguments to be made for the view that a contribution in kind to a partnership is not a taxable supply under the European VAT law.[1195] The question is whether the example of the European VAT law should be adopted for the VAT Act. This can be achieved by specifically deeming partner contributions not to be subject to VAT, even if the contribution is made in the course or furtherance of the partner's enterprise and for consideration.

Van Doesum considers what the preferred VAT treatment of contributions to partnerships is under European VAT law, by testing it against the fundamental principles of European VAT law as acknowledged by the ECJ.[1196] He states that it can be argued that the legal character of VAT – which is the principle that VAT aims at taxing only the final consumer[1197] – and the principle that VAT must be proportional to price, demand that contributions in kind be treated as taxable transactions.[1198] He points out that if the contributing partner can deduct the VAT on the costs of the goods or services he contributes, the partnership obtains such goods or services without the burden of VAT.[1199] He further

[1191] The proposed new provision must be inserted into the VAT Act as part of the definition of "supply" in s 1, instead of s 8 which is headed: "Certain supplies of goods or services deemed to be made or not made" (my underlining). This provision would not be a deeming provision, but would serve to clarify the current position under the VAT Act.
[1192] The proposed new provision must be inserted into the VAT Act as part of the definition of 'consideration' in s 1.
[1193] See para 2.6.3 above.
[1194] Van Doesum 2010-6 *EC Tax Review* 259.
[1195] Ibid at 266.
[1196] Ibid at 259.
[1197] Ibid at 269.
[1198] Ibid at 270.
[1199] Ibid.

argues that not taxing a contribution in kind also infringes the principle of neutrality, because of the inequality which arises when compared to the ordinary supply of goods or services for consideration.[1200]

Not subjecting partner contributions to VAT, would similarly be contrary to VATCOM and the OECD's intention that VAT should be a broad-based, neutral tax on consumption. Partner contributions should, therefore, be taxable like most other goods and services. If the contributions are not taxable, the relevant acquisitions would not be directly and immediately linked to the making of taxable supplies and the partner would probably not be entitled to deduct the VAT on them as input tax.[1201] This would result in the burden of the VAT resting on a 'business'. In my view, these considerations favour continuing with current VAT treatment of partner contributions.

6.3.3 Whether contributions of labour should be taxable

Notwithstanding my conclusion that partner contributions should be subject to VAT provided that the relevant requirements are met,[1202] a question as to whether partners' contributions of labour, in particular, should be excluded from VAT arises. In my view, there is merit in the arguments for such an exclusion, as well as legislative precedent which supports it. I have referred to section 272.1(1) of Canada's ETA[1203] which provides that, "anything done by a person as a member of a partnership is deemed to have been done by the partnership in the course of the partnership's activities and not to have been done by the person."

I argue that where a partner supplies services to a client as agent on behalf of the partnership, both the partner and the partnership could incur VAT liability.[1204] The partnership may be required to account for output tax on the partner's supply made as agent for the partnership, whereas the partner may be required to account for output tax on his contribution of labour to the partnership. Clearly, the same activity – ie, the partner rendering services to a client – gives rise to a VAT liability for two separate persons.

A VAT liability for two separate persons on the basis of a single performance, is not abnormal considering the New Zealand Court of Appeal case *Suzuki New Zealand Ltd v CIR*.[1205] The facts were that one fault sometimes could and did stimulate repair by SNZ both under its warranty to the customer,

[1200] Ibid.
[1201] See *ITC 1744* in para 4.11 above.
[1202] See s 7(1)(*a*).
[1203] See para 3.3.1 above.
[1204] See para 2.6.2 above.
[1205] (2001) 20 NZTC 17,096.

and at SMC's behest to cover warranty breach by SMC.[1206] The court held that this is simply an instance of the common enough situation in which performance obligations under two separate contracts with different counter-parties overlap, with the result that performance of an obligation under one contract, also happens to constitute performance of an obligation under another. In such a case, the court held, a supply can simultaneously occur for GST purposes under both contracts.[1207]

In my view, it can be argued that this 'double' VAT liability violates the OECD principles of neutrality and efficiency.

The distinction made, for VAT purposes, between an employee's supply of services in the course of his employment, and a partner's supply of services on behalf the partnership, is perhaps questionable. Proviso (iii)(*aa*) to the definition of 'enterprise'[1208] provides that the rendering of services by an employee to his employer in the course of his employment,[1209] is not deemed to be the carrying on of an enterprise.[1210] This only applies to the extent that 'remuneration'[1211] is paid to such employee.[1212] As a result, an employee is not considered to be carrying on an enterprise and is, therefore, not required to levy VAT on the remuneration he receives.

Admittedly, a partner and an employee are not exactly the same, which probably justifies their different treatment under the VAT Act. Partners have the power to act as each other's agents. Whilst an agent has authority to make contracts between his principal and third parties, a servant is employed to carry out his master's orders.[1213] Furthermore, in terms of the common law, a partner cannot be an employee of the partnership since a person cannot contract with himself.[1214]

The position of a partner and an employee are, however, similar in other respects. It may happen that for some purposes a servant or employee is vested with authority to contract. The employee is then *pro hac vice*[1215] an agent.[1216] Therefore, both a partner and an employee could be acting as agent on behalf of a partnership and an employer, respectively. It was stated above[1217] that it is a *naturale* of

[1206] See the discussion of the New Zealand High Court decision in *CIR v Suzuki New Zealand Limited* in para 2.6.4.1 above.
[1207] Ibid at para 23.
[1208] Section 1(1).
[1209] Or the rendering of services by the holder of an office in performing the duties of his office.
[1210] Proviso (iii)(*bb*) to the definition of 'enterprise' states that subparagraph (*aa*) does not apply in relation to any employment or office accepted by a person in carrying on an enterprise carried on by him independently of the employer or concern by whom the amount of remuneration is paid.
[1211] Remuneration as contemplated in the definition of 'remuneration' in para 1 of the Fourth Schedule to the IT Act.
[1212] See proviso (iii)(*bb*) to the definition of 'enterprise'.
[1213] Silke *Law of Agency* 17.
[1214] Ramdhin et al "Partnership" para 279; Scamell & I'anson Banks *Lindley on the Law of Partnerships* 34.
[1215] For or on this occasion only.
[1216] Silke *Law of Agency* 17.
[1217] See para 3.3.2 above.

partnership that every partner has the authority to conclude transactions within the scope of the partnership's business and, accordingly, act as agent for his co-partners. The partners can, therefore, agree that a particular partner's agency powers be excluded, although such a partner could, logically, continue to render services for the partnership in the same way that an employee would for his employer.

In my view, the principle of neutrality is violated, because despite the 'similarities' between a partner and employee, they are treated differently under the VAT Act. It must be noted that the neutrality principle only requires that taxpayers in 'similar' situations carrying out 'similar' transactions should be treated similarly. A partner could be required, whilst an employee is not required, to account for VAT on the supply of services on behalf of, respectively, a partnership or an employer. Conversely, however, not taxing partner contributions also violates the neutrality principle, considering that supplies of other goods or services for consideration are generally taxed.[1218]

It is, furthermore, arguable that the levying of VAT on a partner's contribution of labour also potentially violates the principle of efficiency. Should the partnership make taxable supplies only, it would in any case be entitled to deduct any VAT levied on a partner's supply of services as input tax, resulting in a net nil liability and, therefore, no gain to the *fiscus*. If section 10(4) does not apply and so deem the consideration for the supply to be its open-market value, the value of the supply would be deemed to be nil.[1219] The *fiscus* could gain, however, if section 10(4) applies – ie, the supply is made for no consideration,[1220] and the partnership is not exclusively involved in the making of taxable supplies. The partnership would be denied an input tax deduction to the extent of its non-taxable use of the supply.[1221] To the extent that a partner's supply would not result in a gain for the *fiscus*, the requirement that he levy VAT on his services where the requirements of section 7(1)(*a*) are met, results in unnecessary compliance costs for partners and partnerships, and administrative costs for the SARS. This is because the partner must register separately for VAT, and the partner and the partnership respectively, must account for output and input tax.

Arsenault and Kreklewetz contend that one of the most important implications of section 272.1(1) of Canada's ETA, to which I referred above,[1222] is the extent to which it can be used to shelter a partner's 'services' to the partnership from GST.[1223] In other words, a partner could be supplying services to the partnership as a third-party supplier, and falsely claim to be acting as a member of the partnership in

[1218] Van Doesum 2010-6 *EC Tax Review* 270.
[1219] Section 10(23).
[1220] Or for a consideration which is less than its open market value.
[1221] See the definition of 'input tax' in s 1(1) read with s 17(1).
[1222] See para 3.3.1 above.
[1223] Arsenault & Kreklewetz "Partnerships" 45.

order to avoid GST registration and having to account for GST. This problem is similar to the difficulty experienced under the South African VAT Act in distinguishing between a payment made as consideration for a partner's supply, and a distributive share of profits.[1224]

The issue discussed by the CRA in CRA Policy Statement P-244, is the interpretation of the phrase "anything done by a person as a member of a partnership" in section 272.1(1).[1225] The policy statement lists three principal factors which the CRA proposes to apply in order to make this determination, namely: the terms of the partnership agreement; the nature of the action taken by the partner; and whether the partner is performing the activity only for the partnership, or as a separate business.[1226] Regarding the terms of the partnership agreement, a relevant question is whether the partner receives a separate consideration for the supply.[1227]

In my view, judging from the third example given by the CRA of how the criteria in CRA Policy Statement P-244 should be applied, the CRA favours whether a separate consideration is paid as a very important indicator; perhaps even as the decisive indicator. The following factual scenario is given under example 3:

> A partnership is engaged exclusively in a logging business. One of the partners, Mr. T, is an accountant who operates an accounting business and is registered for GST/HST purposes. Under the written partnership agreement. Mr. T contributes to the partnership and receives partnership profits in an equal proportion with the other partners. Also under the partnership agreement. Mr. T provides accounting services to the partnership and is paid a monthly fee based on his normal rate per hour for those services. Mr T's conduct in providing the accounting services and invoicing for those services is consistent with the terms of the written partnership agreement. (Emphasis supplied.)

