

THE TRANSPARENCY OF JERSEY PARTNERSHIPS AND CERTAINTY WHEN PLANNING

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1. The state of Jersey partnership law

- 1.1 The Jersey law of partnership (“**Partnership law**”) is set to change. The Jersey Law Commission produced a paper on the Jersey law of partnerships (the “**JLC Paper**”) in May 2008, and the consultation on the paper finished in October 2008. At present Jersey is unusual among both onshore and offshore jurisdictions in that it does not have a statutory partnership regime (at least for contractual, as opposed to limited or limited liability, partnerships). England and Wales has had one since 1890 and Guernsey since 1995.
- 1.2 However, the customary partnership regime, which continues to apply to both limited partnerships and limited liability partnerships (to the extent that it does not conflict with either the Limited Partnership (Jersey) Law 1994 (the “**1994 Law**”) or the Limited Liability Partnership (Jersey) Law 1997 (the “**1997 Law**”) has not been a source of frequent litigation. The customary law is not always clear, and contains several gaps; additionally it is based on the works of Pothier and Domat, which, given the commercial and legal developments in the jurisdiction since the time they were written, are in some respects a deficient basis for the partnership law of Jersey.
- 1.3 When considering using a Jersey partnership, or a Jersey LP or LLP² the lack of clarity in the current law, and the manner in which the Courts have looked to Customary law, English case law and the Partnership Act 1890, means that there is a distinct lack of legal certainty for anyone involved in, or looking to use, such a partnership. This uncertainty stems initially from

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² The customary law continues to apply to LPs and LLPs to the extent it does not conflict with the written law: Art 48, 1997 Law and Art 40, 1994 Law.

the areas of partnership law which Pothier and Domat do not address but also from the Courts' use of both Customary law and English law (both English case law and the Partnership Act 1890).

- 1.4 Coming, as it does, to the idea of a codified partnership law after many other jurisdictions Jersey can, perhaps, take advantage of the litigation which has already occurred on these statutory regimes, and which indicates the areas in which those regimes are deficient. One area which has been much litigated in England and Wales (as well as in other former Commonwealth jurisdictions) is the nature of a Jersey partnership (“**JP**”) interest.
- 1.5 Thus the reasons for an abundance of caution when using a JP in tax planning are threefold: (i) the law of Jersey does not expressly state the nature of a JP interest; (ii) the nature of such an interest is itself unclear and difficult to define; and (iii) if the JLC Paper outlines the full extent of the proposed Jersey partnership law, this problem is not likely to be resolved and will remain an obstacle to the use of a JP going forward.

2. The current case law on Jersey partnerships

- 2.1 It has been recognised that the nature of the interest in a JP is not settled. In the case of *Cooley v Wood* [1993] JLR 24 Lieutenant Bailiff Le Cras (at page 28, c. line 45) held that:

“the precedents relied on by the parties, so far as relevant, are very old. In those circumstances, the court finds the law is not settled and adopts the approach set out by, it would seem, the English Partnership Act 1890”

In this case the Lieutenant Bailiff dealt with the application of assets after dissolution of a partnership, and it can be considered that the law relating to a partner's interest prior to the dissolution of a partnership is a more difficult interest to determine than that arising after dissolution.

- 2.2 The certainty of Partnership law has improved little since the decision in *Cooley v Wood* [1993] JLR 24, there having been only three further cases on Partnership law. None addresses the nature of an interest in a JP, but are useful because they indicate the sources of Partnership law, as it currently stands. In *Golder v Le Quesne and Thacker (practising as Viberts)* [1993] JLR 344 the liability of partners to third parties for the acts and omissions of the partnership was in issue. Perhaps following the judgment in *Cooley v Wood* [1993] JLR 24, the Bailiff also relied on English law, quoting a passage from Lindley and Banks on Partnership, 16th edition (at 347, lines 35 et seq).

