

PROFESSIONAL FIRMS STOP PRESS – THE TAX ISSUES

(A Paper authored by
**Paul Dowd FCA CTAM Tax
Tax Counsel, Morse Group)**

> **ATO clarification of the third compliance benchmark (30% effective tax rate) in its guidelines on allocation of profits within professional firms**

Mr Bruce Collins (ATO Assistant Deputy Commissioner of Taxation, Technical Excellence Services, Private Groups & High Wealth Individuals) has written to the CA Tax Team, noting that the ATO has received requests to clarify the practical application of the third (30% effective tax rate) compliance benchmark, which states: 'the Individual Professional Practitioner (IPP), and their associated entities, both have an effective tax rate of 30% or higher on the income received from the firm'. These queries relate to how the 30% effective tax rate should be calculated, particularly focusing upon two elements (see below). Here are the relevant extracts from Mr Collins' email:

“Meaning of ‘both’

We have been asked about the meaning of ‘both’ when calculating the 30% effective tax rate - i.e. whether it means collectively the IPP and the IPP’s associated entities have an average effective tax rate of 30% or higher OR whether the IPP and all entities associated with the IPP must each have an effective tax rate of 30% on practice income received.

Our intent for this criterion is that the 30% effective tax rate benchmark requires that the IPP has an effective tax rate of 30% or more in respect of practice income and also that each entity associated with the IPP that receives practice income collectively have an effective tax rate equal to or greater than 30%.

Tax rate on assessable income or taxable income

We have also been asked whether the effective tax rate of 30% must be achieved on assessable income (before taking into account deductible amounts, such as superannuation contributions or prior year losses) or on taxable income (after taking into account such potential deductions).

As is common to effective tax rate calculations, our intent for this criterion is that the 30% effective tax rate is applied to taxable income, i.e. the IPP (and their associated entities) must each have a 30% effective tax rate on their actual taxable income.

Importantly, the excessive use of deductions and over-utilisation of losses are examples of ‘other compliance issues’ which may result in an IPP’s arrangement being rated as ‘higher risk’, in any event.”