

ALLOCATED PROFITS WITHIN PROFESSIONAL FIRMS

LIVE CHAT: QUESTIONS AND ANSWERS

INTRODUCTION

Historically, most professional firms were partnerships of natural persons. Currently, professional firms are structured in a variety of ways, reflecting the economic and legal choices made by owners of those firms.

In some cases, these structures may be used in ways that give rise to different tax consequences and resulting tax compliance risks.

This web chat followed on from a recent recorded presentation which explores:

- the changing commercial, structural and operational issues affecting professional firms in these industries and, more broadly, for their clients in other professions
- the recently released Australian Taxation Office (ATO) guidance on the potential tax implications associated with the allocation of profits within professional firms
- how the ATO will assess the risk of Part IVA applying to the allocation of profits from a professional firm carried on through a partnership, trust or company, where the income of the firm is not personal services income.

The expert panellists who addressed members' questions were:

- Michael Parker, Partner, Hall and Wilcox
- Simon Webster, Professional Firms Risk Manager, Australian Taxation Office
- Adrian Zuccarini, Technical Leader Professional Firms, Australian Taxation Office.

RESOURCES

- Recorded presentation on [Allocating Profits Within Professional Firms](#)
- Guidance from the ATO on [Assessing the Risk: Allocation of Profits Within Professional Firms](#)

QUESTIONS AND ANSWERS

I recently went to a seminar where the firm in question said they allocate profits to partners on the highest non-partner salary and the rest is distributed as they see fit. How does the ATO view this?

The principle underlying the first benchmark, which is commonly known as the equivalent remuneration guideline, is that the amount allocated to the IPP reflects the performance of commensurate duties by those employees which are identified as suitable benchmarks.

I know we are discussing allocated profits within professional firms, are those principles or are those three benchmark also apply to non-professional such as tradesmen, they are with partnership with trustee as partners?

No, the guidelines have been co-designed and formulated specifically for professional firms based on the operation of these firms.

Where would we find these guidelines?

The guidelines can be found on the ATO website through the following link: <http://www.ato.gov.au/business/starting-your-own-business/in-detail/professional-firms/assessing-the-risk-allocation-of-profits-within-professional-firms/>. The ATO no longer publishes hard copy documents/publications but the website is regularly updated so you can be confident that if you are relying on the guidelines as they appear on the ATO website, they will be the latest version.

If you are currently in a partnership, do the new guidelines give these partners comfort to introduce an Everett assignment to say a related company/trust? (Assuming they still pass one of the test)

The choice to enter into an Everett assignment is a personal one that the partner will need to decide, based on their own personal circumstances and commercial considerations. If the choice is made to enter into an Everett assignment, then the guides will have application. For more information about how to apply the guidelines in respect of Everetts is available on the ATO website at <https://www.ato.gov.au/business/starting-your-own-business/in-detail/professional-firms/everett-assignments/>. It is also worth mentioning that the entering into an Everett assignment may have CGT consequences for the partner that need to be considered.

How do you work out market rate for the principal for different profession?

It will be based on arms length comparisons for that particular profession. It is important to compare apples with apples, say for example if you are looking at a lawyer make sure you compare with a lawyer.

For professional services business in company structure, after paying market wages for the principal, can the balance of profit be retained in the company?

Where the guidelines are satisfied for each IPP within the firm, then yes the firm can retain profits.

If partner of the firm is a family trust partner, is there a requirement that spouse/or any adult family member(s) must work for the professional firm for spouse/or family member to get partnership distribution?

No, provided the IPP satisfies one or more of the benchmarks within the guidelines and the family member is a beneficiary of the trust in accordance with the trust deed.

What is included in remuneration?

It should include the entire remuneration package, including superannuation and fringe benefits.

Referring to Jenny's question, if the professional firm is a company structure, can the company have the flexibility to allocate profit between IPP and retain profit within the company at the percentage of their own choice?

The guidelines operate at the IPP level, not at the firm level. So, where the IPP satisfies one or more of the benchmarks the firm is able to retain profits as they see fit. If you have any specific queries or circumstances that you would like to discuss, you can contact the ATO at Professionalppts@ato.gov.au for further assistance.

When applying the guidelines, what does it mean to say that they only apply to 'legally effective' structures?

A legally effective structure is one where the arrangement has been properly implemented, complies with the firm's constituent documents, is sufficiently and appropriately documented and the way the business operates reflects the legal structure implemented.

What if the firm still uses a service entity? Does the income get included in the 50% guideline? Do you just look at the firm's income?

You have to take it all into account.

In terms of risk if you meet one of the benchmarks then you will not be subject to compliance action, are there any issues which could cause you problems even if you meet one of the benchmarks?

The guidelines do not apply to other compliance issues. In cases where other compliance issues exist, taxpayers will be rated as higher risk. Examples of issues that would attract our attention include things such as cases of non-recognition of net capital gains, transfer pricing, misuse of the superannuation system, promotion of schemes, repeated failure to lodge returns or a history of late lodgment of returns, income injection to entities with carry forward losses, trust reimbursement arrangements, avoidance of Division 7A, inappropriate access to low income tax offsets or other benefits, or non-tax advantages which are dependent on taxable income.

How is the 'contribution to the business measured' sometime with different partners it may be hard to tell. Is this based on documented roles such as agreements or do they look through these to what the particular IPP actually does?

What the guidelines are trying to achieve is that IPPs are being appropriately remunerated for the work that they perform. However, when you apply the first benchmark it does that by looking at what the highest paid employee or highest band of employees receive as an appropriate benchmark.

Is profit allocation of professional firm always happening at the end of tax year, i.e. after the completion of tax year profit & loss of professional firm; or is there a requirement that the rule for profit allocation must be made at the beginning of tax year?

In the case of distributions from trusts, the resolutions must be made prior to 30 June (or such other date as the trust deed requires).

Must wages of IPP be paid regularly or can it be paid in lump sum prior to 30 June?

In terms of and for the purposes of the guidelines, then they can be paid however the IPP and firm agree. However, there may be other considerations, such as payroll tax, superannuation and fair work obligations.

In regard to profit distribution among partners, so far all the examples I have read on ATO website, the distributions are equally made among partners, does it has to be equal?

No, it will depend on the proportionate interest provided by the partnership agreement and possibly other factors as agreed by the partners.

Sometimes it's hard to know what the benchmark of highest paid salary as profits for same business may vary. Does ATO have any benchmarks for different profession?

No, the ATO does not provide salary benchmarks for specific industries. If you require further assistance on the application of the guidelines, you can contact the mailbox Professionalpdts@ato.gov.au

If there are 2IPPS in company but each generate income generally, must the wages be apportioned according to the income generated by them?

How the income is proportioned between the two IPPs in this example would be determined in accordance with the constituent documents. This may be dependent on a number of factors, including the proportion of shares held by each IPP or their associated entities, services performed by each IPP, key performance based measures or any other factor that the firm determines is relevant. The guidelines will then apply to the distributions of profits once they are in the IPPs hands. Please feel free to contact the ATO via the above mailbox if you have any further questions.

FURTHER INFORMATION

Australian Taxation Office

<https://www.ato.gov.au/business/starting-your-own-business/in-detail/professional-firms/assessing-the-risk--allocation-of-profits-within-professional-firms/>

CPA Australia

<http://www.cpaustralia.com.au/professional-resources/taxation>

CONTACT

ATO mailbox

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