- 2.3 In *Bennett v Lincoln* [2005] JLR 125 the court considered the principles underlying the creation of a JP. Having quoted the judgment in *Cooley v Wood* [1993] JLR 24 the Bailiff went on to say (at page 130, paragraph 15):

“since that decision the legislature has, however, adopted the Limited Partnership (Jersey) Law 1994 and the Limited Liability Partnership (Jersey) Law 1997. Both are of course particular legal animals but some assistance as to the nature of the species can nonetheless be drawn from the statutes. Article 41 of the 1994 Law provides that “the rules of customary law applicable to partnerships (‘Contrats de Société’) shall apply to limited partnerships except so far as they are inconsistent with the express provisions of this Law””.

Thus, while earlier cases had looked to the English courts and legislature for assistance in interpreting Partnership Law *Bennett v Lincoln* indicated that the customary Jersey law was still of paramount importance. The Bailiff then goes on to approve (i) Pothier’s definition of a partnership (at paragraph 19); and (ii) the essential elements of a partnership as set out in Pothier’s work.

- 2.4 The Bailiff also notes (at paragraph 17) that:

*“not much may turn ... on the genesis of the law of partnership. Indeed, decisions of the English court interpreting the common law and even the 1890 Act may occasionally be helpful. When considering the nature of partnership in *Holme v Hammond* (1827) 7 Ex 218, *Cleasby B* described Pothier as (L.R. 7 Ex. At 234) “a very accurate writer” and, referring to a translation of Pothier in an English textbook, stated “that, in my opinion, explains the general nature of partnership””.*

Thus Partnership law is most likely represented by the law as expounded by Pothier, but it has been recognised by the English courts that Pothier’s treatise shares common principles with the English common law of partnership.

- 2.5 This was explicitly recognised by the Jersey courts in *Cannon v Nicol* [2006] JLR 299. The Deputy Bailiff noted the approval of Pothier in *Bennett v Lincoln* [2005] JLR 125 as well as noting (at paragraph 107) that:

“the principles in relation to partnership outlined by Pothier have much in common with English common law”.

- 2.6 However, he cautioned against adopting Pothier in all cases in the following terms (at paragraph 109): *“the court is, of course, not bound to adopt Pothier when ascertaining the customary law of Jersey. Where the customary law of Jersey on a particular topic has not yet been declared by judicial decision, this court will often look to some other source for guidance. In some areas, the court looks first to sources such as Pothier, in others it looks first to the law of England. But in neither case is it bound to follow the source to which it first looks. The court’s duty is to declare the law of Jersey ... it is not bound to adopt a rule or principle laid down several centuries ago if it is clearly inappropriate for modern times”*.
- 2.7 There has not been a case to date in the Jersey courts which considers the nature of a partnership interest and so it is necessary to look beyond the judgments of the court to discern its nature. Unfortunately at the time of *Canon v Nicol* Partnership law remained unsettled, to the extent that the sources of that law could not be narrowed down to either customary writers, such as Pothier, or English principles. The JLC Paper and the proposed law should go some way towards rationalising Partnership law, but the JLC Paper does not address, nor proposes that the new law should address, the nature of a partnership interest.

3. The JLC Paper on proposed changes to Jersey partnership law

- 3.1 The JLC Paper goes into a great deal of detail on many aspects of Jersey partnership law and identifies, as far as possible the sources of that law. Paragraph 3.7 of the JLC Paper provides:

*“These extracts from the Bailiff’s judgment in *Bennett v Lincoln* and the Deputy Bailiff’s judgment in *Cannon v Nicol* show that the Royal Court consider that the proper and primary source of the Jersey law of partnerships is the ‘customary law’. Noting however that in determining the content of the customary law of partnership, when this has not already been declared by judicial decision, the Court will not feel itself bound to one author or source ... in the event it considers the law stated there to be inappropriate to the needs of modern day Jersey”*.

- 3.2 However, there is little or no reference in the Jersey customary sources to partnership law (see paragraph 3.9 of the JLC Paper) and the JLC Paper advocates looking, especially, to Pothier in the absence of assistance from these sources, saying at paragraph 6.2:

“... there is no evidence that the present Jersey law of partnership is not to be found in the works of Pothier and Domat mentioned above ...”

