INCOME TAXATION OF GENERAL PARTNERSHIPS AND LIMITED PARTNERSHIPS UNDER NORWEGIAN LAW

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1. INTRODUCTION

Under Norwegian law, business can be carried on under the form of a partnership. In general, partnerships have not been made subject to regulation by statute. An exception is constituted by partnerships carrying on shipping business; these are regulated under the Maritime Code, ch. III. Apart from that, two forms of partnership—general partnership and limited partnership—have been developed by the courts, supported by legal writers, who have to a great extent been influenced by Continental law.

The characteristic feature of a *general partnership* is that all the partners have unlimited liability for the debts of the partnership. In a *limited partnership,* on the other hand, it is only required that at least one of the partners shall have unlimited liability, the liability of the other partners being limited to the amount with which they participate in the partnership.

Both general partnerships and limited partnerships must as a rule be instituted by contract. In the absence of regulation by statute the contract may to a great extent regulate the relationship between the partners. For this reason the boundaries between partnership forms tend to be indistinct.

This paper aims at giving a survey of the most important questions of income taxation that may be raised in connection with general partnerships and limited partnerships in Norway.

As far as income taxation is concerned, it is not necessary to distinguish between general partnerships, on the one hand, and joint ventures and the like, on the other. The distinction between partnerships and limited liability companies, however, is of great importance, the limited liability company being a taxpayer on its own account, whereas in a partnership each partner is taxed separately for his share of the partnership. Most partnerships have to be entered on the local commercial register. The registration, however, is of no significance as far as taxation is concerned.

Most general partnerships and limited partnerships, but not all, are accountable under the Accounting Act of May 13, 1977, no. 35. Strangely enough, this new act is not quite clear on the question whether the partnership or its partners are to be regarded as the true accounting unit. The provisions of the Accounting Act, however, at least seem to presuppose

that the partnership, not the partners, is to be considered the accounting unit. As will be discussed below, the answer to this question is of some importance when it comes to computation of taxable income.

The income taxation of partnerships and limited partnerships under Norwegian law is regulated by the general Tax Code of August 18, 1911, no. 8, as amended. The Tax Code contains only a few provisions which have special reference to general partnerships or limited partnerships. Therefore problems of income taxation have to be solved to a great extent by construction of provisions with a rather broad field of application.

Sections 2–5 below give a survey of what may be called the general rules on the income taxation of general partnerships and limited partnerships. In sections 6–11 more special items are considered.

2. PARTNERSHIPS ARE NOT TAXABLE UNITS

Under sec. 15 of the Tax Code, both general partnerships and limited partnerships are in principle taxable units. But sec. 20 contains an exemption clause providing that neither a general partnership nor a limited partnership shall be treated as a taxable unit of its own. Instead the partners are to be taxed separately for their shares of the partnership's income (and net wealth).

In order for the exemption clause to apply, there must be at least one partner who has unlimited liability for the joint obligations. It is only liability towards third parties that counts, not agreements on loss-sharing between the partners or the like. The kind of liability that applies in each particular case depends on the partnership agreement. If the agreement says nothing on liability towards a third party, the partnership is to be regarded as a general one.

Under Norwegian law, a limited liability company (as well as other legal persons) can be a partner with unlimited liability for the joint obligations of the partnership. In fact, limited partnerships usually have a limited liability company as the single general partner.

3. COMPUTATION OF TAXABLE INCOME—GROSS INCOME

3.1. *Gross or Net Method?*

Theoretically, the computation of the partners' income from participation in the partnership may be based on either a gross method or a net method. Computation according to a net method means making an account of the

partnership's incoming and outgoing items and then sharing the partnership's net income (surplus or deficit) between the partners. Computation according to a gross method means in principle sharing the partnership's individual items of income and cost between the partners, and then leaving it to the partners to compute their taxable income, taking into account their shares of the partnership's income and cost items as well as income from other sources.

To a certain extent the two methods will give the same result. But when it comes to capital gains, writing off for depreciation, etc., the methods may give quite different results. The main reason for this is that the gross method allows the single partner to compute his (share of) partnership income on an individual basis, whereas the net method requires that his share of partnership income shall be computed on the basis of the partnership's accounts.

