Federal Court of Australia

Hedges v Commissioner of Taxation [2023] FCAFC 105

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| Appeal from: | *Hedges v Commissioner of Taxation* [2022] FCA 1389 |
|  |  |
| File number(s): | NSD 1094 of 2022 |
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| Judgment of: | **LOGAN, GOODMAN AND HESPE JJ** |
|  |  |
| Date of judgment: | 12 July 2023 |
|  |  |
| Catchwords: | **TAXATION** – appeal from decision of primary judge dismissing appeal from decision of Administrative Appeals Tribunal – where taxpayer is retired partner of a law firm – whether appellant was entitled to receive capital proceeds from disposal of interest in goodwill of partnership – whether appellant made a capital gain |
|  |  |
| Legislation: | *Income Tax Assessment Act 1936* (Cth) *Income Tax Assessment Act 1997* (Cth)*Tax Law Improvement Act (No. 1) 1998* (Cth)*Taxation Laws Amendment Act 1991* (Cth)  |
|  |  |
| Cases cited: | *Commissioner of State Revenue (WA) v Rojoda Pty Ltd* [2020] HCA 7; (2020) 268 CLR 281*Commissioner of State Taxation v Cyril Henschke Pty Ltd & Ors* [2010] HCA 43; (2010) 242 CLR 508*Commissioner of Taxation v Everett* [1980] HCA 6; (1980) 143 CLR 440*Federal Commissioner of Taxation v Sara Lee Household & Body Care (Australia) Pty Ltd* [2000] HCA 35; (2000) 201 CLR 520 |
|  |  |
| Division: | General Division |
|  |  |
| Registry: | New South Wales |
|  |  |
| National Practice Area: | Taxation |
|  |  |
| Number of paragraphs: | 43  |
|  |  |
| Date of hearing: | 25 May 2023  |
|  |  |
| Counsel for appellant | Mr C.J Peadon and Mr M.T Sherman |
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| Solicitor for appellant | Walker Hedges Forestville |
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| Counsel for respondent | Ms J. Gatland |
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| Solicitor for respondent | ATO Litigation and Legal Services |

ORDERS

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|  | NSD 194 of 2022 |
|   |
| BETWEEN: | BRENT HEDGESAppellant |
| AND: | COMMISSIONER OF TAXATIONRespondent |

|  |  |
| --- | --- |
| order made by: | LOGAN, GOODMAN AND HESPE JJ |
| DATE OF ORDER: | 12 July 2023 |

THE COURT ORDERS THAT:

1. The appeal be dismissed.
2. The appellant pay the respondent’s costs of the appeal, as agreed or taxed.

Note: Entry of orders is dealt with in Rule 39.32 of the *Federal Court Rules 2011*.

REASONS FOR JUDGMENT

The court:

# INTrODUCTION

1. The appellant appeals from the decision of the primary judge dismissing his appeal from a decision of the Administrative Appeals **Tribunal**. The Tribunal affirmed the respondent’s objection decision disallowing the appellant’s objection to his assessment for the year of income ended 30 June 2009 (**2009 tax year**).
2. The central issue in dispute is whether based on the terms of a deed of retirement and a partnership deed, the appellant was entitled to receive capital proceeds for the disposal of his interest in the goodwill of a partnership.

# Factual Background

1. The appellant is a retired solicitor who relevantly practised as a partner of the Curwoods Lawyers **Partnership**. He retired from the Partnership at the end of 2008.

## Partnership Deed

1. The terms of the Partnership were recorded in a Partnership Deed dated 25 September 2006. That deed relevantly provided:

2.5 The Partners agree that the provisions of the *Partnership Act 1892* (NSW) shall only apply to the Partnership where there is no corresponding provision herein, it being the intent of the Partners that this Deed sets out all the terms and conditions that shall regulate their relations as partners and this Deed shall be construed accordingly.

3. NO TERMINATION

The death, retirement (including deemed retirement), expulsion or the happening of an event which results in a Partner ceasing to be a member of the Partnership does not terminate the Partnership as between the other Partners as long as there are two or more other Partners to continue the Partnership.

…

24. PARTNER RETIRING BY NOTICE

A Partner wishing to retire from the Partnership shall give to the other Partners not less than six (6) months' previous notice in writing or at any earlier time with the consent of the other Partners.