- 3.3 Unfortunately Pothier does not address whether or not an interest in a Jersey partnership constitutes a beneficial interest³ in the underlying assets of the partnership or an intangible right under the contract, or both.
- 3.4 The problem can be put quite simply: as a partnership does not have separate legal personality, do the partners have (a) a beneficial interest in each of the underlying assets of the partnership; (b) a separately assignable “partnership interest” in the partnership, which does not attach to the underlying assets; or (c) both. This question can not be conclusively answered by considering the proper Jersey sources alone.

4. The 1994 and 1997 Laws

- 4.1 In practice the 1997 Law is less likely to be of relevance because it is created by statute to provide a very different vehicle from a Jersey Partnership; among other essential differences, the 1997 Law expressly provides that a Jersey limited liability partnership has legal personality distinct from that of its partners (1997 Law, article 2(4)). On this basis, the interests of partners in a Jersey Partnership are unlikely to be analogous with those of partners in a Jersey limited liability partnership, and the 1997 Law will not be of assistance in answering the above questions.
- 4.2 The 1994 Law, however, may be of greater assistance⁴. Article 11(1) of the 1994 Law states:

“(1) a general partner in a limited partnership has all the rights and powers and is subject to all the restrictions and liabilities of a partner in a partnership without limited partners except that, without written consent or ratification by all limited partners, a general partner has no authority to –

3 Pothier does not come even close to directly addressing the question of whether or not a partnership interest is in the partnership assets, but does assume that the partnership interest can be assigned, which indicates that there is something other than an interest in the underlying assets of the partnership

4 Article 40 of the 1994 Law provides that “*the rules of customary law applicable to partnerships (Contrats de Société) shall apply to limited partnerships except in so far as they are inconsistent with the express provisions of this Law*”. Therefore, the other provisions of the 1994 Law may give some guidance as to the nature of Jersey partnership law, e.g. where it is necessary for the 1994 Law to amend the customary law, this will indicate the nature of that customary law.

(a) ...

(b) *possess limited partnership property, or dispose of any rights in limited partnership property, for other than a partnership purpose*

(c) ...”

This provision, taken in conjunction with the comments of the Bailiff in *Bennett v Lincoln* [2005] JLR 125, can be taken to indicate that it is a usual incidence of a Jersey Partnership that a partner can “*possess ... partnership property*” or “*dispose of rights in ... partnership property*” for other than partnership purposes. Common to both English law and the law as set out in Pothier’s *Traité du Contrats de Société* is the proposition that a partner may not use partnership property for reasons outside the partnership purpose. It is implicit in this article that a partner in a Jersey Partnership, as opposed to a general partner in a limited partnership, is able to dispose of rights in partnership property for their personal purposes.

- 4.3 Article 21 of the 1994 Law may also provide guidance in relation to the rights of partners in a Jersey Partnership. This article deals with assignment of a partner’s interest in a Jersey limited partnership and states that “*a limited partner shall not assign his or her interest, in whole or in part, in the limited partnership unless ...*” In this article it is implicit that a partner in a Jersey Partnership may assign “*in whole or in part*” his interest in a Jersey Partnership. This suggests that the interest is something other than, or in addition to, the interest in underlying assets, because certain types of tangible property cannot be assigned under Jersey law.
- 4.4 So the 1994 and 1997 Laws do not elucidate the nature of a JP interest further.

5. Pothier⁵ and Domat⁶

- 5.1 Pothier (at paragraph 1) defines a partnership as “*a contract by which two or more persons agree to put something in common ... a community is ... formed between them; but this kind of community is also called a partnership because it is formed in execution of a contract of partnership*”.

⁵ The 1827 edition of *Traité du Contrats de Société* is the most commonly used in Jersey and paragraph references are to that edition, while the English quotations are taken from Tudor’s 1854 translation, entitled “Pothier on Partnership”

⁶ Domat and Pothier essentially concur on the customary law of partnership. On this basis, only Pothier is quoted.

He identifies that a partnership has both an element of community and elements of a contract, and that a partner has contractual rights. Rights under a contract are assignable, and therefore the contractual element of a partnership should be assignable, and as such must constitute something separate from the underlying partnership assets.

