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2 minute quiz: Partnerships

How well do you understand the taxation of partnerships? Try these questions to find out.

Question 1

Which of the following is the definition of a tax law partnership?

1. An association of persons (other than a company or a limited partnership) carrying on a business in common with a view to profit

2. An association of persons (other than a company or a limited partnership) in receipt of income jointly

3. An association of persons (other than a company or a limited partnership) carrying on a business in common and in receipt of income jointly

4. An association of persons (other than a company or a limited partnership) carrying on a business in common, or in receipt of income jointly, or a limited partnership.

Answer 1

The correct answer is 4.

The tax law definition of a partnership is an association of persons (other than a company or a limited partnership):

- carrying on business as partners, or
- in receipt of ordinary or statutory income jointly, or
- a limited partnership.

Question 2

A partnership's financial records show the following:

- A capital gain arising from sale of a partnership asset
- Salaries paid to the partners
- Interest paid on a business loan from a partner
- Interest paid on capital contributed by a partner, and
- Drawings by a partner.

Which of the following amounts are taken into account in calculating a partner's share of the net income of the partnership for tax purposes?

1. The capital gain, salaries, interest on the loan and interest on the capital

2. Only the interest on the loan

3. Only the salaries

4. All of the items.

Answer 2

The correct answer is 2.

A capital gain is not included in the calculation of partnership net income. For CGT purposes, the partner is the relevant taxpayer. A disposal of a partnership CGT asset gives rise to a CGT event happening in respect of each partner's interest in the asset.

Salaries paid to partners are treated as distribution of partnership profits and not deductible to the partnership in the calculation of its net income.

Interest paid by a partnership on a loan received from a partner is an allowable deduction to the partnership (and assessable income to the partner). This is taken into account in calculating the partnership's net income.

However, interest paid on capital contributions is treated as an appropriation of profit and is not deductible to the partnership.

Drawings are not deductible to the partnership and treated as prepayments of the distribution of partnership profits.

The joint ownership of an investment property by individuals (for example, spouses) is taken to be a tax law partnership. As an administrative concession, the ATO does not require such partnerships to lodge a partnership tax return. Rather, each owner's share of the net income from the property is only required to be included in each individual's respective tax return.