Notwithstanding that the accounting services are included in the written partnership agreement, the CRA argues that as T is receiving a separate fee for the accounting services, and that he is carrying on a separate accounting business, he is providing the services otherwise than in the course of the partnership's activities. Section 272.1(1) is, therefore, not applicable, and GST must be levied on the consideration for the supply.[1228]

Considering the CRA's interpretation of section 272.1(1), the CRA's views on when GST should be applied to a partner's supply of services to a partnership, are very similar to the treatment of partner

[1224] I argue that if the payment is consideration, then the supply would be subject to VAT, subject to the relevant requirements being met. If, however, the payment is a profit distribution then it would not be vatable. See para 3.2.3 above.
[1225] CRA Policy Statement P-244 at 1.
[1226] Ibid at 1 – 2.
[1227] Ibid at 2.
[1228] Ibid at 5; s 272.1(3) applies instead. This provision deals with the situation where a partner supplies property or a service to the partnership otherwise than in the course of the partnership's activities.

contributions under the VAT Act.[1229] This is despite the VAT Act not having a provision similar to section 272.1(1). Admittedly, in the example, the CRA does not only rely on the partner receiving a separate consideration for his services. It gives as an additional reason that the partner carries on a separate accounting business to override the consideration that he is required, in terms of the partnership agreement, to render the services. It is not clear from the example how much weight the CRA attaches to the various factors, and whether the CRA would have come to the same conclusion had the partner not carried on a separate accounting business. In other words, it is not clear whether the payment of a separate consideration is a decisive factor that will, at least according to the CRA, on its own trump the terms of the partnership agreement which require the partner to render the services.

Arsenault and Kreklewetz's concern with CRA Policy Statement P-244, is the lack of emphasis on the legal relationships created by the parties, which is normally determined from the written partnership agreement.[1230] They argue that the responsibilities of the partners as set out in the partnership agreement, should be paramount in deciding whether a partner's actions are 'as a member of the partnership'. In essence, if the partner's actions are included in the partnership agreement, the partner should be taken to be acting as a member of the partnership in that respect.[1231]

This is also true for South Africa considering, firstly, that whether a supply constitutes a contribution depends on the terms of the partnership agreement because it is an *essentialia* of a contract of partnership that each of the partners bring something into the partnership. Secondly, the fundamental object of interpreting a contact is to ascertain and give effect to the common intention of the parties.[1232] If the partnership contract provides that a partner is required to contribute the relevant services to the partnership, then it can hardly be denied that when he supplies those services to the partnership, he is doing so in accordance with the partnership contract. Whether that partner only receives profit distributions, or a separate payment, is irrelevant. As stated above,[1233] in terms of South African partnership law, it is a *naturale* of the partnership agreement that a partner is not entitled to compensation for his contribution. The partners may, therefore, specifically agree that a partner is entitled to a separate payment for services rendered. The fact that he receives a separate payment for his services does not in itself mean that he is not supplying the services in terms of the partnership contract.

[1229] I stated in para 3.2.3 above, that if the partnership's payment to a partner in return for his supply to the partnership is consideration, then the partner's supply would be subject to VAT if it is made in the course or furtherance of his enterprise.
[1230] Arsenault & Kreklewetz "Partnerships" 44.
[1231] Ibid. Van Doesum, agreeing that it may not always be clear in what capacity a partner acts, also argues that the arrangements between the parties involved should be conclusive. The obligations and powers in the partnership agreement are, therefore, the primary indication for the capacity in which a partner acts. See van Doesum 2010-6 *EC Tax Review* 263.
[1232] Joubert "Contract" para 351.
[1233] See para 2.6.5 above.

Moreover, in terms of the common law, if labour is contributed, it need not be made available exclusively to the partnership.[1234] Therefore, that a partner supplies labour to both the partnership and to a third party, does not mean that his supply to the partnership is a third-party supply and not a contribution.

Should a provision similar to section 272.1(1) be adopted in the VAT Act, one could argue that whether a partner incurs VAT liability on services supplied to the partnership, subject to meeting the relevant requirements, would simply depend on whether the services are specified in the partnership contract. This makes for easy tax planning. By simply including the services in the partnership contract, a potential VAT liability is avoided. However, in my view, this would be a clear violation of the neutrality principle. If two partners render identical services to the partnership, and they receive equal remuneration, and only one of the partners' services are included in the partnership contract, the one partner could incur VAT liability, while the other does not.

Perhaps the CRA is aware of what I perceive to be the shortcomings of section 272.1(1), and therefore accords the provision an interpretation that is somewhat more acceptable. As stated above,[1235] the CRA's interpretation of section 272.1(1) is very similar to the treatment of partner contributions under the VAT Act.

I am of the view that a provision such as section 272.1(1) should not be adopted for the VAT Act. The ease with which VAT liability on a partner's supply of services to the partnership can be avoided, militates against adopting a similar provision.

As regards the violation of the neutrality principle, van Doesum argues that it is more harmful to the functioning of the European VAT system to treat contributions differently from supplies for consideration, than to treat contributions differently from other forms of investment. He reasons that VAT is a tax on transactions and not on investments, and that inequalities in relation to transactions should outweigh inequalities in relation to other forms of investment.[1236] I agree with van Doesum's argument because, in the case of the South African VAT Act, there would be a broader violation of the neutrality principle were partner contributions not taxable, as it would be treated differently to supplies

[1234] Ramdhin et al "Partnership" para 263. In *V (also known as L) v De Wet NO* [1953] 2 All SA 68 (O) the issue was whether a partnership existed between the applicant and the deceased prior to his death. The applicant and the deceased lived continuously as a man and wife for 21 years and two children were born from the relationship. The deceased was a married man living apart from his lawful wife. The partnership was one of a painting and decorating contractor. The court held that a partnership had existed between the applicant and the deceased despite the applicant contributing labour to the partnership, by doing all the office and clerical work, but in addition to this work and separate from the partnership, the applicant also attended to all the household duties attendant on raising the two children (at 72).

[1235] See under this sub-heading.

[1236] Van Doesum 2010-6 *EC Tax Review* 270.

made for a consideration in general. Should partner contributions of labour and employee services be sufficiently comparable, as I argue above,[1237] the infringement of the neutrality principle would be limited and, therefore, less serious.

I am also not in favour of the adoption of an amended version of section 272.1(1) for the VAT Act. Such an amendment will effectively provide that a partner's contribution of labour is excluded from VAT, if the requirement to provide the labour is included in the partnership contract, and if the labour is not separately remunerated. Currently, the determining factor as to whether a partner is required to levy VAT on his contributions, including on the supply of services, is in any case whether the partner is paid a separate consideration for the services, instead of receiving profit distributions alone.

6.3.4 Partners' shares and company shares

6.3.4.1 Whether partner shares should be treated the same as company shares

An alternative is to subject a partner's share to the same VAT treatment as a company share. Company shares are issued by the company[1238] in return for a consideration,[1239] and their issue and transfer are exempt from VAT.[1240] Apart from exempting the supply of a partner's share, parity between company and partners' shares also requires that the partnership be regarded as issuing the partners' shares, and that the capital contribution made by a partner be deemed a consideration for the partner's share, in the same manner that the share issue price is consideration for the issue of a company share.

In my view, Advocate-General Jacobs's observations in the *Kretztechnik* case[1241] on the similarity between the issue of a partner's share and a company share, also hold true for South Africa. He states that both a holding in a partnership and a share in a limited company involve part-ownership of the entity concerned, and thus, indirectly, of its assets.[1242] He argues that the issue of new shares in exchange for cash, which will increase a company's capital, is closely comparable in economic terms, to the admission of a new partner in exchange for a cash contribution to a partnership's assets.[1243] According to van Doesum, the ECJ does not distinguish between the admission of a partner to a

[1237] See under this sub-heading.
[1238] See Delport et al *Henochsberg* 157, 158; Cassim FHI et al *Contemporary Company Law* 2 ed 197.
[1239] Delport ibid at 178, 178(1), 178(2).
[1240] Section 12(*a*) provides that the supply of any financial services is exempt from VAT. In terms of s 2(1)(*d*) the issue, allotment, or transfer of ownership of an equity security is deemed to be a financial service. 'Equity security' is defined in s 2(2)(iv) as meaning, inter alia, an interest in or right to a share in the capital of a juristic person. A 'juristic person' includes a company. See Du Bois et al *Wille's Principles* 395 - 399; Cassim FHI et al *Contemporary Company Law* 28.
[1241] The *Kretztechnik* case C-465/03 26 May 2005. See para 2.8 above.
[1242] Opinion of Advocate-General Jacobs in the *Kretztechnik* case at para 44.
[1243] Ibid.

partnership in consideration of a payment of a contribution in cash, and the issue of shares in a company.[1244]

Both a partnership and a 'company' are included in the definition of 'person'.[1245] I argue that the deeming of a partnership to be a person for VAT purposes, implies that a partnership, like a juristic person, is endowed with the capacity to acquire rights and incur obligations.[1246] The members of a company pay an amount to the company when they subscribe for shares. This money forms part of the company's share capital and is owned by the company.[1247] In the case of a partnership, the capital contribution which a partner is required to make, is subject to the risks of the partnership business.[1248]

A member owns a share in the company, which consists of a bundle of personal rights entitling the holder to a certain interest in the company, its assets, and its dividends.[1249] A partner's share, like a company share, entitles a partner to an interest in the partnership property and to profits.[1250]

In terms of the Australian GST Act,[1251] Canada's ETA,[1252] the UK's VAT Act,[1253] and the EU's Council Directive,[1254] the issuing and transfer of a partner's share are exempt from VAT/GST. Judging from the provisions in these foreign VAT/GST jurisdictions, the issuing or supply of a partner's share is regarded as a financial service.