- 5.2 In paragraphs 4 – 7 Pothier deals with the nature of partnership, noting that it arises by mutual consent of all the parties and imposes mutual obligations on those parties. Later, (at paragraphs 77 – 83) this theme is developed, Pothier stating that partnership is “*a contract of natural right ... and a consensual contract Not in itself subject to any form*”. Thus a Jersey Partnership can take any form and, in accordance with the principle “*la convention fait la loi des parties*”, the contract can specify any terms that it requires⁷, including amending a partner’s right to share in the profits of the partnership to be something other than a proportion of profits calculated in accordance with his contribution (Pothier, paragraphs 73 to 76). This underlies the essential fallacy of equating a partnership interest with the underlying assets of the partnership.
- 5.3 Pothier also gives guidance as to the assignability of a partnership interest. It is possible for a partnership agreement to specify that, upon death of a partner his personal representative would become a partner (see Pothier, paragraphs 138 – 154). While not expressly stated, it should also be the case that an assignee can be admitted to the partnership, where the partnership agreement provides for this to occur on an event other than death. The assignability of a partnership interest indicates that it is something more than the underlying partnership assets.
- 5.4 Each partner has a right to use partnership property (Pothier, paragraphs 73 – 76) for its intended purpose and in a manner not contrary to the interests of the partnership. A partner (unless he is given power so to do by the partnership contract) has no right to charge or alienate partnership property, although he may charge his own share (Pothier, paragraphs 73 – 76). On this basis Pothier has drawn a clear distinction between the Partnership Assets and the partner’s rights and entitlements under the partnership agreement (the “**Bundle of Partnership Rights**”).
- 5.5 However, what is not then clear is whether or not the Bundle of Partnership Rights includes equitable entitlement to the Partnership Assets. On Pothier’s

⁷ However, it should be noted that a partnership could not be formed which did not, by the terms of the contract, fulfil the 4 elements of a Jersey Partnership (see Pothier, paragraphs 8 to 14 and *Bennett v Lincoln* [2005] JLR 125): (1) a contract under which each party agrees to contribute something of material worth; (2) the benefit of such contribution must be for all the partners; (3) the purpose of the contract is the generation of profit; and (4) the venture from which the profit is to be generated must be lawful.

analysis, which specifically prohibits alienation or charging of the assets themselves, it is arguable that a beneficial interest in the Partnership Assets does not form part of the Bundle of Partnership Rights because such an interest would be alienable by the individual entitled to it, and while the Bundle of Partnership Rights is alienable a partner is expressly prevented from alienating Partnership Assets.

- 5.6 Pothier gives no clear guidance on the nature of partnership interests; while certain inferences can be drawn from his treatise in relation to other aspects of Partnership law, the exact nature of a partnership interest is not determined. However, this question has been considered on numerous occasions in the English courts.

6. The case for setting out the nature of a JP interest – English law

- 6.1 As stated, Pothier does not address this issue and this leaves a gap in Partnership law that should be filled by the proposed law. The question of the nature of a partnership interest has been extensively considered by the English courts and is still not settled (though it should probably be regarded as settled for the purposes of taxation as being an interest in the underlying assets⁸).
- 6.2 From a purely tax planning perspective it is probable that even if the proposed law stated that the JP interest was not in the underlying assets it would be treated as such under English law:

“The justification for treating a Scottish partnership as transparent, though it may be less obvious because of the interposition of the partnership as a legal entity between the partners and the profits of the partnership, can be perceived in that in substance the position of the partners in relation to the profits is the same as in an English partnership: those profits are earned by the partners ... and are shared in the same way and the partners, whilst not directly owning the business and assets, indirectly do so and have an indirect interest in them which is capable of being arrested by the creditor of the partner.” (Memec v Inland Revenue Commissioners [1998] STC 754, Gibson LJ at 765).

⁸ It is settled law that a partnership is transparent for the purposes of both income tax (see, for example, the judgment of the Court of Appeal in *Memec v Inland Revenue Commissioners* [1998] STC 754) and capital gains tax (*Chappell v Revenue and Customs Commissioners* [2009] STC(SCD) 11).

Though the proposed law may address the issues raised by Gibson LJ in *Memec*, it appears that where a partnership is similar to an English partnership it will be treated as transparent.

