INTRODUCTION

Members who satisfy the requirements under CPA Australia’s By-Law 9 can apply for a Public Practice Certificate (PPC) to be issued. In doing so, they are required to identify the practice type they intend to practice under subject to the forms of entity allowed under By-Law 9.3. A member who offers public accounting services may only do so:

- as a sole trader or
- as a partner or
- via an incorporated entity or
- as a trust or
- as a practice structure which is approved by the CPA Australia Board.

Deciding on the appropriate practice structure can be complex and requires a range of issues to be considered including personal liability, succession planning and taxation to name just a few. You need to determine what structure suits your current circumstances and business model and how this choice may affect future plans.

This document takes a brief look at five business structures used in public practice and provides information that might assist you when considering the most appropriate practice structure.

This document is not intended to provide any form of advice or recommendation but rather highlight some areas which may influence your decision when choosing the practice structure which best suits your needs.

As a public practitioner, you will make a number of very important business decisions concerning your practice. Deciding which practice structure to adopt is one of these important decisions and we recommend you seek professional advice during this process.

This document considers legislation relevant to business structures in Australia. Members practising outside of Australia must comply with the specific requirements of local laws and/or regulations.
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Alienation of Personal Services Income (PSI) anti avoidance rules

When deciding on the most appropriate structure for your practice, you must consider the tax law dealing with alienation of personal services income (‘income splitting’).

There are two ways such arrangements can be challenged. The general anti avoidance rules in Part IVA of the *Income Tax Assessment Act 1936* (the ITAA 1936) can apply in certain circumstances to cancel any tax benefit obtained because of income splitting.

In addition, there are specific rules concerning the alienation of personal services income (PSI) which are contained in Part 2-42 of the *Income Tax Assessment Act 1997* (the ITAA 1997).

PSI is income that is derived mainly as a reward for the personal efforts or skills of an individual (where ‘mainly’ means more than half). For example, an accounting practitioner who derives income mainly through their personal efforts would prima facie appear to be deriving PSI.

Where the PSI is derived through a company, partnership or trust, such an entity is regarded as a personal services entity (PSE) under the PSI rules. The PSI may be attributed by the PSE to the individual providing the personal services in certain circumstances.

Where the PSI rules apply, individuals will be restricted to only claiming deductions that would be generally available to an employee. Accordingly, an individual or entity deriving PSI will not be able to claim deductions for rent, mortgage interest payments, rates and land tax to the extent that those expenses are incurred in gaining or producing the individual’s PSI. Nor will a deduction be available for a payment made to the individual’s spouse (or other associate) for any non-principal work.

However, PSI will not be included in the assessable income of that individual if the PSE is conducting a personal service business (PSB) in which case the assessable income and related deductions will be taken to be derived and incurred by the PSE.

A PSE will be carrying on a PSB if:

- the PSE satisfies the results test where at least 75% of the entity’s PSI for the income year is earned under a contract for producing a result, the PSE is required to supply the plant and equipment or tools of trade (if any) needed to produce that result and is liable for the cost of rectifying any defect in the work performed or

- less than 80% of the PSI during the income year is income from a single source (being an entity and its associates) and one of the three additional tests is met being:

  - the unrelated clients test—where the income earned is from two or more entities who are not associates of the individual or the PSE, or of each other, which arose as a direct result of making offers to provide services to the general public

  - the employment test—where the PSE engages one or more non-associated entities to perform at least 20% (by market value) of the principal’s work, or an apprentice is engaged by the PSE for at least half of the income year

  - the business premises test—where the PSE at all times during the income year conducts activities from business premises which are available for its exclusive use in gaining or producing the PSI, and are physically separate from the premises of the individual, the PSE and any entity receiving personal services (or the associates of any of these entities) or

- the PSE obtains a PSB determination from the ATO which does not apply the PSI rules in respect of a particular individual providing personal services which is usually issued where the ATO is satisfied that unusual circumstances prevented any of the results, unrelated clients, employment or business premises tests being met.

A flowchart from Taxation Ruling TR 2001/7 summarising the application of these rules is attached in Appendix 1.
It is important to recognise however that, even if the profile of your practice means that you satisfy the specific PSI rules in Part 2-42, the general anti-avoidance provisions of Part IVA of the ITAA 1936 may still apply in certain circumstances.

So, even though you may have multiple clients, employ staff and operate from a leased office, if your practice income is mainly derived from your personal efforts, it may be assessable to you, irrespective of the structure set up to derive such income.

**Non-Commercial Losses (NCL)**

Tax losses of an individual or an individual partner in a partnership may be disallowed as non-commercial losses under Division 35 of the ITAA 1997 in certain circumstances. Note that these rules do not apply to trusts or companies but trusts and companies are subject to their own loss recoupment rules.

Under the NCL rules, the loss cannot be offset against the individual or partner’s other income, such as salary and wages, but must be deferred until such time that a taxable profit is returned from that activity (e.g. as a sole trader or individual partner carrying on a business as an accountant).

Typically, NCL will be an issue on the commencement of businesses rather than in subsequent years. However, there are four general exemptions that may potentially apply to an accounting practice and satisfying any of these four tests enables the loss to be claimed in the year it is made.

The test most frequently relied upon is the Assessable Income Test, where an exemption is provided if the annual assessable income of the individual or partnership business activity in the year of loss is $20,000 (or would be for a business that commenced part-way through the year).

The Profits Tests provides an alternate exemption where at least three of the past five years (including the current year) have resulted in the business activity returning a taxable profit for the individual or each individual partner.

The Real Property Test applies where the individual or partnership has an interest in real property which is used on a continuing basis in the business activity whose value is at least $500,000, based on the greater of the property’s market value or reduced cost base for CGT purposes.

Finally, the Other Assets Test provides relief where the individual or partnership has other non-real property assets used on a continuing basis in the business activity whose value is at least $100,000 that are not real property, cars or similar vehicles. Such other assets will include copyrights and patents, depreciating assets, trading stock and leased assets which will be respectively valued at their reduced cost base, written down value, valuation applied for trading stock purposes and leased value.

In addition, an individual can only deduct the tax losses that meet any of the above tests so long as they also satisfy a personal income requirement. To satisfy this income requirement the following amounts must in total be less than $250,000 in the relevant year:

- taxable income (without any regard to the tax loss from the business activity)
- total reportable fringe benefits
- reportable superannuation contributions
- total net investment losses – including financial investment losses and rental property losses.

Failing all of these tests, including the income requirement, the individual or partner can request the Commissioner to exercise his discretion and allow the loss. The factors to be considered by the Commissioner are set out in section 35-55 of the ITAA 1997. Such losses will not be available to offset current year income unless the Commissioner exercises the discretion favourably.

**Service trusts**

Service trusts (or other service entities) operate alongside the practitioner’s practice (which can be an individual, partnership, company, trust or any combination of these) to provide services to the practice which may typically include the provision of plant and equipment; the employment of staff; the payment of overheads and utilities; the lease of premises; and the collection of debtors.
Please refer to Appendix 3 for a diagram about how service entities operate alongside a practice. There is additional discussion about the use and restrictions surrounding service entities in the commentary on each practice structure below.

The use and advantages of service entities has been challenged by the Australian Taxation Office (ATO) in recent years. However, the ATO has issued a non-binding guide [Your Service Entity Arrangements] setting out safe harbor rules on how payments made to service trusts (or other service entities) can be potentially structured on an arm’s length basis to satisfy the ATO.

It should also be noted that the Tax Agent Services Act 2009 (the TASA) requires, amongst other things, that registered tax practitioners must disclose any services outsourced to any third party including a related service entity or trust. Accordingly, such practitioners need to make such disclosure in their engagement letters so that clients are notified of any services provided by such a service entity. In this case the practitioner delegating the work will be required to be registered and be subject to the requirements of the Code of Professional Conduct under the TASA, and will also be responsible for the quality and accuracy of the work performed by the related service trust or other service entity.

Guidance on allocation of professional practice income

The ATO issued non-binding guidelines in the 2015 year explaining how it would assess the risk of the general anti-avoidance provisions of Part IVA of the ITAA 1936 applying to the allocation of an individual practitioner’s share of profits from a professional services firm carried on through a partnership, trust or company to associated parties, where the income of the firm did not constitute personal services income under Divisions 84 to 87 of the ITAA 1997.

This guidance applied to all professional services including professional practices carried on by accountants, lawyers, architects, engineers, financial service providers and medical professionals.

The guidelines applied from the year ended 30 June 2015 onwards but the ATO committed to reviewing them after three years and subsequently suspended their application from 14 December 2017 (subject to transitional rules discussed below), and the guidelines can no longer be directly accessed on the ATO’s website.

The guidelines provided that an Individual Professional Practitioner (IPP) would be rated as low-risk from an audit perspective, and not subject to compliance action, where their circumstances indicated that they met one of the following guidelines regarding income derived from the firm:

- the IPP received assessable income from the firm in their own hands as an appropriate return for the services they provided to the firm. In determining an appropriate level of income, the taxpayer could use the level of remuneration paid to the highest band of professional employees providing equivalent services to the firm, or if there were no such employees in the firm, salaries paid by comparable firms or according to relevant industry benchmarks or
- 50% or more of the income to which the IPP and their associated entities were collectively entitled (whether directly or indirectly through interposed entities) in the relevant year were assessable in the hands of the IPP or the IPP, and their associated entities, both had an effective tax rate of 30% or higher on the income received from the firm.

Where none of the guidelines outlined above could be satisfied, the IPP’s arrangement was considered high risk.

In suspending the operation of the guidelines on 14 December 2017, the ATO advised that it had become aware of various arrangements exhibiting high risk factors not specifically addressed within the guidelines including the use of related party financing and self-managed superannuation funds.

The ATO subsequently confirmed that it would develop and publish an appropriate replacement guidance product on profit allocations by a professional services firm for future years.

As part of that process the ATO announced on 28 June 2018 that taxpayers who entered into arrangements before 14 December 2017 which complied with the above guidelines and which did not exhibit high risk factors could continue to rely on the suspended guidelines until 30 June 2018.
Accordingly, where an IPP’s arrangement was already in place before 14 December 2017 and did not exhibit any of the high-risk factors listed below, and the IPP met one of the above three benchmarks previously published, the arrangement would be considered as low-risk for the year ended 30 June 2018.

For the purposes of this transitional relief ‘high-risk’ factors include:

- lack of any meaningful commercial purpose regarding arrangements including, but not limited to the disposal of an equity interest through multiple assignments; the creation of new discretionary entitlements such as dividend access shares and applying amortisation leading to differences between taxable and accounting income
- disregard for CGT consequences and inappropriate use of CGT concessions
- assignments where profit sharing is not directly proportionate to the equity interest held
- the creation of artificial debt deductions
- undertaking an assignment to dispose of an equity interest to a self-managed super fund
- assignments where the arrangement is not on all fours with the principles of the Everett and Galland cases.