The different VAT treatment of a partner's share and a company share under the VAT Act violates the neutrality principle considering the marked similarity of the two types of interest. However, neutrality

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[1244] Van Doesum 2010-6 *EC Tax Review* 264. See the *Kretztechnik* case ibid at paras 23 - 25.

[1245] 'Person' is defined in s 1(1) as including a 'company', which is defined in s 1(1) as meaning a company as defined in the IT Act. The IT Act defines 'company' in paragraph (*a*) of its definition in s 1 as meaning, amongst others, a company incorporated by or under a law in force in the Republic.

[1246] See para 2.3 above.

[1247] Williams *Concise Corporate and Partnership Law* 119; Van Dorsten *South African Business Entities* 131 para 3.8.5.

[1248] See para 2.3 above.

[1249] See para 4.8.2 above.

[1250] See para. 2.6.3 above.

[1251] In terms of s 40-5(1) a financial supply is input taxed. Section 40-5(2) provides that a financial supply has the meaning given by the regulations. Subdivision 40-A of the regulations deals with financial supplies. Under sub-regulation 40-5.09(1), the provision, acquisition, or disposal of an interest in or under securities, including the capital of a partnership, is a financial supply if certain requirements are met.

[1252] Section 123(1)(d) defines a 'financial instrument' as, inter alia, an interest in a partnership. 'Financial service' is defined in s 123(1)(d) as meaning "the issue, granting, allotment, acceptance, endorsement, renewal, processing, variation, transfer of ownership or repayment of a financial instrument." The supply of an interest in a partnership is exempt under Schedule V to Canada's ETA.

[1253] See Hemmingsley & Rudling *Tolley's Value Added Tax* para 23.17; UK Government VAT Guide (VAT Notice 700) para 29.4.10 available at https://www.gov.uk/guidance/vat-guide-notice-700 (date of use: 30 August 2018).

[1254] In terms of art 135(1)(f), transactions, including negotiation but not management or safekeeping, in shares, interests in companies or associations, debentures, and other securities are exempt from VAT. Partner shares are included in the interests envisaged in article 135(1)(f). See Van Doesum 2010-6 *EC Tax Review* 263. Note that the EU's Council Directive is riddled with VAT exemptions, but they are not relevant to the VAT treatment of partnership transactions.

also calls for VAT on the value of financial intermediation services, except for capital amounts, so that all economic activities are treated equally.[1255] There are, nevertheless, arguments both for and against the exemption of financial services.[1256]

The question is how the proposed provisions, which would align the VAT treatment of partners' shares with that of company shares, should be worded. In the case of Australia, the ATO is of the view that the interests which the partners acquire on formation of a partnership constitute consideration for the partners' capital contributions and the mutual obligations that each partner undertakes.[1257] This is not explicitly addressed in the Australian GST Act, but is inferred by the ATO from relevant provisions. The ATO also argues that the better view is that the interests in a partnership are supplied by the partnership and not by the partners to each other.[1258] It reasons that "the partnership entity creates an interest in the partnership in making the supply of that interest". This view, the ATO contends, arises from the acceptance of a partnership as an entity, and "the fact that partners may act in the capacity of partners".[1259] In supplying the interest to the partner, the partnership makes a financial supply which is input- taxed.[1260]

[1255] According to Bird, equity is always and everywhere a central issue in taxation. He argues that equity, with efficiency and administrability, is one of the three principle objectives of designing any tax system. One approach to equity issues, is to consider the details of exactly how different taxes impose burdens on taxpayers who are in the same and different economic circumstances. (Bird M "Value-Added Taxes in Developing and Transitional Countries: Lessons and Questions" available at https://epdf.pub/download/the-vat-in-developing-and-transitional-countries.html (date of use: 19 August 2019) 19, 20)

[1256] As taxing the use of capital may be damaging to an economy, financial services are generally exempt from consumption taxes.. See Cahiers De Droit Fiscal International: 2003 Vol LXXXVIII b: *Consumption Taxation and Financial Services* (IFA cahiers) (Kluwer Law International, International Fiscal Association (IFA) 2003) 30 (hereafter *Cahiers*). According to Bird et al, two reasons are used to justify the exemption of financial services from VAT. First, it may be argued that the consumption of financial services should not be taxed in the first place. However, they contend, contrary to this argument, that the basic logic of VAT would seem to imply that household consumption of financial services should fall into the VAT net since the production of such services consumes real resources, and hence adds value. Secondly, the outputs from financial services activity are so difficult to tax for a variety of reasons, that it is preferable to sacrifice taxing household consumption and instead settle for simply collecting some VAT revenues on inputs used by registered traders along the supply chain. The major difficulty is identifying the intermediation service element that is part of a margin or spread. Under the system found in most VAT countries, financial services are untaxed, but input VAT incurred by suppliers of financial services cannot, for the most part, be recovered. See Bird RM, Gendron P and Rotman JL "VAT Revisited A New Look at the Value Added Tax in Developing and Transitional Countries" 69, 70 available at http://citeseerx.ist.psu.edu/viewdoc/summary?doi=10.1.1.627.8693 (date of use: 20 August 2018). The disallowance of an input credit in the case of an exempt supply will also reduce the neutrality of the VAT, as producers may be induced to purchase other inputs. See Van Oordt *A quantitative measurement of policy options to inform value-added tax reform in South Africa* (PhD thesis University of Pretoria 2015) at 53. NB om te noem dat in SA is die exemption minimaal. Die lys van welke finans dienste belasbaar is, is baie lank. Daarom het SA wel input claims op Fin dienste, maar die input is apportioned. In New Zeeland is daar weer 'n 'limited input credit' om te verhoed dat die 'inputs' wat nie geëis kan word nie, cascade na die verbruiker toe.

[1257] See GSTR 2003/13 paras 32, 58 and 59.

[1258] GSTR 2003/13 para 55.

[1259] Ibid at para 56.

[1260] Ibid at paras 36, 56. If a supply is 'input taxed', no GST is payable on it, but the supplier normally cannot claim input tax credits for the GST payable on its business inputs relating to that supply. See McCouat *Australian Master GST Guide* [E-book] Location 19.

The ATO argues that although the partnership interests are supplied by the partners, they are deemed by section 184-5(1) of the Australian GST Act, to be supplied by the partnership, including at the formation of the partnership. Section 184-5(1) provides that supplies and acquisitions made by or on behalf of partners in their capacity as partners, are treated as supplies and acquisitions by the partnership.[1261] I argue that the ATO's reliance on section 184-5(1) is questionable since a partner does not act in his capacity as partner representing the partnership when he enters into a partnership agreement.[1262] Considering Arsenault and Kreklewetz's commentary on section 272.1(1) of Canada's ETA below,[1263] which is similar to section 184-5(1),[1264] they support my view. Furthermore, the relevance to the ATO of a partnership being an entity is that the partnership is capable of making supplies, including the issuing of the partner's shares at the formation stage.

I stated that in the case of Canada, Arsenault and Kreklewetz claim that the CRA's position is that the making of a capital contribution to a partnership is not included under section 272.1(1) of Canada's ETA. Rather, it is characterised as a supply by the partner to the partnership in exchange for an exempt partnership interest.[1265] They contend that to the extent that the partners are seen to obtain an interest in the partnership from the partnership's formation, or in return for their contribution of property, the supply of that interest is an exempt supply of a financial service.[1266] The partnership interest, they state, is issued from the partnership to the partner. They argue that this follows from the definitions of 'financial instrument', 'financial service', and the general exemption for supplies of financial services in Schedule V to the ETA.[1267] The argument is that insofar as 'the issue' of an interest in a partnership is a 'financial service',[1268] it is only the partnership which can be presumed to issue that interest.

In my view it should be apparent from the above discussion, that both the Australian GST Act and Canada's ETA are not entirely clear that a partner's capital contribution is made in exchange for a partner's share, and that such partner's share is issued, and therefore supplied, by the partnership to the partner on the partnership's formation. If this is what the VAT Act should ideally provide, then, unlike Australia and Canada, this must be expressly and clearly stated for the sake of certainty and simplicity.

[1261] GSTR 2003/13 para 28. See para 2.8 above where s 184-5(1) is cited, and also see para 3.3.1 above.
[1262] See para 2.8 above.
[1263] See under this sub-heading.
[1264] See para 2.6.2 above.
[1265] See para 2.6.5 above.
[1266] Arsenault & Kreklewetz "Partnerships" 27.
[1267] Ibid.
[1268] See the definitions of 'financial instrument' and 'financial service' in s 123(1)(d).

6.3.4.2 Implications of treating partners' shares the same as company shares

I now consider what the impact is of deeming the partners' shares as issued by the partnership in return for the partner's capital contribution, and of exempting the issue and transfer of partners' shares from VAT.