25. EFFECT OF RETIREMENT AND PAYMENT

Upon the retirement of a Partner under clauses 22, 23 or 24 hereof, or otherwise however arising, or, upon the death of a Partner, he, or his legal personal representative, shall be paid:

25.1 the amount standing to the credit of his Capital Account in the books of the Partnership;

25.2 the amount standing to the credit of his Current Account in the books of the Partnership;

25.3 his proportionate part calculated in accordance with the Partnership Interests of the Work in Progress. The value of Work in Progress for the purposes of this clause shall be determined either by the Partners, including the Outgoing Partner, or in the absence of such agreement by an independent costs consultant appointed by the President for the time being of the Law Society of New South Wales (or nominee), which consultant shall act as an expert and not as a mediator or arbitrator and whose decision shall be binding on the Partners unless in the case of a manifest and material error of fact. The costs of such consultant shall be a Partnership expense; and

25.4 his proportionate part calculated in accordance with the Partnership Interests of the goodwill of the Partnership, the value of the goodwill shall be the equivalent of 50% of the annual net trading profit of the Partnership (as opposed to net taxable profit) averaged over the preceding three (3) years. For the purposes of calculating such net trading profit salaries paid to Equity Partners and the profit component of management fees paid by the Partnership to any associated service entity shall be excluded and shall be added back. In the event of a dispute concerning the proper basis for and/or the calculation of the net trading profit, then such dispute shall be determined by the nominee of the accountants for the Partnership (and being a member of that firm) who shall act as an expert and not as a mediator or arbitrator and whose decision shall be binding on the Partners unless in the case of manifest and material error of fact. The costs of such accountants shall be a Partnership expense. If such accountants decline to so act then by an accountant appointed by the President for the time being of the Law Society of New South Wales (or nominee), which accountant shall act as an expert and not as a mediator or arbitrator and whose decision shall be binding on the Partners unless in the case of a manifest and material error of fact.

26. SET-OFF

Upon the retirement or death of any Partner, any moneys owing by such Partner as at retirement or death shall be determined and shall be offset against any amount found owing to the Outgoing Partner as at the date of retirement or death.

27. TERMS OF PAYMENT

Subject to clauses 25 and 26 hereof the amount payable to the Outgoing Partner shall be paid by three (3) equal consecutive six (6) monthly instalments the first to be paid six (6) months after the date of retirement or death of the Outgoing Partner provided that:

27.1 in respect of the instalments or any or all of them, if the same are not paid within seven (7) days of the due date interest shall be payable in respect of such unpaid instalments at the rate for the time being charged to the Partnership on its bank overdraft account from the date on which the payment was due to the date of payment (and if the Partnership does not have an overdraft then at the prescribed rate of interest payable on Judgments of the Supreme Court of New South Wales); and

27.2 irrespective of the provisions contained in this clause, the Continuing Partners shall use their best endeavours to discharge their liability hereunder within six (6) months, or such earlier time than eighteen (18) months as may be practicable, having regard to the overall financial position of the Partnership provided that it is not the intention of the Partners that this clause shall operate as a legally enforceable commitment so to do.

## Deed of Retirement

1. On or about 30 September 2008, the appellant and his then partners executed a Deed of Partner’s Retirement (**Retirement Deed**). That deed relevantly provided:

**BACKGROUND**

A. The Ongoing Partners and the Retiring Partner are parties to a Partnership Deed of 25 September 2006 ("the Deed") in respect of the legal practice called "Curwoods Lawyers" ("the Partnership").

B. The Retiring Partner is retiring from the Partnership upon 31 December 2008 ("the Departure Date")

C. The Parties intend by this Deed to record their agreement as to the retirement from the Partnership of the Retiring Partner to the intent that as and from the Departure Date the Retiring Partner (or his nominee) shall have no further interest in or association with the Partnership; Quinton; and the Quinton Trust.

**DEFINITIONS & INTERPRETATION**

**1. Definitions:**

…

“**Accounts of the Partnership**” means the financial statements (including profit and loss account and balance sheet of the Partnership and the Quinton Trust) prepared by the Accountants as at the Departure Date for the purposes of Clauses 3.7, 3.8, 3.9 and 3.10 hereof.

…

**OPERATIVE PROVISIONS**

Departure Date

3.1 The Retiring Partner shall retire from the Partnership upon the Departure Date

…

**Releases and Indemnities**

3.4 Effective as and from the Departure Date the Ongoing Partners hereby release and indemnify the Retiring Partner from and indemnify him in relation to his liabilities (if any) arising out of each of the following and where the liabilities, guarantees, indemnities, or obligations are owed to a third party shall use their reasonable endeavours (and being no less than the reasonable endeavours used before the date hereof in respect of other retiring partners) to procure from that third party the release of the Retiring Partner from:-

3.4.1 Partnership Liabilities;

3.4.2 Partnership Guarantees; and

3.4.3 Partnership Obligations;

3.5 Until the Retiring Partner is released by a third party as aforesaid the Ongoing Partners shall indemnify and hold indemnified the Retiring Partner from all:-