The ATO has also advised that where IPPs are contemplating new arrangements or have any concerns regarding potential high-risk factors within their current arrangements that they should engage with the ATO as soon as possible.

**Establishing structures**

A prospective practitioner needs to consider an array of commercial, legal, taxation and regulatory issues in choosing and establishing a structure in which to conduct the practice.

Some of these key matters to be considered are listed in Appendix 4, which includes issues associated with asset protection, regulatory matters, constituent documentation and rules and guidelines concerning the creation, operation and winding up of different entity structures.

**Converting structures**

Where a practitioner decides to convert their business structure, careful consideration should be given to the possible tax implications of such a conversion. In particular, you should consider whether there is a disposal of a valuable asset for CGT purposes and whether the CGT rollovers or the CGT discount and the CGT small business concessions can apply to defer, reduce or eliminate any capital gain.

You should also consider whether the new structure is likely to be eligible for these concessions on any eventual sale. In addition, the transfer of work-in-progress may be separately taxable and the sale of the business will be subject to the GST provisions.

Refer to Appendix 2 for a broad comparison of the availability of the CGT discount and the CGT small business concessions on the disposal of a business by various different practice structures which differ depending on whether such entities do or do not have significant individuals for the purposes of the above concessions. Specific advice should be sought on any potential application of the tax law, especially the CGT discount and the CGT small business concessions.

Appendix 5 sets out the key features of the CGT small business restructure rollover which allows a small business entity to rollover business assets under a genuine business restructure to another small business entity without triggering any tax consequences under Subdivision 328-G of the ITAA 1997, subject to certain conditions being met. However, care should be taken concerning the application of such rollover relief as these rules are complex and have only recently been enacted. Furthermore, even where such rollover relief is available regard should be had to other business or regulatory concerns on any restructure including the prospective imposition of stamp duty on the transfer of certain assets.
SOLE PRACTITIONER

General

Brief outline
A sole practitioner, also called a sole trader or sole proprietor, is an individual undertaking business and/or investment activities in his or her own name for his or her own benefit. The legal status of a sole practitioner is not separate from the individual.

Liability
A sole practitioner is exposed to the risk of unlimited liability associated with their practice. In the event that the business is sued (e.g. because of negligent sub-standard work or representations made in respect to the undertaking of the work) the assets of the individual will be available to litigants and creditors to settle a claim.

In the event that the individual is sued personally, the assets of the business will be available to creditors or the trustee in bankruptcy.

Succession
During the lifetime of the sole practitioner, a transfer of business assets will result in potential tax liabilities, however, significant CGT concessions or CGT rollover relief may potentially be available to reduce or defer any capital gain.

If business is transferred upon the death of a sole practitioner, any future CGT liability on the assets is transferred to the estate and/or the beneficiary.

Regulatory issues
See separate guidance on Licences and Registrations for Public Practitioners in Australia, for information on:

- registering as a tax agent, BAS agent or tax (financial) adviser with the Tax Practitioners Board (TPB)
- registering as an auditor through the Australian Securities and Investments Commission (ASIC)
- registering as a liquidator through ASIC or as a Trustee in Bankruptcy through the Inspector General in Bankruptcy under the Bankruptcy Act 1966
- registering to provide financial planning advice through ASIC, which will be subject to a professional standards scheme for certain financial advisers administered by the Financial Adviser Standards and Ethics Authority (FASEA) commencing from 1 January 2019
- the licensing of credit licensees and mortgage brokers by ASIC.

Professional / CPA Australia

Non-membership equity
Not applicable.

Membership
To offer public accounting services a member must be of CPA or FCPA status.

Public Practice Certificate
A member that represents to the public that he/she provides public accounting services must hold a Public Practice Certificate (PPC) if they have a bona fide expectation that their gross annual income from the provision of public accounting services will exceed $45,000. Where a member earns less than $45,000 but more than $10,000 of gross fees per calendar year that member must apply for a Limited Public Practice Certificate (LPC).

These requirements apply to any member providing public accounting services into Australia, no matter where in the world they are located.
Audit/Trust Account

APES 310: Dealing with Client Monies requires a member who holds or receives trust money to establish and maintain Trust Bank accounts and Trust accounts with adequate internal controls and to have them audited annually.

Continuing Professional Development (‘CPD’)

The By-Laws require all members to complete 120 hours of structured CPD each triennium, with a minimum of 20 hours in any year.

Quality Review Program (‘QRP’)

A member must agree to comply with the QRP throughout the period a PPC is held prior to the certificate being granted. Each member must establish and maintain a quality control manual to demonstrate ongoing compliance with APES 320: Quality Control for Firms to show that the PPC holder has addressed and complied with the six elements of quality control specified under that standard.

Risk management

Under APES 325: Risk Management for Firms, a member must establish and maintain a Risk Management Framework, which is tailored to the particular practice conducted by the holder of the PPC and which forms part of the QRP.

Insurance

Professional indemnity insurance must be held for the practice, the policy of which must indemnify the member and the practice. The minimum sum insured shall be as stipulated in CPA Australia’s By-Laws or as prescribed by any other legislative enactment. The member shall produce proof satisfactory to CPA Australia that such insurance is held. Other specific terms that the policy must include may be found in CPA Australia’s By-Law 9.8 including, but not limited to, one or more automatic reinstatement following a claim and cover for all persons affiliated with the practice.

Taxation

Method of accounting

- Cash

  If the practice consists solely of the income producing activities of the sole practitioner, then the cash method of accounting should be adopted.

- Accruals

  If the practice is conducting an accounting business with multiple employees (i.e. as opposed to the practice consisting solely of the income producing activities of the sole practitioner) then the accruals method of accounting is most likely to be appropriate. In Income Tax Ruling IT 2639 the Commissioner accepts that as a general rule of thumb, if the practice has at least as many non-principal practitioners as principal practitioners, then income is considered to be derived from the business structure (and therefore should be accounted for on an accruals basis).

  According to Henderson v FCT (1970) 119 CLR 612, the more substantial the number of employees, practitioners or technicians used in a practice, the more probable it is that income is derived from the business structure rather than from the provision of personal services.

  It is a question of fact as to whether the accruals basis or cash basis is applicable. The ATO’s view (Taxation Ruling TR 98/1, paragraph 36) is that, where the taxpayer’s individual circumstances do not provide clear direction as to which accounting method is appropriate, the accruals basis should be used unless it is an ‘artificial, unreal and unreasonably burdensome method of arriving at the income derived’ (Commissioner of Taxation v Firstenberg [1976] 6 ATR 297). Firstenberg was a solicitor who practised as a sole practitioner. His only employee was a receptionist. A sole practitioner practising on his own account is similar to a wage earner.
or salaried practitioner. A cash basis is appropriate where services rendered by employees are only subsidiary to the professional work for which the practitioner’s fees or costs were charged to clients, as in this case. Receptionists who are not charged out to clients are in this category. However, in an accounting firm context most staff are generally fee earners.

**Income splitting**
Not applicable by definition.

**Service trust**
The service trust can operate alongside the sole practitioner’s practice to provide services.
The service trust commonly owns operating plant and equipment of the business, employs staff, pays bills, rents premises and collects income.

It is very important that the fees the service trust charges the business for its services are commercially realistic (FCT v Phillips 78 ATC 4361). Accordingly, the ATO has issued a number of safe harbour methods available which can be applied to ensure that fees charged by a service trust are calculated on an arm’s length basis. These methods are explained in the ATO publication, NAT 13086: *Your service entity arrangements* and in Taxation Ruling TR 2006/2.

The ATO has advised that it will look at cases where service fees are more than $1m, represent over 50% of the gross fees or business income earned and the net profit of the service trust represents more than 50% of the combined net profit of the professional firm and service trust.

Conversely, the ATO advises the risk of audit is low where the profit of the service trust does not exceed 30% of the combined net profit of the professional firm and service trust and certain indicative mark-up rates are used.

The ATO expects service entity arrangements to fall within the guidelines and continues to review and audit taxpayers who appear to be outside the guidelines.

**Losses**
Tax losses can be off-set against assessable income.

Non-commercial loss rules operate to defer the tax deduction for losses incurred in relation to business activities unless the activity satisfies certain criteria specified under Division 35 of the ITAA 1997, including the income requirement test as discussed above.

**CGT**
- **Access to CGT discount**
  A sole practitioner is able to access the 50% CGT discount under Division 115 of the ITAA 1997. The discount is available to individuals who sell assets at a capital gain that they have held for over 12 months, subject to the application of certain anti-avoidance provisions.

- **Small business concessions**
  Where a sole practitioner meets all the basic conditions for the small business CGT concessions in Division 152 of the ITAA (1997), the sole practitioner will be able to access the 50% active asset reduction and may be able to also access the 15-year exemption, the retirement exemption or the small business rollover subject to separate additional conditions being met for each of these concessions.

  The basic conditions comprise the following:
  - a capital gain would be triggered under a CGT event on the sale of a CGT asset
  - the sole practitioner is a CGT small business entity for the income year in which the CGT event occurs, being a person carrying on a business which meets the $2m aggregated turnover test which must also include the annual turnover of any affiliate or entity connected with the taxpayer as well as the practitioner’s annual turnover. Alternatively, the sole practitioner must be a person who satisfies the
$6m maximum net asset value (MNAV) test just before the CGT event. This $6m MNAV test will be met where the market value of the CGT assets of the taxpayer, connected entities, affiliates (or connected entities of affiliates) are less than $6m immediately before the CGT event reduced by any directly related liabilities and certain provisions

- the CGT asset is an ‘active asset’
- the asset was used as an active asset for half the ownership period as an active asset (or for seven and a half years where it has been owned for more than 15 years).

- Depreciating assets
  The CGT discount and CGT small business concessions are unavailable for gains on the sale of depreciable assets.

GST
A sole practitioner is required to be registered if he or she is carrying on an enterprise and their projected annual turnover meets the registration turnover threshold, which is currently $75,000 for business taxpayers.

Superannuation
Sole practitioners can claim a deduction for personal superannuation contributions made to a complying superannuation fund under section 290-150 of the ITAA 1997 provided various conditions are met, including a cap on concessional contributions, which is $25,000 for the year ended 30 June 2019.