I argue that if the issue of a partner's share is deemed to be received by a partner as consideration for making his contribution, this would have no bearing on whether his contribution is taxable. If the contribution is made by the partner in the course or furtherance of carrying on an enterprise it is taxable, regardless of whether or not the supply of the partner's share to the partner is exempt. As a partner's share is consideration that is not in money, the open-market value of the share would, in terms of section 10(4), be the consideration for the partner's contribution.

A question arising is whether any VAT levied on the partner's contribution is deductible as input tax by the partnership. According to the ATO, it has been suggested that when a partnership acquires an in-kind capital contribution, the acquisition is either not for, or only partly for, a creditable purpose because it relates to the supply of a partnership interest which is input taxed.[1269] The ATO argues, however, that although the in-kind contribution is consideration for the supply of the partnership interest, the acquisition relates to the actual operation of the partnership and, therefore, to the making of supplies by the partnership in the course of its ordinary or general business. Any claim for input tax credits is, accordingly, determined by reference to the use of the in-kind capital contribution in the partnership's business activities, and qualifies as a creditable acquisition provided that the relevant requirements are met.[1270]

This argument would also be true for the VAT Act should it provide that the contribution is consideration for the partner's share supplied by the partnership. Input tax is deductible if the relevant goods or services are acquired for a taxable purpose.[1271] I agree with the ATO, that the contribution is not acquired by the partnership for issuing the partner's share, but for whatever purpose the partnership has in mind with the contribution.

If the supply of a partner's share is exempt from VAT, a valid concern is how the exemption affects the deduction by the partnership (or a partner) of the VAT on accompanying expenses as input tax, since,

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[1269] GSTR 2003/13 para 66.

[1270] Section 11-5 of the Australian GST Act provides that: "You make a creditable acquisition if: (a) you acquire anything solely or partly for a creditable purpose; and (b) the supply of the thing to you is a taxable supply; and (c) you provide, or are liable to provide, consideration for the supply; and (d) you are registered, or required to be registered". See GSTR 2003/13 para 67.

[1271] See 'input tax' as defined in s 1(1).

according to VATCOM, VAT is intended to burden only the private consumer.[1272] Reference is made above to *ITC 1744,*[1273] where the court held that the appellant was not entitled to deduct the VAT levied on services directly and immediately linked to the issue of shares, which are exempt.[1274] Therefore, VAT incurred on any expenses directly and immediately linked to the issue of the partners' shares, would not be deductible as input tax by the partnership. This means that the VAT burden rests on a 'business'.

According to VATCOM, exemption is beneficial if the vendor's clients are wholly or principally end-consumers, but not if they are vendors.[1275] Breaking the VAT chain in the business sector increases prices as the costs of the vendor making exempt supplies are increased by the tax on inputs he must bear. He increases the price of his supplies to recover these additional costs. When the exempt goods or services are supplied to another vendor, the other vendor pays a price which includes the first vendor's tax on inputs. If the second vendor applies these goods or services to make taxable supplies, he builds the first vendor's input tax into his price, resulting in double taxation.[1276]

The VAT on inputs which the partnership cannot deduct because of the exempt issue of the partners' shares, can be included in the prices of goods or services supplied by the partnership. This disadvantages clients who are vendors.[1277] In my view, this exemption will have a limited impact in terms of VAT-cascading in that the issuing of partners' shares is uncommon, and the VAT on accompanying costs will also be minimal. The non-deductible VAT can, alternatively, be included in the price paid for the partner's share.[1278] This is not expected to result in VAT-cascading because it is unlikely that a partner's share will be on-supplied by a partner as part of an enterprise activity.[1279]

[1272] VATCOM Report at 4. According to Bird et al, most broad-based consumption taxes in the world (eg, New Zealand's GST) come close to including most final (private) consumption in the tax base. See Bird RM, Gendron P & Rotman JL "VAT Revisited A New Look at the Value Added Tax in Developing and Transitional Countries" 91 available at http://citeseerx.ist.psu.edu/viewdoc/summary?doi=10.1.1.627.8693 (date of use: 20 August 2018)

[1273] *ITC 1744*. See para 4.11 above.

[1274] That is, in terms of s 12(*a*), read with s 2(1).

[1275] Note, however, that exemption in the context of VAT does not mean 'tax free', as exempt suppliers incur VAT on taxable purchases, whilst they do not receive input tax credits as do taxable suppliers. See Smart M and Bird R "VAT in a federal System: Lessons from Canada" available at https://papers.ssrn.com/sol3/papers. cfm?abstract_id=2115622 (date of use: 28 August 2018).

[1276] VATCOM Report 6. This is also referred to as cascading of VAT because the 'hidden' VAT becomes part of the cost of the product. See *Cahiers* at 31.

[1277] Where VAT cascades through the system, such VAT can be incorporated in the price of exempt supplies. See Bird RM "The GST/HST: Creating an Integrated Sales Tax in a Federal Country" *International Center for Public Policy Working Paper 12-21* April 2012 at 6.

[1278] See the discussion on *Skatteverket v AB SKF* in para 4.11 above.

[1279] See para 4.8.3 above.

Furthermore, I argue that, assuming that the partnership holds the partners' shares and that it supplies those shares to the partners upon the establishment of the partnership, those supplies will probably not be made in the course or furtherance of carrying on an enterprise.[1280] In the unlikely event that the supply of the shares is made as part of an enterprise activity – eg, the partnership trades in partner's shares – the supply could be subject to VAT,[1281] and the proposed exemption would only then apply. In order for an exemption to apply, the requirements of section 7(1)(*a*), including the enterprise requirement, must be met. The point is that the proposed exemption would, in all likelihood, rarely apply. This would, however, not reduce the possibility of VAT-cascading. If a partner's share is not issued as part of an enterprise activity, the share issue is not subject to VAT and the VAT incurred on any attendant expenses cannot be deducted. In terms of the *De Beers* case, which I discuss above,[1282] VAT on expenses incurred as part of a non-enterprise activity, is not deductible as input tax.

The exemption of the issue of partners' shares could create administrative and compliance difficulties, in that it would result in the partnership having both taxable and exempt supplies.[1283] This violates the efficiency principle. The partnership might be required to apportion the VAT on its overheads between that portion which is deductible as input tax, and that portion which is not deductible.[1284] As the issuing of partners' shares will, most likely, not be undertaken regularly, it is worth noting that where the intended use of overheads is at least 95 per cent, it is deemed to have been acquired solely for the purpose of making taxable supplies, and, the VAT it attracts need not be apportioned.[1285]

In my view, when considering whether to subject partners' shares to the same VAT treatment as company shares, the adherence to the neutrality principle outweighs the adverse consequences of VAT-cascading and the burdening of businesses with VAT. There is no justification for granting partnerships a more favourable VAT dispensation than companies with regard to the issuing and transfer of ownership interests.

The question at the heart of the appeal in *CSARS v Marshall NO*[1286] was whether the aero-medical services supplied by the respondent to provincial health departments, were a 'deemed supply' of services as contemplated in section 8(5),[1287] and whether payments received for the services thus

[1280] See para 2.8 above.
[1281] See para 4.8.3 above.
[1282] See para 2.6.3 above.
[1283] VATCOM Report 6.
[1284] See the definition of 'input tax' in s 1(1) read with s 17(1).
[1285] Proviso (i) to s 17(1).
[1286] *CSARS v Marshall NO* (816/2015) [2016] ZASCA 158.
[1287] Section 8(5) provides that a designated entity shall be deemed to supply services to any public authority or municipality to the extent of any payment made by the public authority or municipality concerned to or on behalf of that designated entity in the course or furtherance of an enterprise carried on by that designated entity.

qualified to be zero rated under section 11(2)(*n*).[1288] The court agreed with the Commissioner for the SARS who argued that the services rendered by the Trust to the provincial health departments, were 'actual' services rather than 'deemed' services. The court held that the services, therefore, fell outside the provisions of section 8(5) and were subject to VAT at the standard rate in terms of section 7(1)(*a*). The Commissioner argued, further, that section 8(5) only applies to instances where designated entities received payments which were not made in consideration for the actual supply of goods and services.[1289] Therefore, as I argue that partners' shares received on a partnership's formation are not supplied to the partners,[1290] a new provision must specifically 'deem' the partner's share to be issued and, therefore, supplied by the partnership to the partners when the partnership is established.

I propose, as an alternative to clarifying the current position, that the following new provisions be inserted in the VAT Act:

a. When a new partnership is formed, the partnership is deemed to supply a partner's share to each member of that partnership.[1291]
b. The contributions made by the members to the partnership, in terms of the partnership agreement, are deemed to be consideration for that partner's share.[1292]
c. The issue and supply of a partner's share is deemed to be a financial service.[1293]

6.4 Definition of a partner's share

I argue that whilst in terms of the common law, a partner disposes of his undivided interest in the jointly owned partnership property when supplying a partner's share, this is not true for VAT purposes as only the partnership, which is the deemed owner, is capable of supplying the ownership of partnership property.[1294] A question which arises is whether the term 'partner's share' should, for the purposes of the VAT Act, retain its common-law meaning.[1295] In my opinion, the definition of 'partner's share' must be in line with how the supply of a partner's share is viewed from a VAT perspective.