- 6.3 However, the lack of certainty in relation to a JP extends beyond purely fiscal considerations: upon acquiring the interest in a JP or when considering structuring a business through a JP, the lack of certainty in relation to what the partners are entitled will deter people from using or acquiring them. This alone should be sufficient reason to address the issue in a law which is already proposed.
- 6.4 The English case law highlights the difficulties that can arise where there is no certainty as to partners' entitlement. Prior to the Partnership Act 1890 (which does not address the nature of an English partnership interest) the case law appeared to treat a partnership as opaque. The Master of the Rolls in *Cockle v Whiting* (1829) Tam 55 stating that "*the Defendants have clearly acted by mistake; for they were not entitled to a part of the cargo, but only to a part of the produce, and they are bound to account for the whole of the produce ...*" The defendants (who had transported a cargo of oil) had entered into a partnership with the plaintiff to share the profits of the oil which was their cargo. While they were entitled to the profits of the sale of the oil, they had no claim over the proportion of the oil of which they had (contrary to their rights under the partnership agreement) disposed.
- 6.5 When discussing partnership interests in *Re Bainbridge* (1878) 8 Ch D 218 Bacon CJ stated that (at page 223): "*...neither is more the owner than the other ... a partner is entitled only to such share of the partnership property as may exist after all the debts of the partnership are paid and the property has been realized ...*" At page 224 he goes on to make the position clear: "*the interest which the partner can have in the partnership is not a right in chattels ... that to which the partner may be entitled [is] his ascertained share. The interest which the Respondent had was a chose in action and something which could not be ascertained but by process of law ...*"
- 6.6 Collier J was also of this view in *Marshall v Maclure* (1885) 10 App Cas 325:
- "what was Marshall's share in the mortgage as distinguished from that of his firm? It was not a definite or immediately ascertainable quantity, but only what might be coming to him upon the partnership being wound up and its accounts taken ... the expression "share" is more suitable to that definite share in the mortgage which Marshall held on behalf of his firm, than to the indefinite and fluctuating interest which was all that he personally could have in a partnership asset ..."*

- 6.7 All these cases indicate that the interest in a partnership was something different to a beneficial interest in the underlying assets, because the interest could not be ascertained until the winding up of the partnership; in effect it was an intangible right which only crystallised into a right to the underlying assets upon dissolution. However, modern case law (without reference to the old cases) adopts the view given by Hoffmann LJ in *Inland Revenue Commissioners v Gray* [1994] STC 360:

“as between themselves, partners are not entitled individually to exercise proprietary rights over any of the partnership assets ... they have subjected their proprietary interests to the terms of the partnership deed ... as regards the outside world the partnership deed is irrelevant. The partners are collectively entitled to each and every asset of the partnership, in which each of them therefore has an undivided share ...”

- 6.8 However, not even the modern case law is entirely in agreement. In *Steckel v Ellice* [1973] 1 WLR 201 Megarry J, in addressing the issue of a “salaried partner” held (at 201A – C) that where a partner was not entitled to a share in the profits under the partnership agreement but merely to a salary, he could be a partner, albeit one without “*prima facie* evidence that he is a partner in the business”.
- 6.9 In relation to a salaried partner not having an interest in the capital of the partnership Megarry J (at 202C) said “... *the intention of the 1968 agreement [the partnership agreement] was to exclude the plaintiff from any proprietary interest in the partnership, and I do not think that to hold that a relationship is a partnership for the purposes of section 27 can necessarily mean that the court is obliged to make an order to wind up at the suit of the partner who lacks any such interest.*” Thus an individual without a proprietary interest can be a partner in a partnership, notwithstanding he has no such interest, which suggests that there is, at least in addition to the proprietary right in the underlying assets, an intangible right under the contract.

7. Conclusions

- 7.1 The English case law indicates the confusion arising from a failure to delineate the nature of a partnership interest in the law. A partner in a partnership cannot be sure of his entitlement, or how that entitlement will be treated, even where it is set out clearly and accurately in the partnership agreement because there is disagreement between the cases as to the extent of a partnership interest.

- 7.2 Jersey now has the opportunity to avoid the lengthy process of developing the law by litigation and the uncertainty (and associated unattractiveness of a JP as a planning option) by incorporating the nature of a partnership law within the proposed law and should take the opportunity so to do.