Alternatively, sole practitioners can set up administration companies to provide themselves with access to employer-sponsored superannuation contributions. In Income Tax Ruling IT 2494 and Income Tax Ruling IT 2503, the Commissioner of Taxation requires that the company be established only for the purpose of providing employer-sponsored superannuation benefits for professional practitioners. From the year ended 30 June 2014 an individual will automatically include an amount equal to the sum of any excess concessional contributions in their assessable income but can claim a non-refundable tax offset equal to 15% of their excess concessional contributions.

Substantiation
Where a work expense, a car expense or a business travel expense is a deductible expense, the substantiation rules apply to the individual taxpayer claiming a deduction for the expense.

The substantiation rules set out the documentary requirements that a taxpayer must satisfy in order to be entitled to claim a deduction. Expenses must be substantiated by written evidence (which is a defined concept), which must be retained for five years.

- Work-related expenses
  Work-related expenses are expenses that a taxpayer incurs in producing salary, wages or particular PAYG withholding payments. By definition, sole practitioners earn income from their personal services and not employment income and, therefore, do not have to substantiate work-related expenses.

- Car expenses and business travel expenses
  Similarly, sole practitioners must be able to substantiate ‘car expenses’ and ‘business travel expenses’ for which they claim a deduction. Acceptable methods for calculating and substantiating these expenses are provided in the income tax legislation.
  It is worth noting that the substantiation provisions only apply to individuals and not companies or trusts.

- FBT
  Sole practitioners do not need to justify expenditure on fringe benefits provided to employees, because they will not incur any such expenditure.
**Financing**

Any working capital contributions by the practitioner to the practice will be sourced from ‘after tax’ dollars.

**Analysis**

If income derived by the practice is not regarded as PSI the main disadvantage of a sole practitioner structure is unlimited liability compared with the benefits of potential limited liability if operating the practice via a company structure or a trust with a corporate trustee.

Sole practice meets all forms of registration simply and is therefore the most inexpensive of all forms of practice structure.

If the business test is satisfied the practice has by definition achieved leverage and size. Consideration should then be given to converting the practice to some alternative form of entity, particularly from an asset protection perspective.

**PARTNERSHIP**

**General**

**Brief outline**

A general law partnership is an association of two or more individuals or entities that carry on business in common with a view to making a profit or gain.

Taxation Ruling TR94/8 sets out the following factors which should be considered as to whether ‘persons are carrying on a business’ under a general law partnership:

- the mutual intention of the parties to act as partners as assented to in an agreement (whether written or verbal) being an essential element of a general law partnership
- the joint ownership of assets together with a joint liability for debt with all partners liable for the partnership’s debts to the extent of their own personal assets as well as partnership property
- the registration of a business name in the joint names of the partners
- the existence of a joint partnership bank account where all parties have the power to operate the account as acknowledged by the bank
- the partners are actively participating or involved in the partnership business
- the partners have contributed assets and capital to the business
- the parties share the profits and losses of the partnership (especially if those entitlements are in line with clearly stated rights in a partnership agreement which evidences that a partnership exists)
- the existence of separate partnership accounts (including each partner’s capital contributions, drawings and profit share) and minutes of partnership meetings
- public recognition of the partnership by creditors, suppliers and customers (as evidenced in invoices, receipts, tenders, business letters, contracts and advertising undertaken in the partnership’s name).

Whether a general law partnership exists is a question of fact based on the actual situation at hand. Not all of the above factors would need to be present in order for such a partnership to exist.

A partnership agreement should be entered into which sets out the contractual relationship between the parties operating under a general law partnership. It can be a verbal agreement, or it can be put into writing. While a verbal agreement will suffice at law, a written agreement is preferable so that there is no misunderstanding amongst the partners, especially concerning the terms under which partners are admitted or retire or how profits and losses are shared.

**Liability**

Partners under a general law partnership are exposed to the risk of joint and several liability for the debts of the partnership and their liability is unlimited.
In the event that the partnership is sued, the personal assets of the individual partners will therefore be potentially available to litigants and creditors.

If a partner is sued personally, the partner’s portion of the assets of the business will be available to creditors/trustee in bankruptcy.

Accordingly, to partly mitigate such a liability, a prospective partner may consider holding their interest in a general law partnership via a company (or a trust with a corporate trustee) rather than as an individual partner.

**Succession**

Partnerships do not provide for easy passing of control between generations. Where partnerships are used significant tax planning and the use of tax elections in respect of trading stock and depreciating assets must be relied upon to cost-effectively pass control to the next generation of partners.

The ATO will treat a changed partnership as a reconstituted continuing entity if the original partnership agreement incorporated a provision for a change in membership of the partnership and the following factors apply:

- the partnership is a general law partnership
- at least one of the partners is common to the partnership before and after the reconstitution
- there is no period where there is only one ‘partner’
- the partnership agreement includes an express or implied continuity clause or, in the absence of a written partnership agreement, the conduct of the parties is consistent with the continuity of the partnership’s business
- there is no break in the continuity of the enterprise or firm (that is, the partnership’s assets remain with the continuing partnership and there are no changes to the nature of the business).

In other circumstances, strictly speaking, where an existing partner retires or a new partner is admitted, the partnership is deemed to cease and a new partnership created. This requires two tax returns to be lodged in the income year the change occurs, among other steps. Further, each partner of the old partnership is taken to have disposed of part of their interest in the partnership asset and a CGT liability may arise. There are also separate tax implications arising from the transfer of trading stock and depreciating assets (which can be potentially mitigated by applying rollover relief) as well as collecting income from work-in-progress and debtors.

**Regulatory issues**

See separate guidance on [Licences and Registrations for Public Practitioners in Australia](#) for information on:

- registering as a tax agent, BAS agent or tax (financial) adviser with the TPB
- registering as an auditor through ASIC
- registering as a liquidator through ASIC or as a Trustee in Bankruptcy through the Inspector General in Bankruptcy under the *Bankruptcy Act* 1966
- registering to provide financial planning advice through ASIC, which will be subject to a professional standards scheme for certain financial advisers administered by the Financial Adviser Standards and Ethics Authority (FASEA) commencing 1 January 2019
- the licensing of credit licensees and mortgage brokers by ASIC.

**Professional / CPA Australia**

**Non-membership equity**

A member, with prior approval, may practice with a member or members of a body specified in Appendix 2 of CPA Australia’s By-Laws.

A member may practice with other persons or entities that the Board may approve provided the partnership:

- has a majority of capital in the partnership under the control of members with a CPA Australia Public Practice Certificate (PPC) and abide by the By-Laws regulating the holding of a PPC
- ensures that partners who are members are liable for the provision of professional services and conduct of any non-member partners
• abides with all other regulatory matters including quality assurance, professional and mandatory standards and professional indemnity insurance
• discloses on all stationery and other information provided to clients and potential clients the qualification and professional and business affiliations of partners.

Membership
To offer public accounting services a member must be of CPA or FCPA status.

Public Practice Certificate
A member that represents to the public that he/she provides public accounting services must hold a PPC if they have a bona fide expectation that their gross annual income from the provision of public accounting services will exceed $45,000. Where affiliated with a partnership the member must ensure that it is an approved practice entity under CPA Australia’s By-Laws. Where a member earns less than $45,000 but more than $10,000 of gross fees per calendar year that member must apply for a Limited Public Practice Certificate.
These requirements apply to any member providing public accounting services into Australia, no matter where in the world they are located.

Audit/Trust Account
APES 310: Dealing with Client Monies requires a member who holds or receives trust money to establish and maintain Trust Bank accounts and Trust accounts with adequate internal controls and to have them audited annually.

Continuing Professional Development (‘CPD’)
The By-Laws require all members to complete 120 hours of structured CPD each triennium, with a minimum of 20 hours in any year.

Quality Review Program (‘QRP’)
A member must agree to comply with the QRP throughout the period a PPC is held prior to the certificate being granted. Each holder of a PPC must establish and maintain a quality control manual to demonstrate ongoing compliance with APES 320: Quality Control for Firms to show that the PPC holder has addressed and complied with the six elements of quality control specified under that standard.

Risk management
Under APES 325: Risk Management for Firms, a member must establish and maintain a Risk Management Framework, which is tailored to the particular practice conducted by the holder of the PPC and which forms part of the QRP.

Insurance
Professional indemnity insurance must be held for the practice, the policy of which must indemnify the member and the practice. The minimum sum insured shall be as stipulated in CPA Australia’s By-Laws or as prescribed by any other legislative enactment. The member shall produce proof satisfactory to CPA Australia that such insurance is held. Other specific terms that the policy must include may be found in CPA Australia’s By-Law 9.8 including, but not limited to, one or more automatic reinstatement and cover for all persons affiliated with the practice.

Taxation
Method of accounting
• Cash
  If the practice consists solely of the income producing activities of the partners, then the cash method of accounting should be adopted.
• Accruals

If the practice is conducting an accounting business with multiple employees, then the accruals method of accounting is most likely to be appropriate. In Income Tax Ruling IT 2639 the Commissioner accepts that as a general rule of thumb, if the practice has at least as many non-principal practitioners as principal practitioners, then income is considered to be derived from the business structure (and therefore should be accounted for on an accruals basis).

According to Henderson's Case (1970) 119 CLR 612, the more substantial the number of employees, practitioners or technicians used in a practice, the more probable it is that income is derived from the business structure rather than from the provision of personal services.

Income splitting

Income splitting typically involves structures or arrangements under which income is distributed amongst family members or other related entities. The recipients are often taxed at a lower marginal rate than the person who is directly involved in the professional practice.

CPA Australia’s By-Laws only permit partnerships with unqualified persons where the Board of CPA Australia approves the partnership arrangement. Therefore, income splitting may not be available through such a partnership structure.

If you obtain approval from the Board of CPA Australia and operate your business in partnership with, say, an unqualified spouse, the partnership must be genuine. An anti-avoidance provision in section 94 of the ITAA 1936 imposes liability for tax at a penalty rate on a partner who lacks ‘real and effective’ control of his or her share of partnership income.

Income Tax Ruling IT 2330 provides that all the features of an arrangement must be examined to determine whether the arrangement attracts the operation of the general anti avoidance provisions of Part IVA of the ITAA 1936. Income of a professional partnership usually includes income produced by staff employed by the partnership. In this case it is income of a business and therefore can be structured to embrace income splitting. However, partnership income may be treated as PSI from the rendering of personal services where it is mainly derived from the personal services of the partners, rather than the work of employees and/or income producing assets. In this case, income splitting will breach the specific anti-tax avoidance provisions concerning PSI under Divisions 84 to 87 of the ITAA 1997.