3.5.1 Partnership Liabilities;

3.5.2 Partnership Guarantees; and

3.5.3 Partnership Obligations;

3.6.1 save for any obligations to be performed or observed by a party under this Deed; AND

3.6.2 save for any releases and indemnities given by one party to another party under this Deed AND

3.6.3 Subject to the above the Retiring Partner and the Ongoing Partners mutually release the other from all Claims that either has or may have against the other, whether arising before or after the Departure Date in relation to:-

(a) the relationship of the Ongoing Partners and the Retiring Partner as partners in the Partnership;

(b) the relationship of the Ongoing Partners and the Retiring Partner as directors of Quinton; and

(c) the relationship of the Ongoing Partners and the Retiring Partner through their respective nominee companies / trusts in the Quinton Trust (in respect of which the Ongoing Partners and the Retiring Partner enter this Deed on behalf of their respective companies / trusts).

**Calculation of Retirement Moneys**

3.7 Subject to Clauses 3.8, 3.9 and 3.10 hereof all moneys payable to the Retiring Partner in relation to the Partnership shall be calculated in accordance with Clauses 25 and 26 of the Deed ("**the Retirement Moneys**") on terms provided by Clause 3. 8 hereof.

3.8 Notwithstanding Clause 27 of the Deed, in lieu of three (3) instalments payable thereunder on account of the Retirement Moneys the Ongoing Partners agree to pay or cause to be paid the Retirement Moneys as follows:

3.8.1 Instalment 1 - or before 31 March 2009 - 15% thereof;

3.8.2 Instalment 2 - on or before 30 June 2009 - 15% thereof;

3.8.3 Instalment 3 - on or before 30 September 2009 -15% thereof;

3.8.4 Instalment 4 - on or before 31 December 2009 - 20% thereof;

3.8.5 Instalment 5 - on or before 31 March 2010 - 15% and;

3.8.6 Instalment 6 - on or before 30 June 2010 - 20%

PROVIDED THAT in the period commencing 1 January 2009 and ending 30 June 2009 the Ongoing Partners shall pay on account of Instalment 1 and Instalment 2 of the Retirement Moneys $12,000 each fortnight in arrears until Instalment 1 and Instalment 2 have been paid in full ("the Payments") PROVIDED FURTHER THAT if at a time prior to Instalment 2 falling due the sum of the Payments so made equals the sum of Instalment 1 and Instalment 2 THEN the Ongoing Partners shall be relieved of making any further payments AND if the Payments so made shall be in excess of the sum of Instalment 1 and Instalment 2 then the Ongoing Partners shall offset the overpayment made by them against the next instalment of any other moneys becoming due and payable to the Retiring Partner hereunder on any account.

3.9 All Debtors, Disbursements and WIP that are included in the Accounts of the Partnership as at the Departure Date but which are not paid or recovered on or before the last date for payment referred to in Clause 3.8.6 hereof shall be treated as follows

3.9.1 as to Debtors, a bad debt of the Partnership to be written off;

3.9.2 as to Disbursements, an unrecoverable Disbursement to be written off; and

3.9.3 as to WIP, unrecoverable WIP to be written off;

AND the amount of Instalment 6 shall be reduced by the Proportionate Amount of the sum of Clauses 3.9.1 to 3.9.3 inclusive above PROVIDED THAT if between the Departure Date and the date that Instalment 6 is paid Debtors, Disbursements and WIP that had been written off in the Accounts of the Partnership are subsequently paid or recovered then Instalment 6 shall be increased by the Proportionate Amount of the sum so paid or recovered.

3.10 The parties acknowledge and agree that for the purposes of Clauses 3.7, 3.8 and 3.9 hereof the Accountants shall prepare, based upon the Accounts of the Partnership and the operation of Clauses 3.7. 3.8 and 3.9 hereof Summary Sheets as at the Departure Date and as at the date of Instalment 6.

…

3.15 The parties hereto agree that Clause 3.11 and 3.12 override Clauses 28.2.1 and 28.2.3 of the Deed.

…

**Confirmation**

3.20 The Ongoing Partners confirm that the Partnership (save for the retirement of the Retiring Partner effective upon the Departure Date by this Deed) shall continue after the Departure Date in accordance with the Deed.

3.21 The parties agree to the full extent contemplated by the Deed (unless varied by this Deed) that the provisions of the Deed shall apply as between the Ongoing Partner and the Retiring Partner up to the Departure Date, and thereafter as between the Ongoing Partners only.

…

**4.7 Whole Agreement**

47.1[sic] This Deed contains all the terms and conditions relating to or which concern its subject matter and unless expressly referred to herein there are no other agreements or understandings (oral or in writing) between the parties.