Whether the taxable income is to be computed on the basis of the gross method or the net method depends on sec. 20 of the Tax Code, which states:

> ... the [general] partners shall be assessed separately for their whole share of the partnership's (the consortium's) ... income. Limited partners ... shall also be assessed separately for their ... income.

The tenor of this provision hardly gives a decisive answer to the question whether the gross method or the net method shall apply; nor do the *travaux préparatoires* accompanying the bill, which are rather scanty.

According to legal writing on private law, surpluses and deficits should be computed according to the net method. But this doctrine only expresses a legal rule which can be dispensed with by agreement between the parties. Therefore, one cannot presume that sec. 20 of the Tax Code means that the net method shall apply. But one might say that legal writing on private law gives some support to the view that sec. 20 requires the partner's income to be computed according to the net method.

Historical considerations, too, give some support to this construction of sec. 20. Up to 1922, both general partnerships and limited partnerships were liable to pay income tax. If, however, the number of partners did not exceed eight, it might be claimed that the individual partners should be charged. But of course, even if such a claim was made, the individual partners' income still had to be computed according to the net method.

One might also point to sec. 50 of the Tax Code. This provision states that taxpayers who are under an obligation to keep books—and most general and limited partnerships belong to this category—should be assessed according to their balance sheet. The surplus or deficit being com-

puted according to the net method, the idea suggests itself that the individual partners' taxable income should be computed in the same way.

However, according to a Norwegian Supreme Court case of 1934,[1] the taxable income should be computed according to the gross method as far as general partners are concerned. In fact the actual judgment does not decide on the matter, but a dictum given in the case has been accepted as normative. The Supreme Court held that a general partnership is not a legal entity, and holds it a reasonable consequence of this that the partners should be regarded as joint owners of the partnership's individual assets. The tax authorities have drawn the conclusion that the general partners' taxable income should be computed in the same way as the taxable income of joint owners, i.e. according to the gross method.

For some time there was a discussion whether the income of limited partners should be computed in the same way, or according to the net method. This dispute was settled by the Supreme Court in 1973, through a judgment stating that the gross method must be considered to be in accordance with sec. 20 of the Tax Code as far as limited partners are concerned.[2]

The application of the gross method is limited to partners who are in fact co-owners of the partnership's assets. Partners who have a right to share any surplus and are under an obligation to share any loss in the event of the winding up of the partnership must be accepted as co-owners. So-called sleeping partners, therefore, should not be assessed according to the gross method.

The application of the gross method has a series of implications concerning the quantitative apportionment of the partnership's items as well as concerning the question of assessing the portions according to the Tax Code. This will be shown in the following subsections.

3.2. *Apportionment of the Partnership's Gross Income Items between the Partners*

The various items of a partnership are shared between the partners according to the provisions of the partnership agreement. In the absence of provisions in the agreement, the items must be shared on a per capita basis in general partnerships, and presumably proportionally to the partners' contribution to the partnership in limited partnerships.

An agreement on profit sharing need not necessarily be accepted by the tax authorities. As far as partnerships between spouses and between par-

[1] See 1934 NRt 322.
[2] See 1976 NRt 1019.

ents and children are concerned, sec. 16 of the Tax Code contains special rules. But these are to be considered as instances of a more general doctrine, to the effect that an agreement which implies a transfer of taxable income from one taxpayer to another should not be binding on the tax authorities. Instead, the items should be shared in accordance with the partners' real contributions to the partnership. The doctrine mentioned will apply, for instance, to a partnership between a limited liability company and its controlling shareholder.

3.3. *Conditions under Which the Gross Income Items Are Subject to Tax*

To be taxable, the different items must meet certain conditions stated in sec. 42 or sec. 43 of the Tax Code. At this particular point the effects of application of the gross method are clearly revealed as compared with the net method. The application of the gross method implies that the partners' shares of the items are to be assessed individually. The gross method allows different treatment for tax purposes of the partners' shares in the items, whereas the net method implies analogous treatment. And under the gross method relevant facts must be sought with regard to the partner as well as with regard to the partnership, whereas application of the net method implies that relevant facts must be sought with regard to the partnership only. This may be illustrated in the following way.