• Everett Assignment

If the partnership is deriving business income, it may be acceptable for a professional partner to assign some of his or her interest in the capital and income of the firm to their spouse or a related discretionary trust (for example). The assignment cannot relate to a partnership deriving personal services income. It will therefore only be effective if the partnership is earning business income (i.e. where the partner is entitled to some profits regardless of how much energy he or she has devoted to the partnership). Rights to salary also cannot be assigned.

To be effective, the partner must assign present property, being an entire ‘chose in action’ (i.e. a right to partnership income which is legally enforceable), and the assignment must confer an equitable entitlement to the relevant income to the assignee.

The Commissioner of Taxation determined under Income Tax Ruling IT2540 that the effect of an Everett assignment for CGT purposes is that the partner is regarded as having disposed of his or her partnership interest. Where the disposal to a related party (e.g. a spouse) was not made on an arm’s length basis (as would usually be the case) a sale consideration akin to the market value of that interest will be deemed to have been provided by the associate who has been assigned the partnership interest.

The effect of the assignment is that the assignor partner holds the relevant portion of the income referable to the assigned partnership interest on trust for the assignee who is assessed on such an amount as a beneficiary of a trust and who therefore does not become a partner in the partnership.
Service trust
A service trust can operate alongside the partnership to provide services.

A service trust commonly owns operating plant and equipment of the business, employs staff, pays bills, rents premises and collects income.

It is very important that the fees the service trust charges the business for its services are commercially realistic (FCT v Phillips 78 ATC 4361). Accordingly, the ATO has issued a number of safe harbor methods available which can be applied to ensure that fees charged by a service trust are calculated on an arm’s length basis. These methods are explained in ATO publication NAT 13086 Your service entity arrangements guide and in Taxation Ruling TR 2006/2.

The ATO has advised that it will look at cases where service fees are more than $1m, represent over 50% of the gross fees or business income, and the net profit of the service trust represents more than 50% of the combined net profit of the professional firm and service trust.

Conversely, the ATO advises the risk of audit is low where the profit of the service trust does not exceed 30% of the combined net profit of the professional firm and service trust and certain indicative mark-up rates are used.

The ATO expects service entity arrangements to fall within the guidelines and continues to review and audit taxpayers who appear to be outside the guidelines.

Losses
Tax losses are allocated to the partners, generally in the same proportions as partnership income is distributed. In certain circumstances the application of the non-commercial loss rules will need to be considered, such as whether the partners in the partnership are individuals.

CGT

- Access to CGT discount
  Partners who are individuals or trusts may be able to access the 50% CGT discount in respect of the disposal of their fractional interest in a partnership asset at a capital gain, provided the interest in the partnership asset was held for at least 12 months subject to the application of certain anti-avoidance provisions under Division 115 of the ITAA 1997.

  A partner that is a company cannot claim the CGT discount in respect of any capital gain arising on the disposal of their proportionate interest in a partnership asset.

- Small business concessions
  Partners may be able to access the CGT small business concessions made in respect of capital gains arising on the disposal of their fractional interests in partnership CGT assets on the disposal of partnership assets.

  Where a partner meets all the basic conditions for the small business CGT concessions in Division 152 of the ITAA (1997), it will be able to access the 50% active asset reduction and may be able to also access the 15 year exemption, the retirement exemption or the small business rollover subject to separate additional conditions being met for each of these concessions.

  Eligibility for the concessions is measured against the interest held by the partner in each underlying CGT asset of the partnership which is measured according to the partner’s fractional ownership share in the partnership.

  The basic conditions a partner must satisfy to claim the concessions are as follows:

  - a capital gain would be triggered under a CGT event on the sale of the partner’s fractional interest in an asset of the partnership

  - the partnership is a CGT small business entity for the income year in which the CGT event occurs, being a partnership carrying on a business which meets the $2m aggregated turnover test; or the partner satisfies the $6m MNAV test just before the CGT event. This $6m MNAV test will be met where the market value of the CGT assets of the partner, connected entities, affiliates (or connected entities
of affiliates) are less than $6m immediately before the CGT event reduced by any directly related liabilities and certain provisions. The partner will only include the net market value of the CGT assets of the partnership as a 'connected entity' where the partner is entitled to 40% or more of the partnership’s net income. In such circumstances, the partner is required to include a notional 100% of the partnership assets rather than their actual economic interest.

- the CGT asset is an ‘active asset’
- the asset was used as an active asset for half the ownership period as an active asset (or for seven and a half years where it has been owned for more than 15 years).

- Depreciating assets

The CGT discount and CGT small business concessions are unavailable for gains on the sale of depreciable assets.

GST

The ATO’s view (expressed in GST Ruling GSTR 2003/13) is that, with the exception of a partnership carrying on an activity without a reasonable expectation of profit or gain, a general law partnership carries on an enterprise and may register for GST from the time it is formed.

A partnership is required to be registered upon formation if its projected annual turnover meets the registration turnover threshold, which is currently $75,000 for business taxpayers.

Upon formation of a partnership, the partners each acquire an interest in the entity. The partners’ consideration for their interests can include capital contributions or the promise to provide services, labour or skills.

Superannuation

Individual partners can claim a deduction for personal superannuation contributions made to a complying superannuation fund under section 290-150 of the ITAA 1997 subject to various conditions being met, including capping such concessional contributions to $25,000 for the year ended 30 June 2019.

Alternatively, individual partners can set up administration companies to provide themselves with access to employer-sponsored superannuation contributions. In Income Tax Ruling IT 2494 and Income Tax Ruling IT 2503, the Commissioner requires that the company be established only for the purpose of providing employer-sponsored superannuation benefits for professional practitioners.

From the year ended 30 June 2014 an individual will automatically include an amount equal to the sum of any excess concessional contributions in their assessable income but can claim a non-refundable tax offset equal to 15% of their excess concessional contributions.

Substantiation

- Work-related expenses

Partnerships do not need to substantiate ‘work-related expenses’, because the substantiation rules associated with work-related expenses only apply to taxpayers deriving salary and wages or certain PAYG withholding payments and partners cannot be employed as employees by the partnership which is not a separate legal entity from the partners themselves. However, in the event of a dispute with the ATO, a partnership must still be able to prove that the relevant expenditure has been incurred.

- Car expenses and business travel expenses

Partnerships that include at least one partner who is an individual are required to substantiate their car expenses and business travel expenses with written evidence (which must be retained for five years). Written evidence is a defined concept and does not have its ordinary meaning. The substantiation rules must be satisfied for the partnership to be entitled to claim a deduction.
• FBT
Partnerships must be able to substantiate deductions for fringe benefits provided to employees.

Financing
Capital contributions can be made from after tax profits of each partner.
Taxation Ruling TR 95/25 confirms that interest deductions on borrowed funds are available where a general law partnership borrows money to refinance partnership capital.
Only the partners’ contributed capital can be refinanced using interest deductible loans. Interest incurred on borrowings used to finance a distribution from an asset revaluation reserve or an unrealised profit is not deductible.

Analysis
CPA Australia regulations restrict partnerships to suitably qualified parties holding a PPC.
Partnerships otherwise meet all form of regulatory requirements simply.
As most partnerships have the size to meet the taxation business test, taxation planning through the use of service trusts (or other service entities) is typically possible.
Individual income tax rates apply to a partner’s share of a partnership’s net income but Capital Gains Tax rollovers and exemptions are potentially available, including the CGT discount and the CGT small business concessions on the disposal of a partner’s fractional interest in a partnership asset or business.

COMPANY

General

Brief outline
A company is a legal entity formed by registration under the Corporations Act 2001. It is a legal person that acquires legal rights and liabilities (i.e. it can sue and be sued in its name).
A company acts through its management, directors and members. Directors and management of a company are its controllers. Members (i.e. shareholders) are the owners of the company.

Liability
If the business is sued, only the assets of the company are available to creditors. The shareholders’ other assets are protected other than for unpaid share capital.
However, shareholders need to be aware of their potential personal liabilities.
In some circumstances, a director may be found to be personally liable for certain tax debts, such as unpaid superannuation guarantee contributions or PAYG, and/or if found liable for allowing the company to trade while insolvent. Where such situations occur, the director’s personal assets may be used to pay those outstanding amounts. If the director has insufficient assets, that person may also be made bankrupt.
Accordingly, directors of companies should be careful in ensuring that the company meets its tax obligations and, where possible, take care in owning assets in their own name given their potential liability as directors.

Succession
Companies have perpetual succession (subject to complying with the corporations law). Succession planning with a company structure can be well planned so that the shareholdings and directorships of a company gradually pass to the next generation. Importantly, a company is unaffected by the death of a shareholder.
The CGT consequences of passing shares to the younger generation will vary depending on the transfer method used.
Regulatory issues

See separate document titled Licences and Registrations for Public Practitioners in Australia for information on:

- registering as a tax agent, BAS agent or tax (financial) adviser with the TPB
- registering as an auditor through ASIC
- registering as a liquidator through ASIC or a Trustee in Bankruptcy through the Inspector General in Bankruptcy under the Bankruptcy Act 1966
- registering to provide financial planning advice through ASIC, which will be subject to a professional standards scheme for certain financial advisers administered by the Financial Adviser Standards and Ethics Authority (FASEA), commencing 1 January 2019
- the licensing of credit licensees and mortgage brokers by ASIC.

Professional / CPA Australia

Non-membership equity

A member, with prior approval, may practice in an incorporated structure with a member of a body specified in Appendix 2 of CPA Australia’s By-Laws.

A member may practice with other persons or entities that the CPA Australia Board may approve provided that in the incorporated entity:

- a majority of voting shares in the incorporated entity are held by members holding a CPA Australia PPC or a member of Chartered Accountants Australia and New Zealand (Chartered Accountants ANZ) holding a practising certificate
- a majority of directors of the incorporated entity voting rights are held by members holding a CPA Australia PPC or a member of Chartered Accountants ANZ holding a practising certificate
- the holding of the balance of any voting shares in the incorporated entity or the occupation of the office of a director by non-members shall be subject to the approval of the Board. Such non-members shall:
  - hold such tertiary or other professional qualifications as may from time to time be approved by the Board or
  - have demonstrated such competence, experience and skill in their profession as may be acceptable to the Board or
  - be of such other commercial, community or educational status as the Board may approve.

Membership

To offer public accounting services a member must be of CPA or FCPA status.

Public Practice Certificate (‘PPC’)

A member that represents to the public that he/she provides public accounting services must hold a PPC if they have a bona fide expectation that their gross annual income from the provision of public accounting services will exceed $45,000. Where affiliated with a company the member must ensure that it is an approved practice entity under CPA Australia’s By-Laws. Where a member earns less than $45,000 but more than $10,000 of gross fees per calendar year that member must apply for a Limited Public Practice Certificate.