1. It was an agreed fact that the following was a summary of the final payments:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **Total Amount entitled** | **Year ended 30 June 2009** | **Year ended 30 June 2010** | **Year ended 30 June 2011** |
| **Capital and Current Account** | $0 | **-** | **-** | **-** |
| **Goodwill** | $182,629 | $54,789 | $91,315 | $36,525 |
| **Work in progress** | $410,320  | $131,265  | $218,775  | $60,280  |
| **Other amounts** | $3,250 | $975 | $1,625 | $650 |
| **Repayment of capital account** | ($197,126) | ($31,029) | ($118,641) | ($47,456) |
| **Total** | $399,073 | $156,000 | $193,074 | $50,000 |

## Assessment

1. The respondent assessed the appellant to tax for the 2009 tax year by including in his assessable income a discount capital gain from the disposal of goodwill in the Partnership’s business in the amount of $91,314, calculated as capital proceeds of $182,629 less a cost base of $0 and applying a 50% CGT discount. In determining the capital gain the **Commissioner** of Taxation applied cl 25 of the Partnership Deed.

# Decision of the Primary Judge

1. Before the primary judge the appellant contended that applying cll 25 and 26 of the Partnership Deed and cl 3.7 of the Retirement Deed, the amount he was entitled to receive in respect of goodwill was nil because the goodwill amount was set‑off against an amount the appellant owed to the Partnership.
2. The primary judge dismissed the appellant’s application. At PJ [48] – [51] the primary judge stated:

Clause 25 of the Partnership Deed is under the heading “Effect of retirement and payment”. In plain terms, it provides that upon the happening of the designated event – here, retirement – the Partner shall be paid the amounts specified in cll 25.1 to 25.4. The amount that “shall be paid” “upon retirement” in respect of goodwill is Mr Hedges’ proportionate part, calculated in accordance with his Partnership Interest of 12.57%, of the goodwill of the Partnership, the value of which is calculated as the equivalent of 50% of the annual net trading profit of the Partnership, averaged over the preceding three years. Clause 25 is the source of Mr Hedges’ right to be paid an amount in respect of his proportionate share in the goodwill of the Partnership upon his retirement.

Clause 26 does not confer on Mr Hedges a right to receive payment upon his retirement in respect of, relevantly, goodwill. Clause 26 is directed to providing a set-off mechanism. It requires that “any moneys owing” by an Outgoing Partner “shall be determined” and “shall be offset against any amount found owing to” the Outgoing Partner. Clause 26 requires the determination of amounts owing by and to an Outgoing Partner, but it is not the source of the relevant obligations in respect of such payments. Clause 26 is merely a mechanism that provides a convenient method by which the Partnership can recover amounts owed by Outgoing Partners to the Partnership on their retirement.

Clause 3.7 of the Retirement Deed is similarly directed to the “calculation” of “the Retirement Moneys” which are “all moneys payable” to the Outgoing Partner. Clause 3.7 is directed to the net payment position. Of itself, cl 3.7 does not establish a right to the component payments. Clause 3.7 says that the Retirement Moneys “shall be calculated in accordance with [cll] 25 and 26 of the [Partnership] Deed”. Attention is directed back to cl 25, which is the source of the entitlement to the four categories of payments identified in cll 25.1 to 25.4 (inclusive), and to cl 26, which addresses the mechanism by which the net payment is calculated after applying the contractually agreed set-off mechanism by which debts owed by the Outgoing Partner are recovered. The Tribunal was correct to construe the relevant deeds as giving Mr Hedges an entitlement upon his retirement to the goodwill payment which derived from cl 25, specifically cl 25.4. The relevant event for the purpose of s 116-20(1)(a) of the ITAA 1997 was Mr Hedges’ retirement. Upon this event, Mr Hedges became “entitled to receive” the goodwill payment within the meaning of s 116-20(1)(a) of the ITAA 1997.

The Tribunal was also correct to recognise that, notwithstanding that the goodwill payment was liable to be applied to offset Mr Hedges’ obligation to repay the debt due on the capital account, the capital proceeds of the CGT event were not reduced by the reason of the offset. The effect of s 103-10 of the ITAA 1997 was that Mr Hedges was deemed to receive the goodwill payment at the time it was applied for his benefit in reducing his debt in respect of the capital account.

