BusinessPlus+ Newsletter

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Working Capital Refinancing Opportunity for a Business Partnership

A general law partnership is formed when two or more people (*and up to, but not more than, 20 people*) go into business together. Partnerships are generally set up so that all partners are equally responsible for the management of the business, but each also has liability for the debts that business may incur.

A typical scenario when launching a business based on a general law partnership structure sees each partner advance some working capital to start up the enterprise. As the income years come and go, each partner takes a share of the profit and counts this as part of their personal assessable income for tax purposes.

However as the business becomes established, or better yet proves to be viable and becomes a successful operation, there is likely to come a time when its working capital — which had been financed from each partners' pocket — can be refinanced through the partnership business borrowing funds.

For such partnerships, there is a "refinancing principle" under tax law that spells out some general principles governing the beneficial deductibility of loan interest in such circumstances.

As a general rule, interest expenses from a borrowing to fund repayment of money originally advanced by a partner, and used as partnership capital, will be tax deductible. This is covered in income tax ruling TR 95/25.
The ruling states that to qualify for a tax deduction, the interest expense "must have sufficient connection" to the assessable income producing activities of the business, and must not be "of a capital, private or domestic nature".

However, interest on borrowings will not continue to be deductible if the borrowed funds cease to be employed in the borrower's business or income producing activity. Nor will deductibility be maintained should borrowed funds be used to "preserve assessable income producing assets". There is also a limitation on deductibility of loan interest in that borrowings to repay partnership capital can never exceed the amount contributed by the partners.

The ability to make these interest expense deductions under the "refinancing principle" is generally limited to general law partnerships — and not tax law partnerships - such as those used to jointly purchase an investment property. This principle would also not apply to companies or individuals. (There are very prescribed conditions where, for example, a company may make such a claim, but under very specific circumstances.)

To access a copy of a "*Business Funding Cost Effectiveness Questionnaire*" to review your business finances, please click on the link HERE.

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