EQUITY TRUST

INTERNATIONAL

Equity Trust International Limited

Limited Partnerships Brochure

Table of Contents

1. **Basic Features of a Limited Partnership** 2

2. **Requirements for a Limited Partnership** 2

3. **The Limited Partnership Structure** 3

4. **Practical Uses for Limited Partnerships** 5

5. **Benefits of a Limited Partnership** 6

6. **Taxation** 7

    6.1 Transparency for Tax Purposes 7

    6.2 Source Rules 9

7. **Use of a New Zealand Limited Partnership** 9

Limited Partnerships

1. *Basic Features of a Limited Partnership*

A Limited Partnership is an incorporated and separate legal entity and, subject to any restrictions contained in the limited partnership agreement, has the legal capacity to exercise all the powers of a natural person or company.

A limited partnership agreement is advised to deal with any contingencies which may arise.

A partnership agreement is an agreement between partners that establishes a Limited Partnership and governs the terms and conditions of the partnership relationship. On registration the General Partner, or their agent, must certify that the proposed partners of the Limited Partnership have entered into a partnership agreement which complies with the Limited Partnership Act 2008 before it can be registered.

Unlike a trust a Limited Partnership may exist in perpetuity.

The main legislation dealing with limited partnerships is the *Limited Partnerships Act* 2008.

2. *Requirements for a Limited Partnership:*

The proposed business must register under the Limited Partners Register.

A Limited Partnership must have:

- A registered office address
- An address for service
- A Postal address; and
- An email address

The registered office address and address for service must be physical addresses in New Zealand ie cannot be a Private Bag, DX or a 'virtual office' (that is a mail/message collection point). If the registered office and address for service is at the offices of any firm of chartered accountants or lawyers, or at the offices of any other person then full particulars are required eg name of firm including any particulars of the location in any building, etc.

The General Partner/Agent must certify that the proposed partners of the Limited Partnership have entered into a partnership agreement and that it complies with the Limited Partnership Act 2008.

The name of the Limited Partnership must include the words 'Limited Partnership' or the abbreviation 'LP' or 'L.P.' at the end of the name.

The Registrar must not register a Limited Partnership with a name –

a. the use of which would contravene an enactment; or

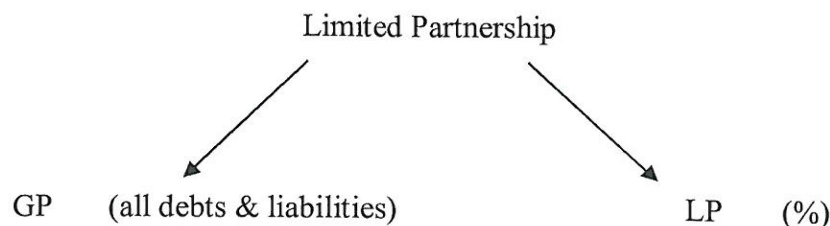
b. that is identical to, or almost identical to, the name of a company registered under the Companies Act 1993 or another Limited Partnership or an Overseas Limited Partnership registered under this Act; or

c. that, in the Registrar's opinion, is offensive

To ensure expediency in registration, you must also ensure that there is no identical or almost identical to the name of a company, Limited Partnership or Overseas Limited Partnership that already exists on the Register.

3. The Limited Partnership Structure

Limited Partnerships are a form of partnership involving **General Partners**, (who are liable for all the debts and liabilities of the partnership) and **Limited Partners** (who are liable to the extent of their capital contribution to the partnership).



A Limited Partnership is separate from its partners and has a general partner ("**GP**") and at least one limited partner ("**LP**"). Any person or company can be a partner, and there is no limit on the number of partners. Usually there will be one GP and each party who contributes to the working capital of the Limited Partnership will be a LP.

Subject to new legislation, it is now a requirement that at least **one** General Partner is a NZ Resident. However, so long as this requirement is met, any further General Partners can be non-residents. Having non-resident partners can be advantageous in terms of tax.