# Grounds of Appeal

1. By an amended notice of appeal the appellant raised two grounds of appeal:
2. The learned primary judge erred in holding that cl 25 of the Partnership Deed dated 25 September 2006 was the source of the appellant’s right to be paid an amount in respect of his proportionate share in the goodwill of the partnership on his retirement (*Hedges v Commissioner of Taxation* [2022] FCA 1389 at [41], [48] and [50] – [51]).
3. The learned primary judge should have held that:
	1. cll 3.7, 3.8 and 3.9 of the Deed of Partner’s Retirement dated 30 September 2008 (**Retirement Deed**) were the source of the appellant’s right to be paid an amount of “Retirement Moneys”;
	2. the “Retirement Moneys” did not include moneys in respect of the disposal of the appellant’s share in the goodwill of the partnership for the purposes of s 116‑20(1) of the *Income Tax Assessment Act 1997* (Cth).
4. The Commissioner did not object to leave being granted for the appellant to file and rely upon the ground set out in the amended notice of appeal. Leave was granted at the commencement of the hearing.

# Relevant statutory provisions

1. Section 104-10(1) of the *Income Tax Assessment Act 1997* (Cth) (**ITAA 97**) provides that CGT event A1 happens if you dispose of a CGT asset. Relevantly, the time of the event is when you enter into the contract for the disposal: s 104-10(3)(a). A capital gain is made if the capital proceeds from the disposal are more than the asset’s cost base: s 104-10(4).
2. The general rule (provided for in s 116-20(1)) is that the capital proceeds from a CGT event are the total of:

(a) the money you have received, or are entitled to receive, in respect of the event happening; and

(b) the \*market value of any other property you have received, or are entitled to receive, in respect of the event happening (worked out as at the time of the event).

1. Section 103-10 provides:

(1) This Part and Part 3-3 apply to you as if you had received money or other property if it has been applied for your benefit (including by discharging all or part of a debt you owe) or as you direct.

(2) Those Parts apply to you as if you are entitled to receive money or other property:

(a) if you are entitled to have it so applied; or

(b) if:

(i) you will not receive it until a later time; or

(ii) the money is payable by instalments.

1. A CGT asset is defined in s 108-5. Relevantly that section provides:

(1) A CGT asset is:

(a) any kind of property; or

(b) a legal or equitable right that is not property.

(2) To avoid doubt, these are CGT assets:

…

(c) an interest in an asset of a partnership;

(d) an interest in a partnership that is not covered by paragraph (c).

(notes omitted.)

1. Section 106-5 of the ITAA 97 is entitled “Partnerships”. It relevantly provides:

(1) Any \*capital gain or \*capital loss from a \*CGT event happening in relation to a partnership or one of its \*CGT assets is made by the partners individually.

Each partner’s gain or loss is calculated by reference to the partnership agreement, or partnership law if there is no agreement.

Example 1: A partnership creates contractual rights in another entity (CGT event D1). Each partner’s capital gain or loss is calculated by allocating an appropriate share of the capital proceeds from the event and the incidental costs that relate to the event (according to the partnership agreement, or partnership law if there is no agreement).

Example 2: Helen and Clare set up a business in partnership. Helen contributes a block of land to the partnership capital. Their partnership agreement recognises that Helen has a 75% interest in the land and Clare 25%. The agreement is silent as to their interests in other assets and profit sharing.

When the land is sold, Helen’s capital gain or loss will be determined on the basis of her 75% interest. For other partnership assets, Helen’s gain or loss will be determined on the basis of her 50% interest (under the relevant Partnership Act).

(2) Each partner has a separate \*cost base and \*reduced cost base for the partner’s interest in each \*CGT asset of the partnership.

(3) If a partner leaves a partnership, a remaining partner \*acquires a separate \*CGT asset to the extent that the remaining partner acquires a share of the departing partner’s interest in a partnership asset.

Note: The remaining partners would not be affected if the departing partner sells its interests to an entity that was not a partner.

Example: (Indexation is ignored for the purpose of this example).

John, Wil and Patricia form a partnership (in equal shares).

John contributes a building (which is a pre-20 September 1985 asset) having a market value of $200,000. Wil and Patricia contribute $200,000 each in cash.

The partnership buys another asset for $400,000.

John is taken to have disposed of 2/3 of his interest in the building (1/3 to Wil and 1/3 to Patricia). His remaining 1/3 share in the building remains a pre-CGT asset. The 1/3 shares that Wil and Patricia acquire are post-CGT assets.

Wil retires from the partnership when the partnership assets have a market value of $1,200,000 ($500,000 for the building and $700,000 for the other asset). John and Patricia pay Wil $400,000 for his interest in the partnership.

Wil has a capital gain of $100,000 on the building and $100,000 on the other asset. John and Patricia each acquire an additional 1/6 interest in the partnership assets. These additional interests are separate assets and post-CGT assets.