According to sec. 42 of the Tax Code any profit gained by business is taxable. A share of profit may be considered to be gained by business when it is connected with a business carried on by the partnership, but it may also be considered to be gained by business when it is connected with a trade carried on by the partner for his own account. And even income earned by a partner on his own may be judged on the basis of its connection with the partnership's business. If, for instance, a limited partner assigns a share in the general partner (which is usually a limited liability company), the gain, if any, must be considered to have been gained by the business which the assignor is carrying on as a partner. But the gain may also be considered to have been gained by any business that the limited partner carries on for his own account, if the ownership of the partnership share has an economic connection with the partner's own business.

According to a special act of December 10, 1971, no. 99, any gain on the assignment of company shares is taxable if the share is assigned within five years from the end of the year in which it was acquired. Now, in the case of a company share belonging to a partnership, a partner assigning his share in this partnership will have enjoyed a taxable gain on the company share if the partnership itself has owned that share for less than five years

reckoned as mentioned. But the partner will also have enjoyed a taxable gain if he has himself been a partner of the partnership for less than five years. The fact that the partnership has owned the share for a longer period does not make the gain tax-free. So, a gain on the partnership's holding of shares may be taxable in respect of one partner, tax-free in respect of another.

Some items must be calculated to find their amount. According to the gross method this calculation is to be based on facts in respect of the individual partner. Therefore any gain on the partnership's assets must be calculated in respect of the partners separately. Consequently the gross method permits the amount to be different for partners owning equal shares of the partnership. Such a difference may be due *inter alia* to differences in calculating the deductible depreciations in respect of the partners, see 4.3 below.

3.4. *The Year of Assessment*

The Tax Code's general rule is that items are chargeable in the year of assessment, beginning on January 1 and ending on December 31, in which they might be collected (cash basis), sec. 41. But for taxpayers who are under a duty to keep books, this rule applies only as far as capital gains and other extraordinary items are concerned. Ordinary business income is to be computed on an accrual basis, i.e. the items are taxable in the year of assessment in which they are earned, sec. 50. As partnerships are usually under a duty to keep books, these rules will apply in computing the partners' taxable income from the partnership. Whether the partnership income is distributed or not is of no significance.

Certain capital gains may be set aside, provided that an investment equal to the consideration or compensation received in connection with the purchase is made in certain types of capital goods within a certain period of time (Tax Code sec. 45). When the investment has taken place, the investor will not have the right to deduct depreciation on the new capital goods in so far as the writing off corresponds to the gain set aside in an earlier year. In partnerships the partners, under the gross method, decide separately whether or not they will use their right to set aside the gain as mentioned. This may lead to a different treatment of the shares of the gain in respect of different partners. If, for instance, the partnership obtains a capital gain on selling a capital asset, one partner may use his right to set aside the gain on his share whereas another partner does not use his right to do the same, and therefore is charged in the year when the consideration is paid to the partnership.

3.5. *Distribution of Income*

As already mentioned, distribution of income is in no way a precondition for taxing the partnership income in respect of the partners. On the other hand, a distribution is meaningless as far as income taxation is concerned.

If the partnership distributes goods in kind, gains may be taxable in respect of the partners who receive the goods; for instance, any gain on an individual asset that has been written off with consequences for the assessment of the partners, and any gain on commodities will be taxable on distribution, secs. 42 and 50 of the Tax Code.

4. COMPUTATION OF TAXABLE INCOME—DEDUCTIONS

4.1. *Introduction*

The gross method discussed in 3.1 above also applies as far as deductions are concerned. Thus it is the individual partner, not the partnership, who decides whether deductions are to be claimed or not, and to what amount. Further, the amount of the different items must be calculated separately for each partner, general partners as well as limited partners.

4.2. *Apportionment between the Partners of Deductible Items*

The apportionment must generally be made in accordance with the norm that applies to the gross income items, see 3.2 above.

Like some gross income items, certain cost items have also to be calculated. This calculation is to be made for each partner separately, not in respect of the partnership.