[1288] Section 11(2)(*n*) zero rates services which comprise the carrying on by a welfare organisation of the activities referred to in the definition of 'welfare organisation' in s 1, and to the extent that any payment in respect of those services is made, in terms of s 8(5), those services shall be deemed to be supplied by that organisation to a public authority or municipality.
[1289] *CSARS v Marshall NO* (816/2015) [2016] ZASCA 158 at para 7.
[1290] See para 2.8 above.
[1291] This provision must preferably be inserted in s 8 which deals with deemed supplies.
[1292] This provision must preferably be inserted into s 10, which deals with the value of supplies.
[1293] This provision must be inserted into s 2(1), which defines 'financial services'. This would have the effect that the supply of a partner's share is, in terms of s 12(*a*), exempt from VAT.
[1294] See para 4.8.2 above.
[1295] A partner's share denotes both the partner's interest in the partnership property such as profits when they are due, and his interest in jointly owned partnership property. See para 2.6.3 above.

According to Arsenault and Kreklewetz, while Canada's ETA clearly deems a partnership to be a separate person, it is not clear on deeming a partner's interest in the underlying capital of a partnership as 'nothing' for GST purposes.[1296] They maintain that although this is likely the intended result, it is not as certain as it might be, because it appears to rely solely on the partnership's status as a 'person'.[1297] They argue that while Canada's ETA has defined an 'interest in a partnership' as a 'financial instrument',[1298] it probably should have added a provision clarifying just what an 'interest in a partnership' is, which is not self-evident.[1299] They suggest that a deeming provision be added to clarify that for GST purposes, it is not appropriate to regard the property interests that a partner has in partnership property to exist[1300] as the partnership property is deemed to be owned by the partnership.

My conclusion – that for VAT purposes, jointly-owned partnership property is deemed to be owned by the partnership[1301] – is also based solely on the VAT Act's deeming of a partnership to be a person. Express provision for this can be included in the VAT Act to create greater certainty as argued by Arsenault and Kreklewetz. Such jointly-owned partnership property would include contributions made *quoad dominium* and all other partnership property owned jointly by the partners.[1302]

Based on the above, I argue that when a partner disposes of his partner's share, the component of the supply that consists of his interest in the jointly-owned partnership property, should not be recognised as a supply for VAT purposes. Consequently, when a partner's share is supplied, the partner should only be considered to be supplying that portion of the share that consists of his right to claim a proportionate share of the partnership assets when this portion is due. The court expounded on the nature of the latter right in *Sacks v CIR*.[1303] According to the court, after the lapse of fixed periods and with the concurrence of the partners, a partner is entitled to claim a separate, determinable share of the partnership profits. A partner also acquires a right to a determinable amount when the partnership agreement terminates, for example, by dissolution.[1304] I explained that on liquidation, and depending on whether there is a remaining surplus, each partner is repaid pro rata what he has contributed to the partnership capital.[1305] The balance of the partnership assets is then divided between the partners. Therefore, the portion of a partner's share that can be supplied by a partner consists of his right to a

[1296] Arsenault & Kreklewetz "Partnerships" 35.
[1297] Ibid at 26.
[1298] In s 123(1) of Canada's ETA.
[1299] Arsenault & Kreklewetz "Partnerships" 35, 36.
[1300] Ibid at 35.
[1301] See paras 2.7 and 5.3.3 above.
[1302] See para 3.3.1 above.
[1303] 1946 AD 31.
[1304] Ibid at 40.
[1305] See para 5.3.3 above. If so agreed by the partners, partnership capital can also be withdrawn by the partners during the operation of the partnership. See para 3.2.1 above.

proportionate share in the partnership profits, and on liquidation, his right to a return of the capital he contributed together with his share of any surplus partnership assets.

In terms of the Australian GST Act, a 'financial supply' is input taxed[1306] and it has the meaning given it by the Regulations.[1307] Sub-regulation 40-5.09(1) of the Regulations provides that the provision, acquisition, or disposal of an interest mentioned in sub-regulation 40-5.09(3), is a financial supply if certain requirements are met. Item 10 in the table in sub-regulation 40-5.09(3) includes 'the capital of a partnership' as securities.[1308] Part 8 of Schedule 7 to the Regulations includes 'interests in a partnership' as an example for item 10.

As both 'the capital of a partnership' and 'interests in a partnership' are mentioned in the Regulations, the ATO considers it important to understand the meaning of these two phrases for the purpose of applying the GST provisions.[1309] On the basis of Australia's common law, the ATO argues that an interest in 'the capital of a partnership' can be regarded, for the purposes of item 10, as a reference to the amounts ventured by the partners, which is commonly represented by the balance in the partner's capital account.[1310] Alternatively, the inclusion of 'interests in a partnership' in the examples, indicates a legislative intent that the expression 'capital of a partnership' be interpreted widely[1311]to cover all the interests that a partner acquires from the partnership.[1312] This includes a partner's right to a proportion of the net assets of the partnership.[1313]

The ATO argues that if the expression 'the capital of a partnership' is interpreted narrowly, it gives rise to an absurd result, in that what is regarded as an element of other interests in a partnership – ie, an interest in the capital of a partnership – would fall within the ambit of item 10, whereas the interest in the partnership itself, would not. The ATO therefore, favours the wider meaning.[1314]

Section 123(1)(d) of Canada's ETA defines a 'financial instrument' to mean, inter alia, 'an interest in a partnership' or 'any right in respect of such an interest'. Article 135(1)(f) of the EU's Council Directive provides that transactions in 'interests' in associations, which includes partnerships,[1315] are exempt from

[1306] Section 40-5(1).
[1307] A New Tax System (Goods and Services Tax) Regulations 1999 Statutory Rules No 245 1999 made under the A New Tax System (Goods and Services Tax) Act 1999 (the Regulations); s 40-5(2).
[1308] See para (d).
[1309] GSTR 2003/13 para 40.
[1310] Ibid para 44.
[1311] Ibid para 47.
[1312] Ibid para 48.
[1313] Ibid para 47.
[1314] GSTR 2003/13 para 49.
[1315] See Van Doesum 2010-6 *EC Tax Review* 263.

VAT. These provisions are not specific on exactly what these interests entail, although the use of 'interest', in my view, implies that all of a partner's interests in a partnership are included – ie, both his capital contribution and his proportionate share in the net assets of the partnership.

I am of the view that the term 'partner's share'[1316] should be used when referring to a partner's interest in a partnership. However, in line with Arsenault and Kreklewetz's suggestion, the term should be defined to clarify which of the partner's rights are covered by the term. I argue that, based on the Australian experience, the definition of 'partner's share' should not only refer to, for example, a partner's right to profit or capital, but that all the partner's relevant interests in the partnership should be included.

Based on the above, I propose that the following definition of a 'partner's share' be inserted into the VAT Act:

a. a partner's share means a partner's right to claim a specific portion of the partnership assets when this portion is due, but excludes that partner's undivided interest in jointly- owned partnership property.[1317]

This would align the issuing and transfer of a partner's share with that of a company share. A company is likewise a separate entity distinct from its shareholders, and its property, therefore, vests in the company not in its shareholders.[1318]

6.5 Goods or services "applied" by the partnership

I argue that a partnership would be 'applying' goods or services, as envisaged in section 18(4), where the goods or services constitute jointly-owned partnership property, or where the partnership has been granted only the right to use the goods or services.[1319] I pointed out that section 18(4) provides that the "goods or services shall be deemed to be supplied" to the partnership, but that it is not specified whether either the ownership or the use of the goods or services is deemed to be so supplied.[1320] I further argue that the goods or services are deemed, by section 18(4), to become jointly-owned partnership property, even if the partnership has only their use.[1321] In my view, if VAT is not levied on the partnership's return

[1316] Ramdhin et al "Partnership" para 279, use this term to describe all a partner's interests in a partnership.
[1317] This provision must be inserted in s 2(2) which defines various terms used in s 2(1).
[1318] See para 4.8.2 above.
[1319] See para 2.7 above.
[1320] Ibid.
[1321] Ibid.

of the goods or services to the partner, it would result in no VAT being levied on a partner's private consumption, which would undermine the purpose of the VAT Act. [1322]

I suggest that all these uncertainties may be ascribed to the absence of a provision that simply states – borrowing from the wording of section 8(2) – that the relevant goods or services are deemed to 'form part of the assets' of the partnership's enterprise. I propose, therefore, that this qualification be inserted in section 18(4).[1323] This would imply that when the goods or services are applied by the partnership, the partnership would acquire the ownership thereof, and upon their return to the partner, the partnership would 'supply' such ownership back to the partner.

6.6 Partnership reimbursing partner's expenses

I argue[1324] that where a partner incurs expenses that are reimbursed by the partnership, the partnership is entitled to an input tax deduction where the partner acted as agent in acquiring the goods or services on behalf of the partnership.[1325] The partner makes an acquisition as agent if he and the third party intended that the obligation, created by the contract which they concluded, will be incurred by the partnership.[1326] I further argue that the partnership could qualify for a section 18(4) deduction, where a partner acquires goods or services as principal.[1327] To be eligible for the deduction, the partner must supply the ownership or use of the goods or services to the partnership, which is required to apply them for a taxable purpose.[1328] I also argue that the partnership would not be entitled to a section 18(4) deduction where, instead of the partner on-supplying the goods or services to the partnership, he merely uses them for the purpose or benefit of the partnership's business.[1329]

I pointed out that in Australia and Canada, the requirements for a deduction by a partnership, of expenses incurred by partners who are reimbursed by the partnership, are less onerous. It is not required that the partnership incur the relevant contractual obligation.[1330] This is also the position of the NZIR in relation to employee expenses reimbursed by the employer.[1331] Therefore, the expenses reimbursed must relate directly to the partners' activities as partners of the partnership (in the case of Australia); that the acquisition is consumed, used, or supplied in the course of activities of the

[1322] Ibid.
[1323] I suggest that this proposed provision be inserted as a proviso to s 18(4).
[1324] In para 3.4.4 above.
[1325] All the requirements of the definition of 'input tax' in s 1(1) must, of course, be met.
[1326] See para 3.3.2 above.
[1327] See para 3.4.2 above.
[1328] See para 2.7 above.
[1329] See para 3.4.4 above.
[1330] Ibid.
[1331] Ibid.

partnership (in the case of Canada); or that the expense was incurred by the employee in the course of the employer's business (in the case of New Zealand).[1332]

The question arising is whether the VAT Act should be amended to align the rules on the deductibility of VAT on reimbursed expenses for partnerships, with those of the above GST jurisdictions.