# Nature of partnership interest under general law

1. Under general law, the partners in a partnership hold legal title to partnership property on trust for the partners. However, an individual partner does not have an equitable interest in any particular asset of the partnership. As the majority of the High Court in *Commissioner of State Revenue (WA) v Rojoda Pty Ltd* [2020] HCA 7; (2020) 268 CLR 281 said at 302 [33]:

unlike a beneficiary of a fixed trust, it was well established that a partner's interest was not an interest in, or in relation to, any specific asset other than an entitlement to the partner's share of the net proceeds from the sale of each asset at the completion of winding up. In other words, the only right that the partners have, both before and after dissolution, in relation to each asset is a right to the account and distribution after sale of the proceeds of that asset – "not to an individual proportion of a specific article, but to an account: the property to be made the most of, and divided". Hence, a partner's equitable interest is not accurately expressed as a "beneficial interest", at least in the sense of being a right to any proportion of, or for the personal use of, or for the benefit from, any particular asset.

(footnotes omitted.)

1. Each partner may thus be said to have an indivisible proportionate interest in the totality of the partnership property. That proportionate interest was itself property that was capable of being assigned. The majority of the High Court in *Commissioner of Taxation v Everett* [1980] HCA 6; (1980) 143 CLR 440 at 446 – 447 explained the position as follows:

Although a partner has no title to specific property owned by the partnership, he has a beneficial interest in the partnership assets, indeed in each and every asset of the partnership (*Canny Gabriel Castle Jackson Advertising Pty. Ltd. v. Volume Sales (Finance) Pty. Ltd.* [1974] HCA 22; (1974) 131 CLR 321, at pp 327-328 ; *Livingston v. Commissioner of Stamp Duties (Q.)* [1960] HCA 94; (1960) 107 CLR 411, at p 453). His share in the partnership consists of a right to a proportion of the surplus after the realization of the assets and payment of the debts and liabilities of the partnership (*Bakewell v. Deputy Federal Commissioner of Taxation (S.A.)* [[1937] HCA 11](http://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/cth/HCA/1937/11.html); (1937) 58 CLR 743, at p 770; *Bolton v. Federal Commissioner of Taxation* (1965) ALR 481, at p 485; (1964) 9 AITR 385, at p 389). Historically the interest of a partner in a partnership has been considered to be an equitable interest because it is a right or interest enforceable in equity and not at law (*Bolton's Case*).

A partner's interest in the partnership is a chose in action assignable in whole or in part (*Hocking v. Western Australian Bank* (1909) 9 CLR 738, at p. 743). The better opinion seems to be that, though the interest of a partner is an equitable interest, it may be assigned under s. 12 of the *Conveyancing Act*, 1919 (N.S.W.), as amended, the counterpart of s. 25 (6) of the *Supreme Court of Judicature Act*, 1873 (U.K.), now s. 136 of the *Law of Property Act,* 1925 (U.K.).

# CGT and partnerships

1. As is apparent from the statutory provisions extracted above, unlike the position at general law, the capital gains provisions are drafted on the basis that each partner has an interest in each partnership asset.
2. This is confirmed by the legislative history.
3. Following the introduction of Part IIIA of the *Income Tax Assessment Act 1936* (Cth) (**ITAA 36**), providing for capital gains and capital losses to be included in assessable income (**CGT**), issues arose in relation to dealings with partnership assets. Part of the complexity arose because although a partnership is not a separate legal entity, the taxable income of a partnership was required to be determined on the basis that the partnership were a resident taxpayer. In 1991 Part IIIA was amended by the *Taxation Laws Amendment Act 1991* (Cth) (originally introduced into Parliament as the Taxation Laws Amendment Bill (No. 6) 1990) to make it clear (in former s 160C) that it was the individual partners who were to account for capital gains and losses on disposals of partnership assets by providing that in determining the net income of a partnership, the partnership was not to be taken to be a taxpayer for the purposes of the CGT provisions in former Part IIIA.
4. For CGT purposes, each partner was to be required to account for capital gains and losses on disposals of partnership assets. The definition of asset in former s 160A was amended to provide that a partner’s interest in each underlying partnership asset was to be treated as a separate asset for CGT purposes. The implication was that for CGT purposes, a partner has an interest in each partnership asset.
5. At the same time, the definition of asset was also amended to separately identify as an asset a partner’s interest in the partnership. This separate identification was to address a concern about potential double taxation. According to the further supplementary explanatory memorandum to the *Taxation Laws Amendment Bill 1991*:

[A] technical argument has been put that because a partnership interest is itself an asset (being a chose in action), the value of which may relate in whole or in part to interests in underlying partnership assets (which themselves are to be treated as separate assets), a partner could be exposed to “double taxation” on the same effective gains.

To ensure that this result cannot occur, the further amendment proposed ensures that a “partnership interest” is to be treated as a separate asset for CGT purposes only to the extent that its value does not relate to a partner’s interests in individual partnership assets which themselves are treated as separate assets for CGT purposes.