The GP is responsible for the management and administration of the Limited Partnership and is jointly and severally liable with the Limited Partnership for all the debts and liabilities of the Limited Partnership.

A GP is normally a limited liability company with no significant capital of its own and is not required to make a capital contribution to the Limited Partnership.

The LP's liability is similar to that of a company shareholder in that it is limited to its capital contribution.

However, a LP that participates in the day to day management may lose its limited liability status and become jointly and severally liable for the debts and liabilities of the Limited Partnership.

It is therefore extremely important that a LP does not compromise its limited liability status by participating in the management of the Limited Partnership. There are certain specified "safe harbour" activities in which an LP may participate without losing its limited liability. These activities are similar to those actions which normally require a special resolution by shareholders of a company and include:

1. making decisions about amending the limited partnership agreement;
2. deciding whether to approve or veto investments;
3. approving decisions regarding employee contracts;
4. making decisions regarding a change in the general nature of the business;
5. enforcing rights under the limited partnership agreement;
6. reviewing and approving accounts;
7. providing services under a contract (provided those services are for the provision of management functions); and
8. discussing the strategic direction or financial prospects of the business.

Limited Partnerships must have a written partnership agreement which is similar to a contract made between the GP and each LP. It is similar to the constitution of the company but Limited Partnership.

The partnership agreement is not publicly registered. At the time of registration the applicant must certify to the Registrar of Limited Partnerships that the limited partnership agreement complies with the Limited Partnerships Act 2008.

In order for a limited partnership agreement to comply with the Limited Partnerships Act 2008 there are a number of essential requirements including:

1. provisions which deal with restrictions on a LP's ability to assign partnership interests;
2. a description of the nature of business able to be undertaken and any restrictions thereto;
3. provisions which deal with entitlements to distributions;
4. procedures for meetings of the partners;
5. provisions dealing with financial statements and audit requirements;
6. provisions dealing with partners entering and leaving the Limited Partnership;
7. a mechanism dealing with termination of the Limited Partnership;
8. provisions dealing with possible conflicts of interests.

An application for incorporation of a Limited Partnership is made to the Registrar of Limited Partners in a prescribed form which can be down loaded from the Companies Office website. The form must be accompanied by a GP consent form. Unlike company incorporations in New Zealand a limited partnership incorporation is not yet fully electronic and must be filed by mail or facsimile.

The GP owes specific fiduciary obligations to the Limited Partnership. Conversely, LPs do not owe fiduciary obligations unless specifically imposed by the partnership agreement.

Both the GP and the LP can contribute to the Limited Partnership. Capital contributions can take any form (including services) but loans are excluded as capital contributions.

Partners who have made capital contributions are entitled to receive distributions. It is usual for only the LPs to make capital contributions and to be entitled to receive distributions pro rata to their capital contribution.

Registration details for the Limited Partnership and the GP are publicly available from the Registrar of Companies. However, information about the LPs is confidential and cannot be publicly accessed.

Generally, the Limited Partnership will be structured so that only the LPs are entitled to receive income.

NZ Resident LP will be subject to tax in NZ at the marginal rate is applicable to them.

Non-resident LP will not be subject to tax in NZ on their share of the income generated by the Limited Partnership - **provided** that the income does not have an NZ source.

4. Practical Uses for Limited Partnerships

Limited Partnerships can be used for asset planning in a number of different ways. The legislation does not restrict the types of uses for limited partnerships. They can carry out business and hold assets of any nature in any part of the world.

The most significant drawback of a Limited Partnership for ***collective investment*** purposes seems to be the inability to unitise individual interests in the fund. Individual interests are instead calculated as a percentage of the net asset value of the total assets. These can make reporting to investors more complicated. If unitised interests are required then a unit trust or company is a better structure to use.

A limited partnership will not be subject to tax on its profits in NZ. All profits flow through the structure and are taxed in the investors' own jurisdictions.

If the investors eventually decide to liquidate their interests then there may be some relief from conveyancing and other transaction costs by virtue of them transferring their interests in the limited partnership rather than the assets itself.