An important instance of this is deduction for depreciation on income-producing assets. Both general partners and limited partners may claim deduction for depreciation in the capacity of co-owners of the partnership's assets. Under the gross method the amount of depreciation is in principle calculated separately for each of the partners. Normally, the amount will be the same for all partners. But where one partner has acquired his share of the partnership at a later stage than the others (e.g. by inheritance), the effect of the gross method is clearly seen. The new partner then has the right to write off the cost (or value if inherited) of his portions of the partnership's assets over a period that may differ from the period that is regarded as the useful life of the portions of the assets in the hands of the other partners. See also sections 6–8 below.

Another effect of using the gross method is that one partner may claim that his portion of an asset should be considered an investment on his part in relation to a gain that he has set aside conditionally in an earlier year, see 3.4 above. If he claims this, he has to depreciate his portion of the asset without claiming deduction of this amount. This means that the total amount that may be deducted is reduced. But such a transaction does not affect the other partners' right to deduct depreciation on their parts of the same asset in the ordinary way. See also 6.2 below.

According to the Tax Code sec. 44 a taxpayer may have a right to deduct additional depreciation within a period of five years. Under the gross method it is for the individual partner to decide whether he will use this right or not and there is nothing to prevent one partner from claiming a deduction for additional depreciation whereas another does not.

Under the Tax Code sec. 44 a taxpayer may, instead of additional depreciation, deduct initial depreciation for certain types of assets, i.e. ships and aircraft. In accordance with the gross method it is again up to the single partner to decide whether or not such a claim shall be submitted on his share of the asset.

4.3. *Conditions under Which Costs and Losses Are Deductible*

To be deductible, a cost must have been incurred in connection with the taxpayer's income or his occupation or business (Tax Code sec. 44). Whether this condition has been fulfilled or not is a matter that must be decided for the partner separately. But in deciding this, it is necessary to consider the partnership's business as well as the partner's business or occupation for his own account. Connection with either of them or both may qualify for deduction.

Likewise, a capital loss is deductible if the loss is suffered either in carrying on the business of the partnership or in carrying on the partner's own business.

A question that is peculiar to partnerships is that of a partner who suffers a loss that is due to another partner's not being able to pay his share of the partnership's debts. If the partnership carries on a business, such a loss must be considered deductible, since the partner takes part in this business. The loss may also be deductible on the ground of being suffered in carrying on the partner's own business. Sometimes, general partners as well as limited partners guarantee that the partnership's debts shall be paid. If the partner then suffers a loss, the loss must be considered deductible, as when the partner takes part in the partnership's business and suffers the loss in connection with his participation.

Occasionally, partners suffer losses on credits granted to other partners, or on guarantees that other partners will pay their debts. Normally, such a loss is not deductible, but if it is connected with the partner's own business, it may be found to be deductible.

In limited partnerships special questions arise owing to the fact that the risk of some partners is limited to their contribution. As will be shown in 5.2 below, the limitation of risk implies a limitation of the limited partner's right to deduct costs and losses relating to his participation. The question here is merely whether the general partner (or other limited partners) may deduct the loss that according to the agreement the limited partner is obliged to cover only if the partnership gives a surplus in later years. The answer to the question must be in the negative. But if there is a probability amounting almost to certainty that the limited partner will not make up the deficit in later years, the general partner has a right to deduct an amount (a reservation) corresponding to the loss he may suffer later on.

4.4. *The Year of Assessment*

As pointed out in 3.4 above, it is a rule that partnership income shall be calculated mainly on an accrual basis, but to a certain extent on a cash basis. The same rule also applies, of course, to corresponding deductions.

To a certain extent a taxpayer may make a reservation by deducting costs in a year previous to the year when the costs are incurred in fact. For instance, a shipowner may anticipate classification costs that will be incurred within the next four years. In partnerships it is up to each partner separately to claim such a deduction on his own share, and the amount of reservation has to be calculated on an indvidual basis.

As far as depreciation is concerned, see 4.2 above.

5. TREATMENT OF THE NET RESULT OF PARTICIPATION

5.1. *The Main Rule*

The Norwegian Tax Code is not based on any system of sources of income or the like. True, the Code defines different types of income: income from work, income from capital, income from business, etc. And these different types of income are to a certain extent subject to different treatment under the Tax Code. The Code does not, however, demand that a special statement shall be made for each "source of income", even though it must be admitted that the wording of sec. 45 seems to point to another construction:

> Any deficit on business that may appear . . . may be deducted from the surplus of the taxpayer's other business activities and sources of income.