Given that the VAT Act, as a rule, only allows input tax deductions in respect of goods and services made to a vendor,[1333] it should be amended to include a concession for partnerships, amongst others. I argue that not permitting a partnership an input tax deduction related to a reimbursement of a partner's expense incurred for the benefit, or in the course of, the partnership's enterprise, is contrary to the principle that the VAT burden should not rest on businesses and may result in cascading of the VAT. Although the expense is incurred personally by the partner, it may nonetheless be for a taxable purpose.

It can also be argued that the OECD's principle of flexibility is violated. In my view, the VAT Act should acknowledge the commercial reality that partners do incur expenses in their own name, but for the benefit of the partnership's business. By denying such a deduction the proverbial 'tax tail' would be wagging the 'commercial dog' as partnerships would be coerced into doing business in a particular way. Furthermore, there is strong foreign precedent from Australia, Canada, and New Zealand for permitting such deductions. To counter possible tax avoidance, the deduction can be allowed subject to strict requirements – eg, the partnership must be in possession of the tax invoice issued to the partner; the partnership only qualifies for the deduction once the partner has been reimbursed; or the deduction can be claimed only once.[1334]

I suggest that the following provisions be inserted into the VAT Act:

a. Where a partnership reimburses a partner for an expense that he incurs that is directly related to his activities as a partner in the partnership, the reimbursement is deemed to be consideration for an acquisition of goods or services made by the partnership from the partner.
b. The partnership would not be entitled to an input tax deduction relating to the expense referred to in paragraph (a) above if:
    (i) The partnership is entitled to an input tax deduction relating to the expense, under any other provision of the VAT Act.
    (ii) The partner is entitled to an input tax deduction for acquiring the goods or services in incurring the expense.

[1332] Ibid.
[1333] See 'input tax' in s 1(1).
[1334] See para 3.4.4 above.

(iii) The partnership would not have been entitled to an input tax deduction had the partnership made the acquisition of the goods or services, or

(iv) The partnership is in possession of the tax invoice for the expense.[1335]

6.7 Distributions to partners

I argue that a partner's debt arising from an *in specie* distribution can be offset against the partnership's indebtedness to the partner.[1336] I also argue that the payment for an *in specie* distribution can, alternatively, be structured in the form of a barter.[1337] An understanding of partnership law is required to know what payment options are available to a partner to pay for the distribution – eg, an amount of capital which the partner is entitled to withdraw, or an amount of profit share due to the partner.[1338] Apart from partnership law, in my view the VAT treatment of set off and barter transactions is, each in its own right, complicated areas. Therefore, the difficulty does not lie in any deficiency in the VAT provisions dealing with partnerships. I argue that the purpose of the VAT Act is not to explain the law of partnership to ease the application of VAT,[1339] and that this is one of the areas of partnership law on which the SARS can provide clarity by means of an interpretation statement. An amendment to the VAT Act is, therefore, not warranted.

I do not favour adopting a provision in the VAT Act similar to section 272.1(4) of Canada's ETA, which deems a partnership's distribution to a partner to be made at the market value.[1340] For the sake of neutrality, partnership distributions should be subject to the same general treatment as other supplies, namely that the amount upon which VAT is levied is the amount received for the supply.[1341] There is no reason for 'deeming' a consideration if there is an 'actual' consideration.[1342]

[1335] I suggest that this proposed provision be inserted into the VAT Act as a new subsection under s 51.
[1336] See para 3.5.2.
[1337] Ibid.
[1338] Ibid.
[1339] See para 6.1 above.
[1340] See para 3.5.2 above.
[1341] Section 10(2) provides that the value to be placed on a supply of goods or services shall, save as otherwise provided in this section, be the amount of the consideration for such supply.
[1342] Should the distribution be made for no consideration, or for consideration below the market value, then s 10(4) which would deem the distribution to be made at the market value could apply; In the *South Atlantic Jazz Festival*-case (see para 3.5.2) the court held that as the transactions in question were barter transactions, the value of the goods and services supplied by the sponsors was, in terms of section 10(3)(*b*) of the VAT Act, the open-market value of the consideration received in return for the supply As a result, where an *in specie* distribution is structured as a barter, the value of the goods and services supplied by the partnership and the partner is the open-market value of the consideration each party receives in return.

6.8 Technical dissolution of a partnership

In Chapter Four I discussed the VAT implications of transactions relating to the technical dissolution of a partnership, including the transfer of the partnership assets from the old to the new partnership,[1343] the transfer and acquisition of a partner's share in the context of the retirement or death of a partner, the admission of a new partner, etcetera.[1344] In my view, an understanding of the partnership law applicable to these areas, is required in order to apply the relevant VAT provisions. For example, it is important to know what may potentially happen to the partner's share of a partner who retires or dies; how the new partnership arises between the remaining partners; the options available to a newly-admitted partner – either to purchase an ownership interest in the partnership property of the dissolved partnership, or to make a contribution to the new partnership, etcetera. I am of the opinion that the application of VAT in these areas can be clarified by the SARS by means of an interpretation statement as it is not the purpose of the VAT Act to explain the law of partnership.[1345] What is important from a purely VAT perspective, however, is my proposal for the insertion of a definition of 'partner's share'.[1346] This is because the technical dissolution of a partnership is accompanied by the transfer and acquisition of partners' shares, which would always exclude the partners' undivided interests in the jointly-owned partnership property.

6.9 The dissolved and new partnership deemed to be one person

I discussed the impact of section 51(2) which applies when a dissolved partnership's business is continued by a new partnership.[1347] I argue[1348] that the effect of section 51(2) is limited to disregarding supplies between the dissolved and the new partnership, but not supplies between other persons.

I have referred to section 272.1(7) of Canada's ETA, which also provides that the new partnership is a continuation of the predecessor partnership, and the difference of view between the CRA and commentators regarding the impact of this provision.[1349] The debate centres on whether, not only the membership change, but also the mechanism used to achieve that change – the supply of a partner's share and all other related transactions – should be ignored and, therefore, have no VAT consequences. Arsenault and Kreklewetz aver that certain commentators appear to suggest that

[1343] See paras 4.7, 4.8.2 and 4.9 above.
[1344] See para 4.4 above.
[1345] See para 6.1 above.
[1346] See para 6.4 above.
[1347] See para 4.7 above.
[1348] Ibid.
[1349] Ibid.

section 272.1(7) may be inadequate given the absence of a provision which deems that there is no supply of assets by the dissolved partnership to the partners or to the new partnership.[1350]

According to Cross, section 57(2)(e) of New Zealand's GST Act is unclear. She claims further that the NZIR has not issued a written statement as to how it approaches the application of the provision.[1351] The Commissioner of the NZIR, however, favours the recognition of changes of membership interests for VAT purposes, notwithstanding section 57(2)(e) providing that "any change of members of that body shall have no effect for the purposes of this Act". I have set out the Commissioner's argument, which, in essence, is that a change of members is not necessarily equal to a change in membership interest, and to disregard a change of members, does not mean that a change in membership interest should also be disregarded.[1352]

There is clearly a measure of uncertainty regarding the impact of sections 272.1(7), 57(2)(e), and 51(2). Considering the relative complexity of the Commissioner of the NZIR's argument on the effect of section 57(2)(e), in my view the mere deeming of a dissolved and a new partnership to be one person does not create adequate certainty.

I argue that section 51(2) requires an amendment which makes it clear that only supplies between the dissolved and the new partnership, which relate to the transition to the new partnership, are deemed not to be supplies, and therefore, not subject to VAT. Supplies between other persons, including supplies between partners (or former partners), and between partners and the dissolved or the new partnership, should be recognised, and their VAT treatment must, therefore, follow the normal VAT rules. I propose that the latter portion of section 51(2) be amended by the deletion of,

> … the dissolved partnership … and the new partnership … shall … be deemed to be one and the same partnership …

and the insertion of,

> … the dissolved partnership … and the new partnership … shall … be deemed to be one and the same partnership *and only any goods or services that are supplied by the dissolved partnership to the new partnership are deemed not to be supplies…*

[1350] Arsenault & Kreklewetz "Partnerships" 52.
[1351] Cross *New Zealand Master Tax Guide* 974 para 23-110.
[1352] See para 4.7 above.

This amendment should make it clear that the deeming of the two entities to be one has no bearing on any other supplies.[1353]

I further argue that where section 51(2) applies, the various transfers of ownership in the jointly-owned partnership property during the transition from the dissolved to the new partnership, are not regarded as supplies and, consequently, have no VAT implications.[1354] The question arising is whether this interpretation is reasonably straightforward, or whether any clarifying amendments are required.