These requirements apply to any member providing public accounting services into Australia, no matter where in the world they are located.

Audit/Trust Account

APES 310: Dealing with Client Monies requires a member who holds or receives trust money to establish and maintain Trust Bank accounts and Trust accounts with adequate internal controls and to have them audited annually.
Continuing Professional Development ('CPD')

The By-Laws require all members to complete 120 hours of structured CPD each triennium, with a minimum of 20 hours in any year.

Quality Review Program ('QRP')

A member must agree to comply with the QRP throughout the period a PPC is held prior to the certificate being granted. Each holder of a PPC must establish and maintain a quality control manual to demonstrate ongoing compliance with APES 320: Quality Control for Firms to show that the PPC holder has addressed and complied with the six elements of quality control specified under that standard.

Risk management

Under APES 325: Risk Management for Firms, a member must establish and maintain a Risk Management Framework, which is tailored to the particular practice conducted by the holder of the PPC and will form part of the QRP.

Insurance

Professional indemnity insurance must be held for the practice, the policy of which must indemnify the member and the practice. The minimum sum insured shall be as stipulated in CPA Australia’s By-Laws or as prescribed by any other legislative enactment. The member shall produce proof satisfactory to CPA Australia that such insurance is held. Other specific terms that the policy must include may be found in CPA Australia's By-Law 9.8 including, but not limited to, multiple automatic reinstatement and cover for all persons affiliated with the practice.

Taxation

Method of accounting

- Cash
  
The cash accounting basis would only typically be appropriate where a sole practitioner is conducting a practice via a company as the income derived will be attributable to the personal exertion of that practitioner.

- Accruals
  
If the practice is conducting an accounting business with multiple employees, then the accruals method of accounting is most likely to be appropriate. In Income Tax Ruling IT 2639 the Commissioner accepts that as a general rule of thumb, if the practice has at least as many non-principal practitioners as principal practitioners, then income is considered to be derived from the business structure (and therefore should be accounted for on an accruals basis).

According to Henderson's Case (1970) 119 CLR 612, the more substantial the number of employees, practitioners or technicians used in a practice, the more probable it is that income is derived from the business structure rather than from personal services.

However, if the company has no fee-earning employees, the cash method should be adopted. The personal nature of the services rendered by practitioners whose business is incorporated will not differ from that of practitioners in partnership or sole practice (see Income Tax Ruling IT 2330). Incorporation, itself, does not carry with it an entitlement or obligation to adopt the accruals method as set out under Income Tax Ruling IT 2503.

Income splitting

Income splitting typically involves structures or arrangements under which income is distributed amongst family members or other related entities. The recipients are often taxed at a lower marginal rate than the person who is directly involved in the professional practice.

If a business is operated through a company, there should be no income splitting of personal services income. However, income derived by the business, rather than through the personal exertion of the individual may be able to be split amongst family members in proportion to their respective shareholdings.
Where a company structure is used, CPA Australia By-Laws require amongst other things:

• CPA Australia members hold a majority of voting shares in the company
• the majority of the directors must be CPA Australia members or a member of Chartered Accountants ANZ.

Please refer to CPA Australia’s By-Laws for further details.

• Business income
  Income derived by the business, rather than through the personal services of the principals, may be able to be split by being distributed to family members that are shareholders, subject to CPA Australia’s By-Laws.

• Non-business income
  No income splitting.

Service trust
A service trust can operate alongside the company to provide services.
A service trust commonly owns operating plant and equipment of the business, employs staff, pays bills, rents premises and collects income.

It is very important that the fees the service trust charges the business for its services are commercially realistic (FCT v Phillips 78 ATC 4361). Accordingly, the ATO has issued a number of safe harbor methods available which can be applied to ensure that fees charged by a service trust are calculated on an arm’s length basis. These methods are explained in ATO publication NAT 13086 Your service entity arrangements guide and in Taxation Ruling TR 2006/2.

The ATO has advised that it will look at cases where service fees are more than $1m, represent over 50% of the gross fees or business income and the net profit of the service trust represents more than 50% of the combined net profit of the professional firm and service trust.

Conversely, the ATO advises the risk of audit is low where the profit of the service trust does not exceed 30% of the combined net profit of the professional firm and service trust and certain indicative mark-up rates are used.

The ATO expects service entity arrangements to fall within the guidelines and continues to review and audit taxpayers who appear to be outside the guidelines.

Losses
Complex rules govern the way in which companies can use prior year and current year tax and capital losses.

Losses are quarantined, meaning they stay within the company and cannot be distributed to shareholders.

The continuity of ownership test (COT) or the same business test (SBT) must currently be satisfied for a company to use or carry forward prior year losses. It is currently proposed that an alternative continuity business continuity test to the SBT will be applicable for income years commencing from 1 July 2015.

Since 1 July 2003, losses can no longer be transferred between companies in a wholly owned group, unless the companies are part of a consolidated group for income tax purposes.

CGT
• Access to CGT discount
  No 50% discount under Division 115 of the ITAA 1997 is available to reduce a capital gain on the disposal of an asset by a company. However, it may be potentially available to reduce capital gain on a sale of the actual shares in the company by a shareholder where all the conditions to claim the CGT discount are met.

• Small business concessions
  Where a company meets all the basic conditions for the small business CGT concessions in Division 152, it will be able to access the 50% active asset reduction and may be able to also access the 15 year exemption, the
retirement exemption or the small business rollover subject to separate additional conditions being met for each of these concessions.

The basic conditions comprise the following:

- a capital gain would be triggered under a CGT event on the sale of an asset
- the company is a CGT small business entity for the income year in which the CGT event occurs as it carries on a business and satisfies the $2m aggregated turnover test comprising the annual turnover of the taxpayer as well as that of any affiliate or connected entity. Alternatively, the company could seek to satisfy the $6m Maximum Net Asset Value (MNAV) test just before the CGT event. This $6m MNAV test will be met where the market value of the CGT assets of the company, connected entities and affiliates (and connected entities of affiliates) are less than $6m immediately before the CGT event reduced by any directly related liabilities and certain provisions
- the CGT asset is an active asset
- the asset was used as an active asset for half the ownership period as an active asset (or for seven and a half years where it was owned for more than 15 years).

A share in a company will only be an active asset where the market value of the active assets and financial instruments of the company and cash is 80% or more of the market value of the company's assets.

In addition, where the asset sold is a share in a company there must also be a CGT concession stakeholder in that company in order for the small business concessions to apply to a disposal of a share in a company. Where shares are directly held by individuals in the company the CGT concession stakeholder must be a significant individual with a 20% or greater ownership interest (i.e. small business participation percentage) in that company or be the spouse of such an individual with an ownership interest greater than zero. Alternatively, where shares are held via interposed entities the CGT concession stakeholders in the object company must ultimately hold at least a 90% ownership interest (i.e. small business participation percentage) in the entity claiming the concessions in respect of the underlying shares in that object company.

Where a CGT event occurs in respect of the shares in a company on or after 8 February 2018, the following three additional conditions must be met in order to claim the small business CGT concessions to reduce any capital gain in respect of the shares:

- if the taxpayer does not satisfy the $6 million maximum net asset value test, the taxpayer must have carried on a business just before the CGT event
- the object entity must be either a CGT small business entity (i.e. an entity carrying on a business whose aggregated turnover does not exceed $2 million), or satisfy the $6 million maximum net asset value test
- the shares must satisfy a modified active asset test that looks through shares in companies to the activities and assets of any underlying entities in respect of which the object entity holds an equity interest.

A company claiming the 15-year exemption in respect of the disposal of an active asset must also have a significant individual for a total of at least 15 years throughout its ownership of the active asset, and the individual who was the significant individual just before the CGT event must be either over 55 and retired or be permanently incapacitated in order to satisfy the 15-year exemption. The CGT small business retirement exemption is similarly available to a company if it has a significant individual just before the CGT event.

• Depreciating assets

The CGT discount and CGT small business concessions are unavailable for gains on the sale of depreciating assets.
GST
A company is required to be registered for GST purposes if its projected annual turnover meets the registration turnover threshold, which is currently $75,000 for business taxpayers.

Superannuation
A company will be entitled to claim a deduction for 100% of the superannuation contributions it makes on behalf of its employees who are subject to a concessional contributions cap of $25,000 in respect of all concessional contributions made in respect of such employees for the year ended 30 June 2018. However, from the year ended 30 June 2014 an individual will automatically include an amount equal to the sum of any excess concessional contributions made on their behalf in their assessable income but can claim a non-refundable tax offset equal to 15% of their excess concessional contributions.

Substantiation
Companies are not subject to the substantiation rules relating to work expenses, car expenses or business travel expenses of individual employees or principals. However, in the event of a dispute with the ATO, a company must still be able to produce documentation to prove that the relevant expenditure was incurred.

Companies must also be able to substantiate deductions for FBT and fringe benefits provided to employees.

Financing
A company can refinance its working capital and can deduct interest on the replacement borrowings under Taxation Ruling TR95/25. A company will not, however, obtain an interest deduction on funds borrowed to finance a distribution of unrealised profits, such as a dividend from an asset revaluation reserve arising on the revaluation of an asset such as internally generated goodwill.

Analysis
If the practice derives income which is regarded as PSI, the sole benefit of incorporation is the potential for limited liability to apply. For practices that satisfy the PSI rules, the lower corporate tax rate needs to be compared with potential capital gains tax disadvantages on sale as a company is not eligible to claim the 50% CGT discount on the disposal of its CGT assets.

Note that a company which is a base rate entity will pay tax at a rate of 27.5% on its taxable income for the year ended 30 June 2019 rather than the standard 30% corporate tax rate that applies to other companies for that year. A company will be a base rate entity for an income year if no more than 80% of the company's assessable income for that income year is 'base rate entity passive income' and its aggregated turnover is less than $50m for the year ended 30 June 2019.

Whilst tax or BAS services, audit services, and financial advisory services can be conducted by a company, currently insolvency services must be conducted by individuals either as sole practitioners or partnerships. It should be noted, however, that only an authorised audit company formally registered with ASIC can conduct audit services.

TRUST

General

Brief outline
A trust is a legal relationship whereby a trustee holds the legal interest or title in trust property for the benefit of others being the beneficiaries of the trust.

A trust is controlled by one or more trustees, who can either be individuals or companies (i.e. corporate trustees). Trustees owe fiduciary obligations to the beneficiaries of the trust, and must act in their best interests.