In spite of the wording, judicial practice has for years understood the provision in the sense mentioned above.

A partner may therefore deduct costs and losses relating to his participation in the partnership from profit from other sources, and he may deduct from his partnership income costs and losses that may have been incurred outside the partnership. The principle is that items stemming from the participation in the partnership must be integrated in a total statement on the part of the partner.

The rule that a total statement of income shall be made on the part of a partner may, of course, be amended by law. A much discussed topic is whether or not limited partners are subject to special treatment, see 5.2 below. Concerning certain allowances, too, questions of modification may arise, see 5.3 below.

According to the Tax Code sec. 53 a deficit on this total statement may be carried forward to be deducted in later years, but not later than ten years counted from the year of deficit.

The rules of the Tax Code secs. 45 and 53 are probably the main reasons why frequent use has been made of partnership forms in Norway, especially in establishing new enterprises. Such undertakings often show a deficit at first owing to initial depreciation or the like. When a surplus arises later on, the partnership is sometimes transformed into a limited liability company.

5.2. *Limitation of a Limited Partner's Right to Deduct a Deficit on His Participation*

The Tax Code does not contain any rule stating expressly that computation of the income of a limited partner shall be subject to special rules as compared with the computation of the income of a general partner. The tax authorities, however, maintain that the limitation of the limited partner's risk also limits his risk of suffering losses under the Tax Code. They have therefore established a special limitation on the limited partner's right to deduct not only costs and losses but also allowances connected with the participation from his income derived from sources other than the partnership. This standpoint has never been examined by the courts, and its legal basis is therefore firm administrative practice.

The special limitation rule requires a special computation of the net profit or net deficit on the participation in the partnership. Items that are

connected with the participation must therefore be separated from other items.

The amount of limitation is to be computed as follows: The point of departure is the limited partner's investment in the partnership, which is either his contribution to the partnership at the founding of the partnership, or his cost if he acquired his share at a later date. It should be noted that the amount of limitation is set by the partner's obligation to contribute (or pay), not by what he actually paid. The amount of limitation is increased if the limited partner has a net profit on his participation. On the other hand, it is decreased if he has a net deficit on his participation—which, as mentioned in 5.1 above, is usually the case for some years following the foundation year owing to deduction of initial depreciation or the like. The amount of limitation is also decreased if a limited partner's portion of a partnership asset is considered a relevant investment in relation to rules claiming investment as a condition for continued tax credit after setting aside a gain as mentioned in 3.4 above or net income as mentioned in 5.3 below.

The effect of the limitation rule is revealed if the computation of the limited partner's income on his participation gives a net deficit. This deficit may be deducted from the limited partner's income from other sources only if the deficit is within the frame of the amount of limitation at the beginning of the year of assessment.

If the computation of a limited partner's income on his participation shows a surplus, deficits from earlier years may be carried forward and be deducted up to the amount of the surplus.

5.3. *Surplus Reserves*

Under Norwegian tax law, a taxpayer has a right to appropriate a surplus for various future purposes and to deduct the reserve from his taxable income. (Appropriation of certain capital gains with similar effect is dealt with in 3.4 above.) As regards partnership income, the reservation must, of course, be deducted from the partners' income. But the question arises whether the amount of appropriation shall be computed for the partners in common on the basis of the partnership's income, or whether the computation is a matter of the individual partner.

Under the Investment Fund Act of December 14, 1962, no. 1, the partners have an option. They may choose to compute the amount of reservation in respect of the partnership, but they may also choose to compute the amount in respect of each partner separately. In any case the individual partner decides whether he will deduct the reservation or not.

Under the District Tax Act of June 19, 1969, no. 72, partners are supposed to have the same options, though this is not expressly provided for. Clearly, the individual partner decides whether he will deduct the reservation or not.

Anyhow, it is the individual partner who must fulfil the Act's requirements, for instance to acquire, within certain time limits, a new asset, the cost of which must be at least as great as the amount of reservation, and reduce the amount that is subject to ordinary depreciation by an amount not less than the reservation amount. The individual partner may consider his portion of an investment in respect of the partnership as his new asset, but he may also acquire an asset of his own.