In the case of Canada, Arsenault and Kreklewetz argue that legislative reform may not be necessary if it is already sufficiently clear that the ownership of the partnership property would, for GST purposes, remain unchanged throughout since one cannot transfer something to oneself. The relevant factors they consider are: that a partnership has a separate legal status for GST purposes; that section 272.1(7) deems the new partnership to be the same person as the old partnership; and that the ownership of the partnership property lies with the partnership while the partners own only a 'financial instrument' known as the 'partnership interest'.[1355]

All the factors mentioned by Arsenault and Kreklewetz are also true for the VAT Act, save for the definition of 'partner's share' (or 'partnership interest' in the case of Canada), which I propose should be added.[1356] The specific exclusion of a partner's undivided interest in jointly- owned partnership property from the proposed definition of 'partner's share', should place it beyond doubt that the supply of a partner's share does not affect the ownership of such partnership property, which remains with the partnership. Moreover, as the old and new partnerships are deemed[1357] to be the same partnership and, therefore, the same person, the jointly owned partnership property is not supplied for VAT purposes.

6.10 The deductibility of VAT on pre-formation and pre-business expenses

I have also referred to section 19 which allows for the deduction of VAT levied on the acquisition of goods or services for or on behalf a company, but only before the incorporation of that company.[1358] I

[1353] In the case of the technical dissolution of a partnership, a new partnership is established (see para 4.1 above). There is no legal fiction in the common law, which deems the old and the new partnership to be one and the same partnership. Section 51(2), although in need of some refining as argued, deems the two entities to be one person, subject to meeting the relevant requirements. Although a (legislative) deeming provision comes with inherent difficulties (see paras 1.1 and 2.3.3), it is the mechanism used in our law to create a legal fiction.
[1354] Ibid.
[1355] Arsenault & Kreklewetz "Partnerships" 52.
[1356] See para 6.4 above.
[1357] By s 51(2).
[1358] See para 2.9 above.

pointed out that relief under section 19 expressly applies only to companies, and is, therefore, not available to partnerships. I argue that while section 19 permits an input tax deduction on goods or services acquired on behalf of a company before its incorporation, section 18(4)(*b*) does not allow a deduction related to acquisitions made before the establishment of a partnership. As a result, a partnership is not allowed a deduction in relation to pre-formation expenses, but only on expenses incurred before the commencement of business.[1359]

In my view, the different criteria applied for the deductibility of VAT on pre-incorporation expenses and pre-formation expenses, in the case of a company and a partnership, respectively, violate the neutrality principle. The differences between a company and a partnership are significantly reduced by deeming a partnership to be a 'person', and there is no reason to place a company in a more favourable position than a partnership.

I consider that, notwithstanding that section 19 corresponds to international legislative precedent, this provision should be amended to extend the relief to partnerships, amongst others. The strict conditions in section 19, slightly adjusted for partnerships, would ensure that deductions are only be permitted in relation to goods and services applied in the partnership's enterprise when it is established that:

a. the goods or services are acquired in connection with the formation of the partnership;
b. the person who incurred the expense has been reimbursed by the partnership;
c. the goods or services are acquired for the purpose of an enterprise to be carried on by the partnership, and have not been used for any purpose other than carrying on such enterprise; and
d. the partnership is in possession of the tax invoice for the expense.[1360]

6.11 Conclusion

In this chapter, I have proposed both amendments to current provisions and new provisions for the VAT Act. These are in line with what the VAT Act seeks to achieve, and the commonly- accepted principles of a sound VAT system. My proposed amendments are primarily aimed at clarifying and simplifying the law. The proposed amendment to section 51(2), for example, makes it clear that only supplies between the dissolved and new partnerships are disregarded. An important addition I propose, is the insertion of a definition of 'partner's share', which will exclude interests in jointly-owned partnership property which, for VAT purposes, vests in the partnership. I have also proposed changes to the law, for example, my recommendation that, in the interests of neutrality, the VAT treatment of partners' shares

[1359] Ibid.
[1360] See s 19.

be aligned with that for company shares. An important implication of this proposal is that the making of capital contributions and the receipt of partner shares on the commencement of a partnership, will be regarded as having been received in exchange, and therefore as consideration for, one another. I further propose that the requirements for the deduction of VAT related to partnership reimbursement of a partner's expenses, be relaxed so that the burden of the VAT does not rest on a business. I identified those areas which do not warrant amendments to the law, but ideally require an interpretation statement from the SARS. An interpretation statement would facilitate the application of VAT provisions by explaining difficult areas of partnership law – eg, transactions related to the technical dissolution of a partnership. In my view, these proposed amendments to the law, coupled with interpretation statements, will bring much needed clarity to the complex area of VAT on common partnership transactions.

CHAPTER 7

CONCLUSION

When considering the VAT treatment of common partnership transactions, I determined the nature of the particular transaction in terms of the common law relating to partnerships. I also considered whether the VAT character of the transactions differs from its common-law character in view of the deeming of a partnership to be a 'person'[1361] and other provisions in the VAT Act that have a bearing on the transaction, especially section 51. Only once I had established the nature of the transaction for VAT purposes – whether in keeping with or differing from the common law – did I apply the relevant provisions of the VAT Act to determine the VAT implications of the transaction.

I then highlighted certain of my more important arguments. In Chapter Two, I deal with the VAT implications of transactions relating to the formation of a partnership. I maintain that the deeming of a partnership to be a person, implies that for VAT purposes it is capable of making supplies and acquisitions, carrying on an enterprise, and registering for VAT as a single person.[1362] I argue that in terms the VAT Act, a partner can make supplies to the partnership and vice versa. These arguments correspond to what the consensus view is in Australia, Canada, New Zealand, and the UK (hereafter, the other jurisdictions) on how GST/VAT applies to these transactions. In my view, what is supplied or acquired by the body of persons who make up the partnership, within the course and scope of its common purpose is, for VAT purposes, supplied or acquired by the partnership as a separate person.[1363]

I contend that a partner's contribution to the partnership is subject to VAT if it meets all the requirements of section 7(1)(*a*), especially if the contribution is made for consideration.[1364] In my opinion, a partner's share and any profit distributions are not reciprocally connected and, therefore, do not qualify as consideration for a partner's contribution. As a result, a partner does not make his contribution to the partnership in exchange for consideration, save where the partners agree that he is to receive a specific payment for that contribution.[1365] I argue that the partners could wish to claim that a payment is a profit distribution and not consideration, in order to 'shelter' the supply from VAT.[1366] The other jurisdictions,

[1361] See Chapter One.
[1362] See para 2.3 above.
[1363] Ibid.
[1364] See para 2.6.1 above.
[1365] See para 2.6.5 above.
[1366] See para 3.2.3 above.

save for the UK,[1367] are unanimous in the view that a partner's contribution can be subject to GST/VAT. The position in Australia and Canada differ from that in South Africa in that a partner's capital contribution and his partner's share are regarded as consideration for one another.[1368]

I further conclude that the partners' shares are not supplied to the partners when the partnership is formed, which reflects the position in New Zealand. However, in Australia and Canada the agreed view is that the partners' shares are issued to the partners upon formation of the partnership.[1369]

Considering a partner's agency powers, I agree with the view that a partner's contribution to the partnership may simultaneously serve as a supply on behalf of the partnership to a third party, and by carrying out that task, as an in-kind contribution of labour to the partnership which gives rise to a potential VAT liability for both the partnership and the partner.[1370] The acts of the partner as agent of the partnership are, furthermore, attributed to the partnership. The partnership must, accordingly, account for output and input tax on the supplies and acquisitions made by the partner as agent. These transactions are subject to the same GST/VAT treatment in New Zealand and the UK. The position in Canada is that a partner is not required to account for GST on the supply of agency services to the partnership.[1371] Although the relevant Australian and Canadian provisions are similar,[1372] in my view, the GST treatment in Australia corresponds to that of South Africa.[1373]

I support the argument that a partnership will only be in a position to 'apply' goods or services that have been acquired by a partner, and be permitted a deduction under section 18(4), if the partner contributed either the ownership or the use of such goods or services to the partnership. The goods or services are deemed by section 18(4), to be jointly-owned partnership property, resulting in potential VAT liability on their return to the partner.[1374]

I argue that a partnership is not permitted a deduction in relation to pre-formation expenses, but only for expenses incurred prior to the commencement of business. This is also the position in the other jurisdictions.[1375]

[1367] The position in the UK is that the entry of a new partner into a partnership in consideration for a contribution in cash or in kind, is not a taxable supply. See para 2.6.5 above.
[1368] See para 2.6.5 above.
[1369] See para 2.8 above.
[1370] See para 2.6.2 above.
[1371] Ibid.
[1372] That is s 184-5(1) of the Australian GST Act and s 272.1(1) of Canada's ETA.
[1373] See para 2.6.2 above.
[1374] See para 2.7 above.
[1375] See para 2.9 above.