There are essentially two basic forms of trusts:
1. **discretionary trusts**: where entitlements to income and/or capital of the trust are not fixed. Accordingly, a discretionary trust will arise where the trustee has some discretion on how income and/or capital is distributed amongst a group of potential beneficiaries

2. **fixed trusts**: where entitlements of the beneficiaries are fixed. The most common form of fixed trust is a unit trust, where beneficiaries’ entitlements to trust income and capital are fixed in proportion to the number of units they hold.

**Liability**

If a trustee is sued, the trustee’s own assets may be at risk. Accordingly, a company is often appointed as the corporate trustee, and its only asset (other than share capital) is generally its right to be indemnified under the trust deed to the extent that the trust has net assets. Accordingly, the appointment of a corporate trustee together with a carefully drafted trust deed can provide some form of limited liability protection.

**Succession**

Discretionary trusts offer many succession planning opportunities. The key advantage is that control of a trust can generally pass to the next generation without triggering stamp duty or CGT liabilities.

**Regulatory issues**

See separate document titled *Licences and Registrations for Public Practitioners in Australia* for information on:

- registering as a tax agent, BAS agent or tax (financial) adviser with the TPB
- registering as an auditor through ASIC
- registering as a liquidator through ASIC or as a Trustee in Bankruptcy through the Inspector General in Bankruptcy under the *Bankruptcy Act 1966*
- registering to provide financial planning advice through ASIC, which will be subject to a professional standards scheme for certain financial advisers administered by the Financial Adviser Standards and the Ethics Authority (FASEA), commencing from 1 January 2019
- the licensing of credit licensees and mortgage brokers by ASIC.

**Professional / CPA Australia**

**Non-membership equity**

A member, with prior approval, may practice through the medium of a trust with a member of a body specified in Appendix 2 of CPA Australia’s By-Laws.

A member may practice with other persons or entities that the Board may approve provided that:

- the trustee of the trust is either:
  - a member or members all of whom hold a PPC issued by CPA Australia or
  - an incorporated entity approved by the Board in accordance with By-Law 9.3, the majority of the directors of which are holders of a PPC issued by CPA Australia or
  - if there is more than one trustee, a member or members who hold a PPC issued by CPA Australia and a member of his or her or their family as defined in the By-Laws.

- the ability of the member to conduct the practice is not impaired in any way by the trust arrangement
- the practice conducted by the member maintains an adequate working capital
- control of the practice and of any trust, its assets and income remains with the member, his or her partners or directors and shareholders holding a CPA Australia PPC
- the trust is not so arranged as to result in any creditors receiving less than they would have received if the member practised in corporate form
- the practice is conducted in a manner which complies with the Constitution, By-Laws and Code of Professional Conduct of CPA Australia
• income from the trust is shared only by beneficiaries who are:
  - members or their family
  - entities of which a member or his or her family or both, are the sole owners
  - non-member directors of a practice company approved by the Board or entities of which those persons or their families or both, are the sole beneficiaries.

Membership
To offer public accounting services a member must be of CPA or FCPA status.

Public Practice Certificate (‘PPC’)
A member that represents to the public that he/she provides public accounting services must hold a PPC if they have a bona fide expectation that their gross annual income from the provision of public accounting services will exceed $45,000. Where affiliated with a trust the member must ensure that it is an approved practice entity under CPA Australia’s By-Laws. Where a member earns less than $45,000 but more than $10,000 of gross fees per calendar year that member must apply for a Limited Public Practice Certificate.

These requirements apply to any member providing public accounting services into Australia, no matter where in the world they are located.

Audit/Trust Account
APES 310: Dealing with Client Monies requires a member who holds or receives trust money to establish and maintain Trust Bank accounts and Trust accounts with adequate internal controls and to have them audited annually.

Continuing Professional Development (‘CPD’)
The By-Laws require all members to complete 120 hours of structured CPD each triennium, with a minimum of 20 hours in any year.

Quality Review Program (‘QRP’)
A member must agree to comply with the QRP throughout the period a PPC is held prior to the certificate being granted. Each holder of a PPC must establish and maintain a quality control manual to demonstrate ongoing compliance with APES 320: Quality Control for Firms to show that the PPC holder has addressed and complied with the six elements of quality control specified under that standard.

Risk management
Under APES 325: Risk Management for Firms, a member must establish and maintain a Risk Management Framework, which is tailored to the particular practice conducted by the holder of the PPC and will form part of the QRP.

Insurance
Professional indemnity insurance must be held for the practice, the policy of which must indemnify the member and the practice. The minimum sum insured shall be as stipulated in CPA Australia’s By-Laws or as prescribed by any other legislative enactment. The member shall produce proof satisfactory to CPA Australia that such insurance is held. Other specific terms that the policy must include may be found in CPA Australia’s By-Law 9.8 including, but not limited to, multiple automatic reinstatement and cover for all persons affiliated with the practice.
Taxation

Method of accounting

• **Cash**
  Cash accounting will be appropriate if the trustee is a sole practitioner operating through a trust. This is because the income of the trust will be for the personal exertion of the sole practitioner.

• **Accruals**
  If the practice is conducting an accounting business with multiple employees, then the accruals method of accounting is most likely to be appropriate. In Income Tax Ruling IT 2639 the Commissioner accepts that as a general rule of thumb, if the practice has at least as many non-principal practitioners as principal practitioners, then income is considered to be derived from the business structure (and therefore should be accounted for on an accruals basis).

  According to Henderson's Case (1970) 119 CLR 612, the more substantial the number of employees, practitioners or technicians used in a practice, the more probable it is that income is derived from the business structure rather than from personal services.

Income splitting

Income splitting typically involves structures or arrangements under which income is distributed amongst family members or other related entities. The recipients are often taxed at a lower marginal rate than the person who is directly involved in the professional practice.

As with any other arrangement, all the features of a trust arrangement must be examined to determine whether the arrangement attracts the operation of the general anti avoidance provisions of Part IVA of the ITAA 1936.

Professionals and all other service providers should receive income from the trust that is commensurate with their duties and responsibilities, or they should be the sole beneficiaries to the trust in relation to that income.

Business income of the trust may be split by being distributed to non-qualified beneficiaries (family members) so long as the trust arrangement is explicable by reference to ordinary business or family dealings, and no income from personal services is split. (see Income Tax Ruling IT 2330).

Pursuant to CPA Australia's By-Laws, income from the trust can generally only be shared by:

- family members (which is defined) and/or
- entities of which a member and/or his or her family are the sole owners.

From 1 July 2010 a trustee has been able to differentially stream or allocate capital gains and franked dividends (and attached franking credits) to ‘specifically entitled’ beneficiaries of discretionary trusts where permitted by the trust deed, and various conditions imposed under Divisions 115 and 207-B have been met. All other classes of income will be included in the net income (i.e. taxable income) of the trust which will be distributed on the basis that presently entitled beneficiaries will receive the same share of net income as their share of trust income.

- **Non-members**
  Where a professional practice is run through a trust structure, CPA Australia's By-Laws require, amongst other things, that the trustee must be either:
  i. a CPA Australia member or
  ii. an incorporated entity that complies with certain control and ownership requirements or
  iii. a CPA Australia member and a member of his or her family (as defined).

Service trust

A service trust can operate alongside the trust through which the business is operated to provide services.
A service trust commonly owns operating plant and equipment of the business, employs staff, pays bills, rents premises and collects income.

It is very important that the fees the service trust charges the business for its services are commercially realistic (FCT v Phillips 78 ATC 4361). Accordingly, the ATO has issued a number of safe harbor methods available which can be applied to ensure that fees charged by a service trust are calculated on an arm’s length basis. These methods are explained in ATO publication NAT 13086 ‘Your service entity arrangements’ guide and in Taxation Ruling TR 2006/2.

The ATO has advised that it will look at cases where service fees are more than $1m, represent over 50% of the gross fees or business income and the net profit of the service trust represents more than 50% of the combined net profit of the professional firm and service trust.

Conversely, the ATO advises the risk of audit is low where the profit of the service trust does not exceed 30% of the combined net profit of the professional firm and service trust and certain indicative mark-up rates are used.

The ATO expects service entity arrangements to fall within the guidelines and continues to review and audit taxpayers who appear to be outside the guidelines.

Losses

Trusts are not able to distribute losses to beneficiaries and there are also special rules relating to the carrying forward or utilisation of tax losses. Separate complex rules apply depending on whether the trust is a fixed or non-fixed trust for tax loss purposes under Schedule 2F of the UTAA 1936. However, losses may be able to be transferred if the trust is a subsidiary member of a consolidated group.

CGT

- Access to 50% discount
  
  Trusts have access to the 50% discount under Division 115 of the ITAA 1997 if the trust sells an asset at a capital gain which it has held for over 12 months. Note that when the proceeds are distributed to the beneficiary, the discount is removed. The beneficiary then needs to separately determine whether they are entitled to reapply the discount after the beneficiary has applied any available capital losses.

- Small business concessions
  
  Where a trust meets all the basic conditions for the small business CGT concessions in Division 152, it will be able to access the 50% active asset reduction and may be able to also access the 15 year exemption, the retirement exemption or the small business rollover subject to separate additional conditions being met for each of these concessions.

  The basic conditions comprise the following:
  
  - a capital gain would be triggered under a CGT event on the sale of an asset
  - the trust is a CGT small business entity for the income year in which the CGT event occurs as it satisfies the $2m aggregated turnover test comprising the annual turnover of the taxpayer as well as that of any affiliate or connected entity. Alternatively, the company could seek to satisfy the $6m Maximum Net Asset Value (MNAV) test just before the CGT event. This $6m MNAV test will be met where the market value of the CGT assets of the trust, connected entities and affiliates (and connected entities of affiliates) are less than $6m immediately before the CGT event reduced by any directly related liabilities and certain provisions
  - the CGT asset is an active asset
  - the asset was used as an active asset for half the ownership period as an active asset (or for seven and a half years where it was owned for more than 15 years).

  Where the asset sold is an interest in a trust there must also be a CGT concession stakeholder in that trust. In this case the CGT concession stakeholder must be a significant individual with a 20% or greater interest (i.e. small business participation percentage) in that trust or be the spouse of such an individual with an ownership
interest greater than zero. Alternatively, where the interest in the object trust is held via interposed entities the CGT concession stakeholders must ultimately hold a 90% ownership interest (i.e. small business participation percentage) in the entity claiming the concessions in respect of the underlying interest in the object trust.