6. FOUNDING OF A PARTNERSHIP

6.1. *Contribution in Cash*

In many cases the partners contribute to the partnership's capital in cash. Then no serious questions of tax treatment are likely to arise.

A question that may arise, however, is whether the partner's contribution to the partnership's capital may be considered a new investment as this term is used in provisions concerning reservations as mentioned in 3.4 and 5.3 above. The share as such is not relevant. But if some of the other partners contribute an asset in kind that meets the requirements of the tax provisions, the cash-contributing partner's acquisition of a portion of this asset may be considered a new investment on his part.

For a limited partner, using assets of the partnership as his new investment also has another consequence: The limitation on his right to deduct a deficit on his participation is decreased by an amount corresponding to the amount of the reservation that is applied, see 5.2 above.

6.2. *Contributions in Kind*

Contributions in kind may give rise to different questions of taxation.

One important question is whether the transference of an asset realizes a capital gain in respect of the partner. The answer is that the asset must be considered to be in part transferred to the other partners, and so far a capital gain may be realized. As far as the contributor's own part of the asset is concerned, this has not been transferred, and no capital gain is realized on this part. A gain on the parts of the asset that have been

transferred is also realized if the other partners contribute assets in kind, provided of course that these assets are of some value.

Any gain is the difference between the consideration for the parts that have been transferred, that is to say the value of the parts of the other partner's contribution that the partner acquires, and a proportionate part of the book value of the asset which the partner has contributed.

Under Norwegian tax law, any capital gain is generally taxable. Only gains on a few special types of assets, such as bonds, are exempted (Tax Code sec. 43).

Occasionally a partner's contribution consists of the lease of an asset to the partnership. If so, in general no capital gain is realized, but even in this case a capital gain may be considered to be realized on special types of assets, such as sandpits and the like.

Any taxable gain is to be taxed in the year of the founding of the partnership. But the gain may be set aside according to the rules dealt with in 3.4 above, and the partner may consider his portion of the partnership's assets as his new investment.

A partner contributing a going business may have had a deficit in earlier years. If he had continued in business for his own account, he would have been entitled to carry forward the deficit for tax purposes for up to ten years, see 5.1 above. The deficit on income from business, however, is not deductible in later years if the business is transferred to others. Transferring a business to a partnership as a contribution in kind is generally supposed not to end the right to carry forward the deficit for tax purposes. In this case the contributing partner carries on his business in part. Therefore, the right to carry forward the deficit must be maintained.

Where a partner contributes an asset in kind, the other partners become co-owners of the asset in question. If the asset is depreciable, the acquirers have the right to deduct ordinary depreciation and initial or additional depreciation on their portion of the asset. And again, the amounts of depreciation are to be computed on an individual basis, and the individual acquiring partner decides for himself whether or not he will deduct depreciations as mentioned, see 4.2 above.

Sometimes a partner contributes the good will of a business. According to Norwegian tax law as it is understood by the tax authorities, the acquiring partner has no right to deduct his acquisition costs for good will, either in the year of acquisition or in later years in the form of depreciation. Only if the business is transferred and the good will then proves to be lost, may the acquisition costs be deducted. The interpretation mentioned is open to discussion, and strangely enough, the Norwegian Supreme Court has not yet decided upon the question.

6.3. The Terminal Date of Partnership Income

When a partner contributes an asset or a going business, the question arises from which date the yield of the asset or the business is to be distributed in accordance with the provisions of the partnership agreement.

In general the date on which the partnership agreement was concluded must be considered to be the terminal date. If, however, the agreement provides that it shall be carried out at a later date, this is the relevant date. Sometimes the agreement says that the partnership shall be considered to be founded as from an earlier date. In this case the contracting day must be regarded as the terminal date for tax purposes. If, however, the partnership agreement only formalizes a partnership that in fact has been operative from an earlier date, this agreed day may be considered the terminal date.