In Chapter Three I discuss the operation of a partnership. I argue that, subject to section 18(4), a partnership can only supply or acquire an item if it supplies or acquires the ownership of that item (ie, in the case of a 'purchase'), even though the item forms part of its taxable activity. The other jurisdictions concur in this view.[1376]

I argue that a contracting partner makes an acquisition as agent on behalf of the partnership, he and the third party intend that the obligation created by the contract is incurred by the partnership. Even though a contract may be for the benefit of the partnership, it will not be liable if the contracting partner and the third party intended the obligation to be incurred personally by the partner. Australia, Canada, and the UK agree with South Africa's approach. In New Zealand, however, a partnership is permitted a deduction not only when it is in a contractual relationship with the supplier, but also where a partner incurs an expense in the course of the partnership business.[1377]

I argue that an *in specie* distribution by a partnership to a partner can be subject to VAT, and deal with the VAT treatment of the transaction, on the basis of whether payment for the distribution is by means of set off or barter. Such *in specie* distributions are also potentially taxable in the other jurisdictions.[1378]

I consider the VAT consequences of a partnership permitting a partner to use partnership property for private purposes, which creates an opportunity for VAT abuse. I conclude that this could result in a VAT charge for the partnership, either in terms of section 7(1)(*a*), or in the form of a change in use adjustment in terms of section 18(2). The GST/VAT consequences can also potentially ensue, in these circumstances, in the other jurisdictions.[1379]

In Chapter Four, I deal with VAT on transactions related to the technical dissolution of a partnership. I consider the impact of section 51(2), and argue that the jointly-owned partnership property is deemed to belong to the partnership, and that the dissolved and the new partnerships are deemed to be the same person. The various transfers of ownership in such property under general law, are not regarded as supplies and, consequently, hold no VAT implications. I argue that the fact that supplies between the old and the new partnership are disregarded, obviously does not mean that supplies between other persons should not be recognised.[1380] This is the view in Australia, New Zealand, and the UK. In Canada, there is criticism of the view of the CRA that the supply of property from the predecessor

[1376] See paras 3.3.1, 3.4.1 above.
[1377] See para 3.4.3 above.
[1378] See para 3.5.2 above.
[1379] See para 3.6 above.
[1380] See para 4.7 above.

partnership to the new partnership should be recognised for GST purposes, despite these entities being deemed to be the same partnership.[1381]

I maintain that if section 51(2) does not apply, it is possible for the key requirements in section 11(1)(*e*) to be met, which would zero rate the transfer of the partnership business from the dissolved to the new partnership. In the other jurisdictions it is also recognised that there can be a transfer of a going concern in these circumstances, although the GST/VAT treatment of such a transfer is not always the same. In the UK, for example, the transfer of a business as a going concern falls outside the scope of VAT.[1382]

I also consider the VAT implications of transactions involving partners' shares supplied by the partners after the formation of the partnership.[1383] The supply of a partner's share could be subject to VAT, although it would be uncommon, in my view, for a partner to hold his share as part of an enterprise.[1384] As the jointly-owned partnership property is owned by the partnership, I argue that when a partner disposes of his partner's share, the component of the supply that consists of his interest in such property, should not be recognised as a supply for VAT purposes. A partner's right to profit, however, unlike jointly-owned partnership property, is not deemed to be owned by the partnership. As a result, the partner, rather than the partnership, can supply the ownership of the right to profit. This is also the position in Australia, New Zealand, and the UK, and according to one view, also the likely stance in Canada.[1385]

I question the proposed extension of the reorganisation relief in section 8(25) to partnerships in that certain of the transactions contemplated in the relevant provisions of the IT Act can simply not apply to partnerships. The other jurisdictions do not have a provision similar to section 8(25).[1386]

In Chapter Five I deal with the VAT treatment of transactions related to the liquidation of a partnership and the distribution of its assets. I consider the VAT implications of some of the important changes that take place after dissolution. For example, partners share in profits after dissolution by virtue of their right to fairness and good faith. I argue that any profit distributions made after dissolution, would not be subject to VAT because the profit share is merely the result of the partners' entitlement to fairness and good faith, and not in exchange for any reciprocally connected supplies made by the partners to the partnership. This is also likely the view in other jurisdictions.[1387]

[1381] Ibid.
[1382] See para 4.9 above.
[1383] See para 4.8.1 above.
[1384] See para 4.8.3 above.
[1385] See para 4.8.2 above.
[1386] See para 4.12 above.
[1387] See para 5.2.2.2 above.

I further argue that the debts of each of the partners to the partnership, or of those of the partnership to each of the partners, do not come to an end on dissolution. Section 22(1) would, therefore, not automatically be triggered when a partnership dissolves.[1388] As the partnership's indebtedness remains in existence, dissolution will also not automatically trigger a section 22(1) deduction for a partnership's creditor.[1389] Considering that the partnership's rights do not cease on dissolution, there can be no argument that such rights are, on dissolution, surrendered by the partnership by operation of law. This gives rise to a potential VAT liability. This should also be the position in the other jurisdictions.[1390]

I discuss the VAT consequences of the sale or transfer of a partner's share to an heir following the partner's death. In the absence of specific provisions in the VAT Act, I conclude that this matter is adequately dealt with by the general provisions; in particular, by sections 46(g) and 53. The position in the other jurisdictions corresponds to that in South Africa.[1391]

As regards the liquidation of the partnership, I argue that as the function of the liquidator is to wind up the partnership's affairs, and as his actions result in the termination of the partnership's enterprise, the supplies he makes will be deemed to be made in the course or furtherance of the partnership's enterprise.[1392] Any surplus assets will be applied in payment of what may be due to the respective partners, including the repayment of capital.[1393] In my view, there should be no difference between a distribution *in specie* to a partner during the partnership's operation and its liquidation.[1394] This is also the view propagated by the ATO, and is likewise the position in Canada, New Zealand, and the UK.[1395]

In Chapter Six I propose amendments to the VAT Act, and that certain aspects of the VAT relating to partnership transactions be clarified by the SARS in an interpretation statement, primarily for the sake of certainty and simplicity.

Although I favour maintaining the *status quo* in which capital contributions made as part of a partner's enterprise activity are subject to VAT,[1396] I propose that provisions be inserted in the VAT Act to clarify certain important aspects regarding the receipt of a partner's share and a partner's contribution during

[1388] See para 5.2.3.1 above.
[1389] See para 5.2.3.2 above.
[1390] Ibid.
[1391] See para 5.2.4 above.
[1392] See para 5.3.2.2 above.
[1393] See para 5.3.3 above.
[1394] Ibid.
[1395] Ibid.
[1396] See para 6.3.2 above.

the formation stage.[1397] I also hold the view that partners' contributions of labour, in particular, should not be excluded from VAT because this would violate the neutrality principle.[1398]

I argue that the different VAT treatment of a partner's share and a company share under the VAT Act, violates the neutrality principle considering the close similarities between the two types of interest. I therefore propose that a partner's share be subjected to the same VAT treatment as a company share.[1399] I also propose that a definition of 'partner's share' be included in the VAT Act to clarify that when a partner's share is supplied, the partner should only be regarded as supplying his right to claim a specific portion of the partnership assets when this portion is due, which includes his right to profit.[1400]

Furthermore, the uncertainties surrounding section 18(4) can be clarified by an amendment which simply provides that the goods or services applied by the partnership, are deemed to 'form part of the assets' of the partnership. This ensures, by implication, that the partnership acquires ownership in such goods or services.[1401]

I argue that, subject to strict conditions, a partnership be permitted an input tax deduction related to a reimbursement of an expense incurred personally by a partner, but for the benefit or in the course of the partnership's enterprise. This avoids the VAT burden falling to a business and upholds the principle of flexibility.[1402]

I am of the view that the VAT treatment of a partnership's distribution to a partner, where the payment therefor is either by offset or barter, is another area in which the SARS can provide clarity by issuing an interpretation statement. The amendment of the VAT Act in this regard, is therefore unwarranted.[1403]

I further maintain that an understanding of partnership law is a prerequisite for a proper appreciation of the VAT implications of transactions related to the technical dissolution of a partnership. I argue, therefore, that the application of VAT in these areas can be clarified by the SARS by means of an interpretation statement.[1404]

[1397] See para 6.3.1 above.
[1398] See para 6.3.3 above.
[1399] See para 6.3.4.1 above.
[1400] See para 6.4 above.
[1401] See para 6.5 above.
[1402] See para 6.6 above.
[1403] See para 6.7 above.
[1404] See para 6.8 above.

Section 51(2), in my view, requires an amendment to clarify that only supplies between the dissolved and the new partnership which relate to the transition to the new partnership, should be deemed not to be supplies, and therefore not subject to VAT. This amendment should make it clear that the deeming of the two entities to be one does not have a bearing on supplies between other entities.[1405]

For the sake of upholding the neutrality principle, I argue that given the similarity between companies and partnerships for VAT purposes, and subject to requirements, partnerships should also be permitted to deduct VAT on pre-formation expenses.[1406]

The implementation of these proposals would, to my mind, result in greater certainty in the VAT treatment of common partnership transactions. It would also align the South African VAT Act with the accepted principles which characterise an effective VAT system.

Further Research Opportunities

I discuss[1407] the possible zero rating of a partner's contribution of services in terms of section 11(2)(*ℓ*). To qualify for zero rating it is, amongst others, required that the partnership must not be resident in, and that the partnership or 'any other person' must not be present in the Republic at the time the services are rendered. It might be difficult to determine the residency of a partnership which has both resident and non-resident partners, and to determine whether a partnership is present in the Republic as contemplated in section 11(2)(*ℓ*). It is also not clear what sort of a presence is required by this provision – legal, economic, or physical – and how a partnership would fulfil whatever presence is envisaged. If 'any other person' is a resident partner, the question is whether his presence in the Republic would invariably disqualify the services from being zero rated, or whether there would still be scope for zero rating.

The VAT Act contains no explicit 'place of supply' rules.[1408] Consequently, issues that require further research, especially where a partnership is involved in cross-border trade, are for example, the location where a partnership carries on its 'enterprise or activity' as envisaged in the definition of 'enterprise';[1409] how to establish whether "services are physically rendered elsewhere than in the Republic" by a partnership as contemplated in section 11(2)(*k*); and also whether "services are utilized or consumed in the Republic" by a partnership as required by the definition of 'imported services'.[1410]

[1405] See para 6.9 above.
[1406] See para 6.10 above.
[1407] In para 2.6.5 above.
[1408] Davis Tax Committee *First Interim Report on Value-Added Tax* July 2015 at 9.
[1409] Section 1(1).
[1410] Ibid.

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