IT 276 - Payments to service companies : splitting of professional income

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TAXATION RULING NO. IT 276

PAYMENTS TO SERVICE COMPANIES : SPLITTING OF PROFESSIONAL INCOME

F.O.I. EMBARGO: May be released

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F.O.I. INDEX DETAIL

REFERENCE NO:	SUBJECT REFS:	LEGISLAT. REFS:
I 1102450	SERVICE COMPANY - PAYMENTS TO - ALIENATION OF INCOME PROFESSIONAL INCOME-SPLITTING PHILLIPS V FC OF T	51 (1)

PREAMBLE The following issues are seen to have emerged from the Federal Court's decision in the case Phillips v FC of T, reported as 8 ATR 783; 78 ATC 4361.

2. The case was concerned with the question whether a national accountancy firm could deduct under section 51 payments which it made to a service trust for hire of office furniture and equipment, non-professional staff, provision of share registry services, interest on outstanding amounts due to the trust and other incidental charges. A significant effect of the arrangement, in the Commissioner's view, was to divert income from the partners to persons interested in the trust. The latter comprised persons nominated by the partners; generally their wives and dependants or family companies and trusts.

3. Despite this substantial transfer of income, the taxpayer was able to satisfy the trial judge that the rates charged by the trust were realistic and not in excess of commercial rates. This was a crucial finding which could not be effectively challenged on appeal. Additionally, it was accepted that there were sound commercial reasons for the arrangement quite apart from tax savings. The sale of plant and equipment by the firm to the trust released working capital and enabled accrued profits to be distributed; assets were moved away from the firm and thus protected against possible litigation based on professional negligence.

RULING 4. Given the view of the facts which the court adopted, that is, a re-arrangement of business affairs for commercial reasons and realistic charges not in excess of commercial rates, the decision to allow a deduction must be accepted as reasonable. Accordingly, the decision is not seen as requiring any alteration to existing policy concerning payments of this nature.

5. The case demonstrates the practical difficulties, of reducing or disallowing claims for deductions where the payments are

marginally above commercial rates. Fisher J. in his judgment commented that, if a payment allegedly for services was grossly excessive, the presumption would arise that it was made for some other purpose. He also referred to the necessity to be able to identify and quantify the consideration applicable to any advantage unconnected with business activity. The decision indicates the need for a close examination of all relevant facts before deductions are allowed in cases of this kind.

COMMISSIONER OF TAXATION