Because a Limited Partnership is a separate legal entity it can be used as a direct asset holding vehicle in the same way as a ***holding company*** might be used. Such a limited partnership can be beneficially owned by a trust, company or an individual resident anywhere in the world.

Limited Partnerships can be used to hold passive income producing assets or as an ***active trading entity***.

A Limited Partnership can be used for trading activities as an alternative to a company or traditional form of partnership. The liabilities of the LPs will be limited to their capital contributions (provided they do not participate in the management of the company beyond the "safe harbours").

The GP is the "agent" of the Limited Partnership and will remain jointly and severally liable with the Limited Partnership. However, typically a GP will be a limited liability company with no significant assets of its own.

It is possible for the client to hold all the shares in the general partner company. This may allow the client to retain a higher level of control over the limited partnership than might otherwise be reasonably possible if a trust was used.

The GP company would not normally be entitled to participate in the profits of the Limited Partnership. However, it may be appropriate for the GP to be paid a fee for management services it renders.

All profits generated by the Limited Partnership will flow through the structure to the limited partners who will each be taxed as appropriate to them.

If there are a number of limited partners within the same family then income can be split between them thereby reducing the overall tax liability.

Otherwise, a family trust or company could be a limited partner.

With the recently announced changes to the LAQC regime it is anticipated that Family Limited Partnerships will become an increasingly common vehicle through which family wealth is structured. This is because both losses and profits can be attributed to individual LPs.

5. *Benefits of a Limited Partnership*

The Limited Partnership is a further and welcome addition to the tool box of asset planners in NZ. The regime is a modern and flexible legal framework which has three main benefits over other forms legal entities:

(1) limited liability;

(2) separate legal personality; and

(3) fiscal transparency.

Either or two of these features are available in isolation though various other legal entities but not together.

However, the range of practical uses is unlimited and extends into areas in which a trust or company have traditionally been the only vehicles contemplated by advisors.

Where assets are held by a diverse group of individuals, some of whom may be resident overseas, then a limited partnership can provide an expedient solution.

6. Taxation

Limited partnerships return profits via distribution. Distributions are typically by reference to the relevant partners' **pro rata capital contributions**. Both general partners and limited partners are entitled to make capital contributions. Like a company, such distributions are subject to the solvency test.

The profits of the business of a limited partnership **are taxed as if the business was carried on by partners in partnership** (known as "flow through" tax status). This is in contrast to the position of a company, which is regarded as a separate taxable entity. Any loss or profit from the limited partnership flows through (on a pre tax basis), and is attributed directly to the partners to the extent of the partner's economic interest in the limited partnership.

6.1 Transparency for tax purposes

A vehicle that satisfies the definition of "partnership" is treated as a "flow through" vehicle for income tax purposes.

For the purposes of a partner's liabilities and obligations under this Act in their capacity of a partners of a partnership, unless the context requires otherwise,-

a. The partner is treated as carrying on an activity carried on by the partnership, and having a status, intention, and purpose of the partnership and the partnership is treated as not carrying on the activity or having the status, intention, or purpose:
b. The partner is treated as holding property that a partnership holds, in proportion to the partner's partnership share, and the partnership is treated as not holding the property:
c. The partner is treated as being party to an arrangement to which the partnership is a party, in proportion to the partner's partnership share, and the partnership is treated as not being party to the arrangement:
d. The partner is treated as doing a thing and being entitled to a thing that the partnership does or is entitled to, in proportion to the partner's partnership share, and the partnership is treated as not doing the thing or being entitled to the thing.

The structure allows these entities to derive income directly from a business activity or investment without that income suffering tax in the hands of the investment vehicle itself (which would ordinarily generate non-refundable imputation credits).

The tax transparency of a partnership also makes it an ideal structure for investments that are expected to generate losses. The expenditure generating partnership losses is treated as being incurred by the partners personally, with the consequence that those losses are available to partners to shelter income from other sources.