1. As part of the rewrite of the CGT provisions into the ITAA 97, s 106-5 was introduced into the ITAA 97 by Sch 1 to the *Tax Law Improvement Act (No. 1) 1998* (Cth). Beyond rewriting the former s 160C to ensure that a capital gain or loss from the happening of a CGT event is made by the individual partners and not the partnership, the new section also specified the CGT consequences of a change in the membership of a partnership.
2. Because, in this instance, there is a “partnership agreement” (the Partnership Deed, as read with the Retirement Deed), it is not necessary, in order to determine the appeal, to consider the specification in s 106-5(1) of the ITAA 97 of calculation by reference to “partnership law”, which is only applicable in the absence of a “partnership agreement”. That may be fortunate. That is because the reference in s 106-5(1) to “partnership law” must be a reference to the general law of partnership, with the feature, already noted, of absence of title to specific property owned by the partnership, and yet, contrary to the general law of partnership and as also already noted, the CGT provisions generally treat a partner as having an interest in individual partnership assets which themselves are treated as separate assets for the purposes of those provisions.
3. It is against this background that the facts in the present case are to be considered.

# POSITION OF THE PARTIES

1. On appeal, the parties were agreed that:
	1. By the time of entry into the Retirement Deed, the appellant’s proportionate interest in the Partnership was 13.435% (cf PJ at [15]).
	2. CGT event A1 occurred on 30 September 2008. For the purposes of Part 3-1 of the ITAA 97, the appellant disposed of his interest in the partnership and in each of the partnership assets under the Retirement Deed.
	3. The appellant had a nil cost base in the goodwill asset disposed of upon his retirement.

## Appellant’s Contentions

1. The appellant contends that the primary judge misconstrued the effect of the Retirement Deed. The Retirement Deed provided that the Partnership Deed applied between the partners up to the “Departure Date” “unless varied by [the Retirement] Deed”: cl 3.21. The Departure Date was 31 December 2008.
2. The appellant contends that the effect of the Retirement Deed was fourfold:
3. It varied the Partnership Deed up until the Departure Date.
4. It provided for the Partnership Deed to cease to apply from the Departure Date.
5. It effected a series of mutual releases of all rights and obligations, including accrued rights and obligations.
6. It exclusively regulated the rights and obligations of the appellant as regards the Ongoing Partners from the Departure Date.
7. The appellant contends that the source of his contractual entitlement to a payment on retirement was cll 3.7, 3.8 and 3.9 of the Retirement Deed and these clauses provided for a single sum of “Retirement Moneys” to be paid. The sum of Retirement Moneys was to be calculated by reference to the integers provided for in cll 25 and 26 of the Partnership Deed. Contrary to the conclusions of the primary judge (esp PJ [48], [50]), the Partnership Deed was not the source of the appellant’s contractual entitlement to receive moneys.
8. Because the only amount to which the appellant was entitled under the Retirement Deed was a sum of Retirement Moneys, it could not be said that the appellant received or became entitled to receive any amount for the disposal of his interest in the goodwill of the partnership. No payment was made under the Retirement Deed for the appellant’s interest in the partnership goodwill.
9. When applying the integers in clls 25 and 26 of the Partnership Deed, the resulting sum of Retirement Moneys to which the appellant was entitled was nil and therefore no capital gain arose as a result of CGT event A1 occurring on entry into the Retirement Deed.