Where a CGT event occurs in respect of the interests in a trust on or after 8 February 2018, the following three additional conditions must be met in order to claim the small business CGT concessions to reduce any capital gain in respect of the trust interest:

- if the taxpayer does not satisfy the $6 million maximum net asset value test, the taxpayer must have carried on a business just before the CGT event
- the object entity must be either a CGT small business entity (i.e. an entity carrying on a business whose aggregated turnover does not exceed $2 million), or satisfy the $6 million maximum net asset value test
- the interests in the trust must satisfy a modified active asset test that looks through interests in the trust to the activities and assets of any underlying entities in respect of which the object entity holds an equity interest.

A trust claiming the 15-year exemption in respect of the disposal of an active asset must also have a significant individual for a total of at least 15 years throughout its ownership of the active asset, and the individual who was the significant individual just before the CGT event must be either over 55 and retired or be permanently incapacitated in order for the 15-year exemption to apply. The retirement exemption is similarly available to a trust if it has a significant individual just before the CGT event.

- Depreciating assets
  
  The CGT discount and CGT small business concessions are unavailable for gains on the sale of depreciable assets.

GST

As the trust itself has no legal entity, it is the trustee who will be required to be register for GST in their capacity as trustee if the projected annual turnover of the trust meets the registration turnover threshold, which is currently $75,000 for business taxpayers.

Superannuation

A trust will be entitled to claim a deduction for 100% of the superannuation contributions made on behalf of its employees who are subject to a concessional contributions cap of $25,000 in respect of all concessional contributions made in respect of such employees for the year ended 30 June 2019. However, from the year ended 30 June 2014 an individual will automatically include an amount equal to the sum of any excess concessional contributions made on their behalf in their assessable income but can claim a non-refundable tax offset equal to 15% of their excess concessional contributions.

Substantiation

Trusts are not subject to the substantiation rules relating to work expenses, car expenses or business travel expenses of individual employees or principals. However, in the event of a dispute with the ATO, the trustees of a trust must still be able to prove that the relevant expenditure was incurred.

Trusts must also be able to substantiate deductions for FBT and fringe benefits provided to employees.

Financing

A trust can refinance its working capital and obtain an interest deduction on replacement funds borrowed under Taxation Ruling TR95/25. However, no such interest deduction will be available to fund a payment from an unrealised profit or asset revaluation reserve.
Analysis

CPA Australia rules permit the use of trusts, although the use of a corporate trustee does not currently meet insolvency registration requirements. The TPB does not require notification of a trust relationship but rather regulates the trustee which can be an individual or a company. Corporate trustees provide the potential benefit of some limited liability if the trust deed is appropriately worded.

As CPA Australia rules permit beneficiaries to include associated family and entities, income tax planning opportunities exist for trusts that satisfy the relevant income tax requirements. Capital gains tax concessions including the 50% CGT discount and the CGT small business concessions are potentially available if the relevant eligibility requirements are met.

PARTNERSHIP OF DISCRETIONARY TRUSTS

General

Brief outline

A partnership of discretionary trusts is simply a number of discretionary trusts acquiring assets in partnership. Typically, they would be governed by a partnership agreement and a corporate manager would be appointed to conduct the partnership’s business. This corporate manager would be the party that would deal with the public.

Liability

Discretionary trusts with corporate trustees provide the beneficiaries with asset protection if the trustee’s right of indemnity is limited to the net assets of the trust under the trust deed. Any losses of the partnership cannot be passed through the discretionary trust to be utilised by the beneficiaries but may be applied to reduce other assessable income if appropriately structured. The discretionary trust, but not the beneficiaries, will be able to claim interest deductions on borrowings used to acquire an interest in the partnership. If the discretionary trust has any other assets, those assets will be exposed to the risks to which the partnership is exposed. Therefore, it is often recommended that new trusts be established, which become the partners.

Succession

Partnerships do not provide for easy passing of control between generations. Where partnerships are used significant tax planning and the use of tax elections in respect of trading stock and depreciating assets must be relied upon to cost-effectively pass control to the next generation of partners.

Generally, the ATO will treat a changed partnership as a reconstituted continuing entity if the original partnership agreement included a provision for a change in membership or shares and the following factors apply:

- the partnership is a general law partnership
- at least one of the partners is common to the partnership both before and after reconstitution
- there is no period where there is only one ‘partner’
- the partnership agreement includes an express or implied continuity clause or, in the absence of a written partnership agreement, the conduct of the parties is consistent with continuity
- there is no break in the continuity of the enterprise or firm (that is, the partnership’s assets remain with the continuing partnership and there is no change to the nature of the business).

In other circumstances, where an existing partner retires or a new partner is admitted, the partnership is deemed to cease and a new partnership created. This requires two tax returns to be lodged in the income year the change occurs, among other steps. Further, each partner of the old partnership is taken to have disposed of part of their interest in the partnership asset and a CGT liability may arise. There are also implications for the transfer of assets such as trading stock, work-in-progress, debtors and depreciating assets.

Regulatory issues

See separate document titled Licences and Registrations for Public Practitioners in Australia for information on:
• registering as a tax agent, BAS agent or tax (financial) adviser with the TPB
• registering as an auditor through ASIC
• registering as a liquidator through ASIC or as a Trustee in Bankruptcy through the Inspector General in Bankruptcy under the Bankruptcy Act 1966
• registering to provide financial planning advice through ASIC, which will be subject to a professional standards scheme for certain financial advisers administered by the Financial Adviser Standards and Ethics Authority (FASEA), commencing from 1 January 2019
• the licensing of credit licensees and mortgage brokers by ASIC.

Professional / CPA Australia
Refer to information in this section under ‘Partnerships’ and ‘Trusts’.

Taxation
Method of accounting
• Cash
  If the practice consists solely of the income producing activities of the partners, then the cash method of accounting should be adopted.

• Accruals
  If the practice is the conduct of an accounting business with multiple employees, then the accruals method of accounting is most likely to be appropriate. In Income Tax Ruling IT 2639 the Commissioner accepts that as a general rule of thumb, if the practice has at least as many non-principal practitioners as principal practitioners, then income is considered to be derived from the business structure (and therefore should be accounted for on an accruals basis).
  According to Henderson’s Case (1970) 119 CLR 612, the more substantial the number of employees, practitioners or technicians used in a practice, the more probable it is that income is derived from the business structure rather than from personal services.

Income splitting
Income splitting typically involves structures or arrangements under which income is distributed amongst family members or other related entities. The recipients are often taxed at a lower marginal rate than the person who is directly involved in the professional practice.

Professionals and all other service providers should receive income from the trust that is commensurate with their duties and responsibilities, or they should be the sole beneficiaries to the trust in relation to that income. Income from rendering personal services cannot give rise to income tax liability for anyone other than the person who rendered the personal services.

CPA Australia By-Laws only permit partnerships with unqualified persons where the Board of CPA Australia approves the partnership arrangement. Therefore, income splitting may not be available through a partnership structure.

Pursuant to Income Tax Ruling IT 2330 all the features of an arrangement must be examined to determine whether the arrangement attracts the operation of the general anti avoidance provisions of Part IVA of the ITAA 1936. Income of a professional partnership usually includes income produced by staff employed by the partnership. In this case it is income of a business and therefore can be structured to embrace income splitting. However, partnership income will be treated as income from the rendering of personal services where it is derived from the personal services of the partners, rather than the work of employees and/or income producing assets. In this case, income splitting will breach the specific anti-tax avoidance provisions of Divisions 84 to 87 of the ITAA 1997.
• Everett Assignment

If the partnership is deriving business income, it may be acceptable for a professional (as trustee of one of the trusts of the partnership) to assign some of his or her interest in the capital and income of the firm to their spouse or a related discretionary trust (for example). The assignment cannot relate to personal services income. This will only be effective if the partnership is earning business income (i.e. where the partner is entitled to some profits regardless of how much energy he or she has devoted to the partnership). Rights to salary also cannot be assigned.

To be effective, the partner must assign present property, being an entire ‘chose in action’ (i.e. a right enforceable by legal action), and the assignment must confer an equitable entitlement to the relevant income to the assignee.

The Commissioner of Taxation determined under Income Tax Ruling IT 2540 that the effect of an Everett assignment for CGT purposes is that the partner is regarded as having disposed of his or her partnership interest. Where the disposal to a related party (e.g. a spouse) was not made on an arm’s length basis (as would usually be the case) a sale consideration akin to the market value of that interest will be deemed to have been provided by the associate who has been assigned the partnership interest.

The effect of the assignment is that the assignor partner holds the relevant portion of the income referable to the assigned partnership interest on trust for the assignee who is assessed on such an amount as a beneficiary of a trust and who therefore does not become a partner in the partnership.

Service trust

The service trust can operate alongside the partnership to provide services.

The service trust commonly owns operating plant & equipment of the business, employs staff, pays bills, rents premises and collects income.

It is very important that the fees the service trust charges the business for its services are commercially realistic (FCT v Phillips 78 ATC 4361). Accordingly, the ATO has issued a number of safe harbor methods available which can be applied to ensure that fees charged by a service trust are calculated on an arm’s length basis. These methods are explained in ATO publication NAT 13086 Your service entity arrangements guide and in Taxation Ruling TR 2006/2.

The ATO has advised that it will look at cases where service fees are more than $1m, represent over 50% of the gross fees or business income and the net profit of the service trust represents more than 50% of the combined net profit of the professional firm and service trust.

Conversely, the ATO advises the risk of audit is low where the profit of the service trust does not exceed 30% of the combined net profit of the professional firm and service trust and certain indicative mark-up rates are used.

The ATO expects service entity arrangements to fall within the guidelines and continues to review and audit taxpayers who appear to be outside the guidelines.

Losses

Generally, trusts are not able to distribute losses to beneficiaries and are also subject to special rules when carrying forward or utilising losses. Separate complex rules apply depending on whether the trust is a fixed or non-fixed trust for tax loss purposes under Schedule 2F of the ITAA 1936. However, losses may be able to be transferred if the trust is a subsidiary member of a consolidated group.

CGT

• Access to CGT discount

As the partners are trusts, they will be able to access the 50% CGT discount in relation to a capital gain made on the disposal of their fractional interests in partnership assets.

• Small business concessions

Refer to information on this topic under Partnership – Taxation.
- **Depreciating assets**
  
  The CGT discount and CGT small business concessions are unavailable for gains on the sale of depreciable assets.

**GST**

The ATO’s view (expressed in GST Ruling GSTR 2003/13) is that, with the exception of a partnership carrying on an activity without a reasonable expectation of profit or gain, a general law partnership carries on an enterprise and may register for GST from the time it is formed.

A partnership is required to be registered upon formation if its projected annual turnover meets the registration turnover threshold, which is currently $75,000 for business taxpayers.

Upon formation of a partnership, the partners each acquire an interest in the entity. The partners’ consideration for their interests can include capital contributions or the promise to provide services, labour or skills.

