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AUSTRALIAN TAX ADVISER

2107: APRIL 2021

Tony Westhuysen

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SECTION 1 – PROFESSIONAL DEVELOPMENTS

ALLOCATION OF PROFESSIONAL FIRM PROFITS

¶7.1 Draft PCG 2021/D2

Readers may recall that in December 2017, the ATO suspended the application of its guidelines *Assessing the Risk: Allocation of profits within professional firms*.

Originally, the ATO had issued guidelines indicating when it would seek to apply Part IV A to the use of partnerships of discretionary trusts and similar structures. The guidelines explained how the ATO would assess the risk to the Revenue arising from the allocation of profits from a professional firm carried on through a partnership, trust or company, where the income of the firm was not personal services income.

The original guidelines applied to arrangements within professional firms including those providing services in the accounting, architectural, engineering, financial services, legal and medical professions.

The guidelines would apply where:

- an individual professional practitioner (IPP) provided professional services to clients of the firm, or was actively involved in the management of the firm and, in either case, the IPP and/or associated entities had a legal or beneficial interest in the firm
- the firm operated by way of a legally effective partnership, trust or company; and
- the income of the firm was not personal services income (as defined in s 84-5 of the ITAA97).

In some cases, the guideline said practice income may be treated as being derived from a business structure, even though the source of that income remained, to a significant extent, the provision of professional services by one or more individuals.

The guidelines classified these arrangements into either low or high risk, depending on the particular features of each type of arrangement. So for example, the ATO rated arrangements as low risk, and not subject to compliance action where they met one of the three benchmarks outlined below.

Benchmark 1: Equivalent remuneration

Benchmark 1 would be met where the IPP gets paid an appropriate amount for the services they provided to the firm. In determining an appropriate level of income, the ATO regarded the level of remuneration paid to the upper quartile of the highest band of professional employees providing equivalent services to the firm as being appropriate.

So, as long as the IPP received remuneration equivalent to (or higher) than the lowest paid member of the upper quartile, the ATO would regard this as a low risk arrangement and would not seek to apply compliance action. If there were no such employees in the firm, then employees from comparable firms or relevant industry benchmarks could be used.

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