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Is a partnership an "entity"?

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In the recent decision of *White v FC of T* [2009] FCA 880 (18 August 2009), the Federal Court examined the meaning of the term "entity" in the context of the now repealed section 152-30 of the ITAA 1997. In the decision, Sundberg J interpreted the word "entity", as used in section 152-30, as having a narrower meaning than that term's definition in section 995-1(1) of the ITAA 1997. This narrower meaning was derived from the commentary in the Explanatory Memorandum to the provisions, rather than from anything expressly or implicitly stated in the legislation itself. Importantly, the court viewed partnerships as excluded from the concept of an "entity". This article critiques and evaluates his Honour's reasoning in the decision.

Facts

In 2002/03, the taxpayer, W, sold a pharmacy business. Just before the sale, W held a variety of assets including interests in two other pharmacy partnerships. The total value of the assets of the two partnerships exceeded the then maximum net asset value threshold of $5,000,000. The total value of W's assets - including her share in the assets of the two partnerships was approximately $3,862,201.

Under Division 152 of the ITAA 1997, a taxpayer is entitled to small business CGT relief, if the net value of the taxpayer's assets, just before a CGT event, does not exceed $5 million (now $6 million: section 152-15 of the ITAA 1997).

In calculating the net value of a taxpayer's assets, section 152-15(a)(ii) requires that the taxpayer take into account the net value of all CGT assets of any entities connected with the taxpayer. While section 152-30 (since repealed and replaced by section 328-125) stipulates that one entity is connected to another if the first entity has the right to receive 40% of the income of the second entity.

In light of the above, the key issue before the Court was whether a partnership should be considered an "entity", as that term was used in the then section 152-15(a)(ii) of the ITAA 1997. If a partnership was not an "entity", then the net value of the taxpayer's assets should only include the taxpayer's share of the assets of the partnerships, rather than the total assets of the two partnerships.

Taxpayer's submissions

The taxpayer submitted that the legislative intention of the provision was to exclude partnerships from the meaning of "entity" as that term was used in section 152-30. The taxpayer argued the fact that section 152-30 and its Explanatory Memorandum only referred to companies and trusts, but not to partnerships, was evidence of the legislative intention to exclude partnerships from the meaning of "entity" (paragraph 17 and 18).

In addition, W also relied on section 106-5 of the ITAA 1997 – that a capital gain or loss from a CGT event in relation to a partnership accrues to the partners individually – and argued that since the calculation of the tax liability of partnerships accrues on an individual basis, so too should the calculation of net assets (paragraph 14 and 15).

Commissioner's submissions

The Commissioner argued there was a clear legislative intention that the term "entity", as used in section 152-30, include partnerships. The Commissioner asserted that the CGT regime (eg Division 106) expressly treats partnerships as entities, even though they are not taxpayers (paragraph 21). Further, the Commissioner argued that the word "entity" should be interpreted consistently with its definition in section 960-100(1) defined to "mean", among other entities, a partnership (paragraph 22 to 27).

Federal Court decision

Before discussing the Court's decision, it is worth extracting the text of the then section 152-30:

> "Section 152-30
>
> ...
>
> (2) An entity (the first entity) controls another entity if the first entity, its small business CGT affiliates or the first entity together with its small business CGT affiliates:
>
> (a) beneficially own, or have the right to acquire the beneficial ownership of, interests in the other entity that carry between them the right to receive at least 40% (the control percentage) of any distribution of income or capital by the other entity; or
>
> (b) if the other entity is a company – beneficially own, or have the right to acquire beneficial ownership of, shares in the company that carry between them the right to exercise, or control the exercise of, at least 40% (the control percentage) of the voting power in the company;"

The Federal Court held that a legislative intention to exclude partnerships could be found, in relation to the use of the word "entity", in section 152-30. In particular, the court stated that the provision's Explanatory Memorandum referred only to individuals, companies and trusts and not to partnerships (paragraph 35 and 36).

His Honour reasoned that this was sufficient evidence of a legislative intent not to include partnerships in the meaning of "entity". In light of his finding, Sundberg J rejected the Commissioner's argument that the term "entity" in section 152-30 should be defined consistently with its definition in section 960-100(1), on the grounds of a clear contrary legislative intention (paragraph 45).