# Analysis

1. The essence of the dispute as framed on appeal concerns the construction and effect of the Retirement Deed.
2. The appellant’s contention that the source of his entitlement to a payment on retirement was cl 3.7 of the Retirement Deed and that, although calculated by reference to integers derived from cll 25 and 26 of the Partnership Deed, the only amount which the appellant was entitled to receive pursuant to that clause was the calculated net sum, is rejected as a matter of construction of the deeds.
3. Clause 3.7 of the Retirement Deed does not confer an entitlement on the appellant to be paid but provides for the terms on which the moneys payable under the Partnership Deed are to be paid. It refers to “all moneys payable to the Retiring Partner” and ascribes to the total of these moneys the label “Retirement Moneys” but it does not create in the Partnership or in the remaining partners the obligation to pay moneys. The Retirement Moneys is the total of those moneys payable to the appellant pursuant to cl 25 of the Partnership Deed and does not constitute an obligation to pay an undissected lump sum for the appellant’s partnership interest. Clause 3.7 of the Retirement Deed incorporates the terms of cll 25 and 26 of the Partnership Deed and provides for cl 3.8 to determine the instalments for payment of the moneys liable to be paid pursuant to cll 25 and 26 of the Partnership Deed. The effect of cl 3.8 was to amend the instalment regime otherwise provided for in cl 27 of the Partnership Deed.
4. Because the appellant’s entitlement to receive moneys was created by cl 25 of the Partnership Deed, one of the amounts the appellant was entitled to receive was a “proportionate part calculated in accordance with the Partnership Interests of the goodwill of the Partnership”: Partnership Deed cl 25.4. That proportionate amount was an amount calculated as referable to the appellant’s interest in the partnership asset of goodwill. For CGT purposes, the appellant had a CGT asset in the form of his interest in the goodwill of the Partnership with a separate cost base.
5. By its terms, the Retirement Deed did not rescind the Partnership Deed but purported to vary it: *Federal Commissioner of Taxation v* ***Sara Lee*** *Household & Body Care (Australia) Pty Ltd* [2000] HCA 35; (2000) 201 CLR 520 at [22] – [24]. Unless varied by the Retirement Deed, the provisions of the Partnership Deed applied up to the Departure Date, and thereafter as between the Ongoing Partners only: Retirement Deed cl 3.21. The purpose of the Retirement Deed was not to bring the Partnership Deed to an end but to provide for the appellant’s departure date and with “the intent that as and from the Departure Date the Retiring Partner (or his nominee) shall have no further interest in or association with the Partnership”: Retirement Deed recital C. The releases effected by the Retirement Deed are to be construed in light of the purpose of the Retirement Deed. It was the claims arising from the partnership relationship which were released by cl 3.6.3. In releasing accrued rights and obligations, the release in cl 3.6.3 did not effect a release of rights and obligations otherwise accruing upon the retirement of the appellant but related to rights and obligations that accrued in relation to the business operations of the Partnership.
6. The purpose of cl 3.7 of the Retirement Deed was not to confer a right on the appellant to be paid or to impose an obligation on the remaining partners to pay the monetary entitlements of the appellant upon his retirement but to vary the payment terms and manner of calculation of the quantum. Properly construed, cl 3.7 did not create a new obligation to pay “Retirement Moneys”. The term “Retirement Moneys” was just a convenient label to ascribe to the total of the moneys which cl 25 of the Partnership Deed required the remaining partners to pay after the set-off provided for in cl 26 of the Partnership Deed. Clause 3.8 of the Retirement Deed varied the instalment schedule provided for in cl 27 of the Partnership Deed. The concluding words of cl 3.8 “any other moneys becoming due and payable to the Retiring Partner hereunder on any account” do not confer an entitlement on the appellant to be paid “Retirement Moneys”. Clause 3.9 varied the basis on which the last instalment was to be calculated and cl 3.10 provided for the preparation of accounts for the calculation of both the total and the instalment amounts.
7. Clause 26 is of no assistance to the appellant’s construction. As the primary judge correctly concluded (PJ at [49]):

Clause 26 is merely a mechanism that provides a convenient method by which the Partnership can recover amounts owed by Outgoing Partners to the Partnership on their retirement.

1. Clause 26 provides for an offset of amounts owing to the retiring partner against amounts owed by the retiring partner. That offset is not constrained to the retiring partner’s proportionate share of goodwill of the Partnership. Contrary to the submissions of the appellant, that offset did not result in the cl 25.4 amount being “zeroed” in the calculation of the Retirement Moneys. The amount of cash to be paid to the appellant was a balance remaining after offset. It was that balance that was to be subject to the quantum adjustment and instalment regime provided for in the Retirement Deed.
2. There was no dispute that the appellant had disposed of his interest in the Partnership goodwill for CGT purposes. Clause 25 provided for the appellant to be entitled to receive an amount for that interest in the goodwill and for the agreed basis on which the value of that goodwill was to be determined.
3. It was agreed that the time of the CGT event was upon entry into of the Retirement Deed. The High Court in *Sara Lee* at [49] held that the relevant contract for the purposes of determining the timing of a disposal was that contract which was the source of the taxpayer’s obligation to dispose of the asset. The context in the present case is a disposal which occurs as a matter of law upon the retirement of a partner. It is the retirement of a partner which brings the existing partnership to an end and which results in the remaining partners being taken to have acquired the leaving partner’s interest in each of the assets of the partnership. The obligation of the partners to account to the retiring partner was reflected in equitable principles and did not find its source in contract: *Commissioner of State Taxation v Cyril Henschke Pty Ltd & Ors* [2010] HCA 43; (2010) 242 CLR 508at [22]. The parties proceeded on the basis that the contract for the disposal is in this context the contract for the retirement of the leaving partner which in the present case was the deed that set the agreed departure date of the appellant from the partnership.

# Disposition

1. The appeal is to be dismissed with costs.

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| I certify that the preceding forty-three (43) numbered paragraphs are a true copy of the Reasons for Judgment of the Honourable Justices Logan, Goodman and Hespe.  |

Associate:

Dated: 12 July 2023