7. JOINING AN EXISTING PARTNERSHIP

The questions of tax treatment that may arise when a person joins an existing partnership are on the whole analogous to the questions discussed in section 6 above. As far as the joining partner is concerned, nothing can be added. As for the preexisting partners, acceptance of one more partner implies a transference in part of their shares of the partnership's business. Thereby a taxable capital gain on their shares may be realized. Apart from this, the tax position of the preexisting partners will be unchanged, though of course their share of partnership items may be reduced.

8. ASSIGNMENT OF A SHARE

Under Norwegian general company law a share of a partnership cannot be transferred without the consent of the other partners unless this is provided for in the partnership agreement. This rule applies even as far as assignment to another partner of the same partnership is concerned.

The tax treatment of an assignment of a share is analogous to the tax treatment of the partnership's transference of its business in part, and this again is parallel to the tax treatment of a transference of the partnership's individual assets, see 3.3 above.

Thus, if the share is assigned for a consideration, a taxable gain may be

realized. But whether this is the case or not is not a matter to be decided in respect of the share as such. It is necessary to consider the individual assets of the partnership, including its good will, and to answer the question whether there would have been a taxable gain if these assets had been transferred separately.

The taxable gain, if any, on each separate asset is the difference between the asset's portion of the consideration and its book value (if any). The gain on the share assigned is the sum of all such taxable gains on separate assets.

If the consideration is paid by instalments the question arises whether the gain is to be treated as one regarding the year of assessment or whether the gain on each separate asset of the partnership is to be treated separately. The point is that whereas a gain on the share of the partnership is supposed to be taxed on a cash basis, the gains on at least some assets, such as stock in trade and the like, must be taxed on an accrual basis if treated separately, see 3.4 above. The tax authorities seem to follow the last-mentioned line, and the courts have not dealt with the question.

If the assignor as a partner has made tax-free reservations, the assignment of his share of the partnership does not affect his reservations. He may dispose of them as if they have not had any connection with the partnership. Nor does the assignment affect the assignor's right to carry forward deficits from earlier years and deduct them from the gain on the share assigned or other surplus in the year of assignment. If the assignment means that the assignor's carrying on of the business has come to an end, the right to carry forward a deficit is ended (Tax Code sec. 53, cf. section 10 below).

Even a limited partner, subject to the special limitation on his right to deduct a deficit on his participation from other income as described in 5.2 above, may carry forward the deficit and deduct it from the gain on the share assigned. And it is suggested that his right to carry forward a deficit on his participation is not to be ended as mentioned, as sec. 53 does not deal with this problem.

The assignor may have a right to set aside, wholly or in part, the gain on the share assigned, but again the gain cannot be dealt with as a unit. It must be separated into parts, one part for each of the partnership's assets, and only gains on special assets, machinery and the like may be set aside. Any gain on the partnership's good will, for instance, may not be set aside.

If the assignment causes a loss on the share of the partner, this loss may be deducted from the assignor's income from other sources. A loss is, however, deductible only in so far as a corresponding gain would have been taxable (Tax Code secs. 44 and 45).

On the part of the acquirer the cost price of the share of the partnership

must be allocated to the acquirer's share of the different assets of the partnership, each being dealt with in accordance with applicable rules. The part of the cost price relating to the acquirer's share of the partnership's machinery being depreciable, the cost price relating to the acquirer's share of the partnership's good will may not be deducted until the business is transferred and the investment is thereby or in other ways proved lost.

The tax positions of the other partners of the partnership are not affected by an assignment of a share as discussed above.

9. RETIREMENT OF A PARTNER

A partner may for various reasons retire from the partnership (without assigning his share to third parties).

The tax treatment of such a retirement is mainly analogous to the tax treatment of an assignment, see section 8 above. Only a few remarks, therefore, need be added. If the price of redemption exceeds the book value of the retiring partner's shares in the partnership's assets, there will be a gain that is taxable to the extent it would have been taxable if the part was assigned, see section 8 above. And correspondingly, a loss computed in a parallel way may be deducted from the retiring partner's income from other sources.