However, the court conceded that partnerships were within the meaning of the term "entity", as the term was used in section 152-15 and Division 106 of the ITAA 1997. In coming to this conclusion, the court reasoned that the word "entity" did not have the same consistent meaning whenever it was encountered in the ITAA 1997 (paragraph 49). His Honour reasoned that there was a clear legislative intention from the text of the Act that partnerships were included in the term "entity" for the purposes of section 152-15 and Division 106 (paragraph 49).

Accordingly, the court held that, for the purposes of section 152-30, partnerships were excluded from the term "entity" (paragraph 55).

Critique of decision

The Federal Court's decision to depart from the broad definition of the term "entity" in section 960-100(1) was based on a finding of a contrary legislative intention. However, the word "entity" as used in section 152-30, was defined by reference to section 960-100(1) where it is defined to "mean", amongst other entities, partnerships. Accordingly, to depart from that definition, the Court needed to firstly, justify its jurisdiction to examine external sources (ie establish an ambiguity in the text of the provision) and then, consistently with the opening words of section 995-1(1) (ie "except so far as the contrary intention appears :"), satisfy itself of a contrary legislative intention.

If a "means" definition is used it is generally narrower and stricter than "includes". More specifically, where a statute states that a term "means" a certain thing, the definition is an exhaustive and confined definition, no other meaning can, subject to the overriding intention disclosed by the context, be assigned to it (*Gough* v *Gough* (1891) 2 QB 665). Where a statute instead uses the word "includes", then the statute does not intend to substitute the statutory meaning for the ordinary meaning of word but, rather, to confer some meaning additional to the ordinary meaning (*Stephen* J in *FC of T* v *St Hubert's Island Pty Ltd* (1978) 138 CLR 210*)*.

The Court's reasoning should have followed a clearer approach. In particular, since section 152-30 only referred to "entities" with separable legal and beneficial ownerships, it is arguable that this provision meant to exclude partnerships (where the legal and beneficial ownership is not usually separated). The possible ambiguity in the provision, would thus allow the Court to determine the legislative intention of the term from sources other than the legislation, by reason of section 15AB of the *Acts Interpretation Act* 1901 (Cth), such as the provision's Explanatory Memorandum. Only upon finding a contrary legislative intention in the Explanatory Memorandum, consistently with section 995-1(1), could the court depart from the definition of the term "entity" in section 960-100(1).

In contrast to this approach, his Honour simply obtained the legislative intention of the provision from the Explanatory Memorandum to the provisions (paragraph 32 to 37). Thus, Sundberg J failed to first, adequately explain the ambiguity in the provision and justify his jurisdiction to depart from the definition in the Act, before going on to examine the Explanatory Memorandum. Even though his Honour eventually established his authority to depart from the definition, it was towards the end of his judgment (paragraph 53) and without in any way citing the relevant legislative provision (ie section 995-1(1)).

With respect, the structure and reasoning of the Court indicates a fallacy in the Court's approach to interpreting tax law. In essence, his Honour found the legislative intention of the provision from its Explanatory Memorandum first (paragraph 32 to 37); then explained section 152-30 and rejected the general definition of "entity" (paragraph 45); and finally established his authority to depart from the definition (paragraph 53).

In *Mills v Meeking* (1990) 169 CLR 214 at 235, it is explained that the interpretation of a statute may take into account the purpose of a statute even where there is no apparent ambiguity in the wording of the provisions. However, if his Honour had relied on this authority, he should have explained this before proceeding to consider the Explanatory Memorandum.

Not mentioned in the decision, but interestingly, in contrast to section 152-30, section 152-15 uses the term "you" instead of "entity". Under section 4-5 of the ITAA 1997, the word "you", as used in section 152-15, applies to "entities" generally unless its application is **expressly limited**. By contrast, the definition of "entity", in section 960-100(1), may be deviated from if there is **a contrary intention in the legislation**. In the *White* decision, the Court found a contrary legislative intention in section 152-30 but no express limitation in section 152-15; consequently the term "you" and "entity" may have very different meanings depending on their context.

Conclusion

Where words are clearly defined in tax legislation, those words should be given their statutory meaning. A departure from the statutory meaning of a word should

only happen after a Court has established a clear jurisdiction for doing so. In *White*'s case, even though the outcome of the case might have been similar irrespective of the interpretation method applied, the erroneous jurisprudence regarding statutory interpretation could nevertheless create uncertainty and confusion for taxpayers and practitioners alike.