**Superannuation**

- **Administration Company**

  Pursuant to Income Tax Ruling IT 2630 the Commissioner of Taxation accepts that one of the purposes for which administration companies have been set up by partnerships has been to enable employer-sponsored superannuation benefits to be provided to the partners. For such entities to be accepted by the Commissioner there must be no element of income diversion and the superannuation contributions must be made to a complying superannuation fund.

**Substantiation**

Partnerships with no partners that are individuals are not required to comply with the substantiation rules relating to work expenses, car expenses or business travel expenses of individual employees or principals. However, in the event of a dispute with the ATO, a partnership must still be able to prove that the relevant expenditure was incurred.

All partnerships must be able to substantiate deductions for FBT and fringe benefits provided to employees.

**Financing**

Capital contributions can be made with after tax retained profits.

Taxation Ruling TR 95/25 confirms that interest deductions are available where a general law partnership borrows money to refinance partnership capital.

Only the partners’ contributed capital can be refinanced using interest deductible loans. Interest on borrowings used to finance a distribution from an asset revaluation reserve or unrealised profits is not deductible.

**Analysis**

This structure owes its popularity to the fact that it offers a number of potential benefits if properly structured, including access to the CGT discount and the CGT small business concessions and offers potential limited liability if the trustee is a corporate trustee whose right of indemnity is limited to the trust’s net assets.

A partnership of discretionary trusts is a structure which can now be registered by the TPB under TASA irrespective of whether the trustee is an individual or a company.
APPENDIX 1 – PERSONAL SERVICES INCOME FLOWCHART

Appendix 1 – Personal Services Income flowchart (reproduced from paragraph 16 of Taxation Ruling TR 2001/7, as downloaded from the Australian Taxation Office website at ato.gov.au)

Does an individual or a personal services entity have income that is mainly a reward for personal efforts or skills of an individual (an individual’s personal services income) and not mainly a reward from the use of assets, the sale of goods, or a business structure? (Division 84)

Yes

Does the individual or personal services entity satisfy the ‘results test’?

No

Is 80% or more of the individual’s personal services income from one source? (Division 87)

Yes

Has the Commissioner of Taxation made a personal services business determination relating to the individual’s personal services income? You will need to meet one of the following tests:

- the ‘results’ test;
- the employment test;
- the business premises test; or
- unusual circumstances.

No

Does the individual or the personal services entity meet at least one of the following three personal service business tests:

- the unrelated clients test;
- the employment test or
- the business premises test?

Yes

The individual or the personal services entity is conducting a personal services business. Divisions 85 and 86 do not apply. However Part IVA of the ITAA 1936 may still apply if income splitting occurs.

No

The individual or the personal services entity is not conducting a personal services business. Divisions 85 and/or 86 applies.

Part 2–42 of the ITAA 1997 does not apply

No

The individual or the personal services entity is not conducting a personal services business. Divisions 85 and/or 86 applies.
One or more Significant Individuals

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<th>2 Discretionary Trust disposes of Business</th>
<th>3 Unit Trust disposes of Business</th>
<th>4 Company disposes of Business</th>
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<td>15 Year Retirement Exemption</td>
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* Some of the exemption will be clawed back under CGT event E4 when distributed by the unit trust.

? On distribution to an individual shareholder the amount will be an unfranked dividend. It would be possible to get some of the benefit of the exemption if the company was liquidated.
No Significant Individuals

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? On distribution to C the amount will be an unfranked dividend. It would be possible to get some of the benefit of the exemption if the company was liquidated.
APPENDIX 3 – SERVICE ENTITIES

Appendix 3 - Service Entities (reproduced from Australian Taxation Office publication ‘Your Service Entity Arrangements’ guide NAT 13086, as downloaded from the ATO website at ato.gov.au)
APPENDIX 4 – GENERAL MATTERS TO BE CONSIDERED

The following issues and many others should be considered in choosing and establishing a structure.

Asset protection
Identify and ensure appropriate structuring and insurance cover for "at risk" issues:
   a) **Structuring**: consider holding investment and personal assets separately from "at risk" business exposures
   b) **Insurances**: consider full range of cover for various business risks not just professional indemnity.

Regulatory matters
Ensure compliance with all relevant regulatory requirements:
   a) CPA Australia By-Laws and professional standards requirements imposed by the APESB
   b) TASA requirements
   c) ASIC registrations
   d) ATO registrations and requirements
   e) Other licensing and regulatory requirements.

Constituent documents
Consider appropriateness and obtain advice on one or more of the following:
   a) Partnership agreement
   b) Company constitution
   c) Shareholder agreement
   d) Management deed
   e) Trust Deed
   f) Unitholder agreement
   g) Service Agreements (particularly associated with service entities)
   h) Other legal requirements.

Key events to consider
There are numerous matters which should be considered in selecting any structure and they are often best dealt with by enshrining terms in the constituent documents in order to minimise the risk of future disputes between commercial partners.

Common matters include the following:
   a) **Working capital**: how much capital is each party required to contribute? How much of the profit is to be retained as opposed to distributed?
   b) **Gearing policy**: is there an appropriate debt level for the practice? How is this to be allocated between external debt versus partner funded debt?
   c) **Voting**: which, if any, matters require formal voting resolutions?
   d) **Dispute resolution**: how are disputes between parties resolved?
   e) **Profit share**: how is each party's profit share resolved?
   f) **Valuation of practice**: in particular, is it a goodwill or non-goodwill practice? On what basis is the practice to be valued?
   g) **Partnership changes**: how do you deal with incoming/outgoing/disabled partners? How do you deal with succession generally?
APPENDIX 5 – SMALL BUSINESS RESTRUCTURE
ROLLOVER RELIEF

Where it is now determined that a small business entity should have been structured differently to that originally implemented there is scope on or after 1 July 2016 to transfer business assets from an existing structure to a new structure without triggering any tax consequences, subject to a range of conditions being satisfied under Subdivision 328-G of the ITAA 1997. However, these provisions have only been recently enacted and are complex to apply in practice. Accordingly, it would be prudent to obtain professional advice before restructuring existing business entities.

Essentially, optional rollover relief is available under Subdivision 328-G of the ITAA 1997 where a small business entity transfers an active asset(s) of the business (e.g. goodwill) to another small business entity as part of a genuine business restructure on or after 1 July 2016 where there has been no material change in the underlying economic ownership of assets.

The effect of the rollover is to defer any gain or loss arising from the transfer of active assets that are CGT assets, depreciating assets, trading stock or revenue assets where all the requirements of Subdivision 328-G are satisfied.

Such rollover is in addition to other rollover relief currently available under the ITAA 1997, such as where an individual or all the partners in a partnership transfer assets to a wholly owned company of that individual or the partners under Subdivisions 122-A and 122-B of the ITAA 1997.

Section 328-430 (i) provides that small business entity rollover relief is available in relation to an active asset transfer where all of the following conditions have been met:

- the asset transfer is part of a genuine business restructure of an ongoing business. There is no definition of what constitutes a ‘genuine’ business restructure and the issue of whether this requirement is met will need to be determined based on the facts of each transaction. However, a restructure will not be regarded as genuine if it is artificial or unduly tax driven. However, section 328-435 effectively provides that a restructure will in most cases be regarded as being genuine if in the three year period after the transfer there is no change in the ultimate economic ownership of any significant assets (other than trading stock) that were transferred under the restructure; those assets continue to be active assets used in a business; and there is no significant or material use of those assets for private purposes.

- each party to the transfer must be a small business entity for the year in which the asset transfer occurred. A small business entity will be an entity that carries on a business where the aggregated annual turnover of that entity and other entities that are affiliated or connected with that entity are less than $10m. In addition, the rollover may also be available for assets that are used by the small business entity but held by an entity connected with the small business entity; an entity for which the small business entity is an affiliate; or a partner of a partnership with a small business entity which is a partnership

- the transaction must not have the effect of materially changing the ultimate economic ownership of the transferred assets. Ultimate economic ownership of an asset is held by individuals who, directly or indirectly, beneficially own an asset. Where more than one individual is the ultimate economic owner of an asset those individuals must maintain the same proportionate share of ultimate economic ownership in the asset before and after the asset transfer

- where a non-fixed trust chooses to use the rollover as a transferor and/or transferee of an asset, the ultimate economic ownership condition will be met if the transferor and/or transferee trust is subject to a family trust election which specifies the same test individual. The effect of this alternate ownership test is that members of the family group will have the same ultimate economic ownership of the assets transferred both before and after the asset transfer

- the asset transferred must be an active asset being essentially an asset that was used in the course of carrying on a business as defined under section 152-40 of the ITAA 1997. Accordingly, assets whose main use is to derive passive income such as interest, annuities, rents, royalties or exchange gains will typically be excluded

- both the transferor and transferee must be residents of Australia under the various definitions of ‘resident’ that apply to individuals, companies, trusts, partnerships and corporate limited partnerships
both the transferor and transferee must choose to apply the rollover under Subdivision 328-G in respect of the assets transferred. Where such a choice is made automatic rollover relief will be available in respect of depreciable assets transferred as part of the business transfer under balancing adjustment rollover relief available under section 40-340. Under this rollover relief the transferee will inherit the adjusted value of any depreciable assets transferred and will calculate the decline in value of those assets in the same way that the transferor made such a calculation.

The tax consequences arising under the rollover are as follows:

- no income tax consequences arise from the rollover and the transfer of an asset by a private company to a shareholder will not be regarded as a payment and therefore a deemed dividend for Division 7A purposes
- no gain or loss will arise on the transfer of an asset where it is transferred at its rollover cost. The rollover cost is the transferor’s cost of the asset for income tax purposes which will essentially be inherited by the transferee
- for post-CGT acquired assets, the rollover cost is the transferor’s cost base of an asset whilst pre-CGT acquired assets will retain their pre-CGT status in the hands of the transferee. Where trading stock is transferred the rollover cost will be either cost or the opening value of trading stock, whilst the rollover cost of a revenue asset is the amount that would result in the transferor not making a profit or loss on transfer of the revenue asset
- the transferee also inherits the transferor’s history for the purpose of applying the small business CGT replacement rollover and the small business CGT 15-year exemption.

Where membership interests (e.g. shares or units) are issued in consideration for the asset transfer, the cost base of any new membership interests is worked out based on the sum of the rollover costs and adjustable values of the rolled over assets less any liabilities that the transferee undertakes to discharge in respect of those assets. However, any capital loss on a membership interest in the transferor or transferee that is made after the rollover will be disregarded except to the extent the taxpayer can show that loss is reasonably attributable to something other than the asset transfer.