Sometimes the retiring partner and the continuing partners agree that the price of redemption shall be paid in the form of a pension. The amount of pension paid annually is of course taxable, but the question arises whether the retiring partner has a right to deduct the book value (cost price) of his shares in the partnership's assets. The tax authorities have refused a claim for deduction, and a dictum of the Supreme Court of 1976 supports this view, which, however, is in no way a convincing construction of the Tax Code.[3]

Computing the retiring partner's share of the partnership's net property under general company law, it may appear that the net property is a negative one. A retiring general partner will then have to pay his share of the shortfall. The amount paid is deductible as a loss under the Tax Code. A limited partner is of course under no obligation to pay such a share of a shortfall.

It is pointed out in 5.3 above that the partners may choose to reserve a surplus for investment purposes in the partnership. If this has been done,

[3] See 1973 NRt 679.

a retiring partner must carry with him his part of the reserve. The problem of carrying forward deficits from previous assessment must be solved in the way mentioned in section 10 below.

From the point of view of the continuing partners, the retirement of one partner must be considered to be an acquisition of his share of the partnership's assets. The cost price of this share will often, owing to individual treatment under the gross method, differ from the book value of the other partners' previous shares of the same assets. For depreciation purposes this may entail a somewhat complicated computation.

If the price of redemption is paid in the form of a pension, the other partners may deduct the annual amount of pension that is paid. They have no right in addition to capitalize the obligation to pay the pension, and deduct the depreciation of the capital value as the cost price of the retiring partner's share of the partnership's assets.

In so far as the price of redemption is a payment for a share in the partnership's good will, the other partners are not entitled to deduct the cost until the business or their individual shares are transferred. A pension may, however, be deducted even if it is a consideration for good will.

10. WINDING UP OF THE PARTNERSHIP

A partnership may be wound up in different ways, and the situation regarding taxation will to some extent differ correspondingly. (Bankruptcy will not be dealt with here.)

If the winding up is carried out by selling the partnership's assets, separately or as a whole, the tax problems are analogous to the questions discussed in section 3 above.

If the winding up is carried out by dividing the partnership's assets in kind between the partners, the transaction must be regarded as a bundle of exchanges of property, which under Norwegian tax law may realize gains in the same way as other assignments. The situation may be described as the reverse of the founding of a partnership with contributions in kind, see 6.2 above.

The winding up may also be carried out by an agreement that the partners shall continue as joint owners of the assets, but without trading together as partners. In this case no special tax consequences are involved. The previous partners are taxed as if they had still been partners, but usually they will have no common profit for sharing.

On winding up the partnership it may be found that a partner must bear

a loss that earlier was conditional upon other partners not being able to pay. Such a loss is normally deductible, cf. 4.3 above.

Moreover, the winding up of the partnership does not lead to any particular consequences for the partners. If, however, a partner has a deficit from earlier years, the winding up may be considered to be such a closing down of the business as ends the right to carry forward the deficit for deduction in later years. Instead, the deficit may be carried back for deduction in the two years preceding the year of closing down (Tax Code sec. 53).

If a previous partner, who has acquired a partnership asset in kind upon the winding up, in a later year assigns the asset, the gain, if any, is still supposed to be considered income from business on his part.

11. ALIENS TAKING PART IN PARTNERSHIPS WITH NORWEGIANS

Norwegian citizens who are partners together with aliens are, of course, liable to pay Norwegian income tax. On the other hand, an alien's liability to pay Norwegian income tax may have been abolished by provisions of a double taxation convention. Apart from that, an alien will be liable to pay Norwegian income tax on income from a business that is "carried on" or "managed" in Norway (Tax Code sec. 15c).

The term "carried on" covers business that actually takes place on Norwegian territory. It is, for instance, not sufficient that business contracts are concluded with Norwegian parties.

The term "managed" covers business the managing decisions of which are taken in Norway. So, the business of a limited partnership whose general partner is a Norwegian citizen must be considered to be managed on Norwegian territory. On the other hand, a general partnership whose managing decisions are taken by the partners jointly must be considered to be managed on Norwegian territory only as far as the Norwegian partners are concerned. Therefore, in this case alien partners will be under no obligation to pay Norwegian taxes. This view, however, may be disputed. There are arguments in favour of the view that for tax purposes a partnership must be considered to be either a Norwegian partnership as a whole or a foreign partnership as a whole. This question, which seems to be of little importance from a practical point of view, has not been settled by the courts.