In addition, the effect this "flow through" structure is that capital gains realised by a partnership are treated as being realised by the partner in proportion to the partner's partnership share (and not by the partnership). Capital gains therefore flow through to partners, including non-resident partners, on a tax-free basis, as and when those gains are realised. By contrast, capital gains realised by a company cannot be distributed to shareholders in a tax-free manner until the company is liquidated and, in fact, cannot be distributed tax free at any time to non-resident corporate shareholders that are associated with the company. Furthermore, capital gains generated from related party transactions cannot be distributed tax-free on liquidation of a company, unless there is sufficient available subscribed capital to cover those gains.

The fact that partners of a partnership are treated as holding partnership property in proportion to their partnership share is also significant. Perhaps the main consequence is that a partner who disposes of their interest in a partnership will be treated as disposing of their share of each individual item of partnership property, potentially triggering taxable gains where that property is held on revenue account, or depreciation recovery income or loss where the property is depreciable property. The partnership rules include safe harbour provisions that are intended to relieve partners who dispose of their partnership interests from the tax consequences that would ordinarily flow from those disposals. These safe harbour rules will be addressed in a later article in this series.

An allocation rule is further provided for which allows further tax benefits. The allocation rule means that **it may not be possible for certain types of benefit to be streamed to partners in the partnership who are in the best position to derive that benefit.** For example, where two partners, one of whom is tax exempt and one of whom is a 30% taxpayer, agree to allocate income on a 70/30 basis, any capital gains generated by the partnership must also be allocated between the partners on a 70/30 basis, even though it may be advantageous for as much of the capital gain to be allocated to the taxpaying partner. **The allocation rule also limits the ability to stream foreign-sourced income to non-resident partners in order to minimise the New Zealand tax impost on that particular source of income**.

Importantly, the anti-streaming rule does not apply to expenditure or loss that an entering partner has as a consequence of acquiring an interest from another partner, but only to the extent that the safe harbour rules do not apply. An example of where this exception will have practical application is where a new partner acquires an interest in depreciable property from an exiting partner in circumstances where the safe harbour rules (to be addressed in a later article) do not apply. In this case, the new partner may obtain a step-up in the cost base for the relevant share of the depreciable property, entitling that partner to a greater proportional amount of depreciation loss than other partners in the partnership that maintain the original cost base for the property.

The anti-streaming rule also has no application to supplementary dividends and conduit tax relief additional dividends, presumably on the basis that those "dividends" must be payable to non-residents only to achieve the relief purposes of those respective tax regimes.

6.2 Source Rules

New Zealand's Tax Legislation has been amended to provide that income is treated as being sourced in New Zealand if, treating all the partners of a New Zealand partnership as resident in New Zealand, the income is sourced in New Zealand under a provision in that section. A "New Zealand partnership" is defined as a partnership that is a limited partnership registered under the Limited Partnerships Act 2008, or has 50 percent or more of its capital held by New Zealand residents, or has its centre of management in New Zealand.

7. Uses of a New Zealand Limited Partnership

A New Zealand Limited Partnership can be used for just about any purpose and is ideally suited to investment funds. They are also particularly suitable as the underlying asset holding vehicle for a New Zealand foreign trust. Having both the trustee and the asset holding vehicle established in the same jurisdiction simplifies administration of the structure, reduces legal complexities and extends to the underlying entity the benefits of New Zealand as a reputable jurisdiction.

As the limited partnership is a contractual arrangement there are no issues as regards "sham" or "alter ego" which can arise in relation to trusts.

The Limited Partnership agreement can provide for the limited partnership to be wound up after a certain period, on the occurrence of a certain event or allow for the Limited Partnership to exist in perpetuity.

The limited partnership agreement and the constitution of a corporate General Partner can set out a family investment strategy and a management process that can be maintained over several generations. The board of directors of the General Partner can be provided by Trustees Executors and/or the Donor and members of the family.

The Limited Partnership will then execute the investment strategy, for example, through an investment holding company in the British Virgin Islands, an investment management account in Hong Kong, a bank account in Switzerland or real property holdings in France. It is important to remember however that there should be no income earning assets situated in New Zealand otherwise tax will be paid on that income in New Zealand.