


CR 2008/65 - Income tax: private practice arrangements for salaried medical officers in South Australian public hospitals

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Class Ruling

Income tax: private practice arrangements for salaried medical officers in South Australian public hospitals

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① This publication provides you with the following level of protection:

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you – provided the Commissioner is not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

What this Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the relevant provisions identified below apply to the defined class of entities, who take part in the scheme to which this Ruling relates.

Relevant provision(s)

2. The relevant provisions dealt with in this ruling are:

- section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- section 8-1 of the ITAA 1997;
- section 17-5 of the ITAA 1997;
- section 45-120 of Schedule 1 to the *Taxation Administration Act 1953* (TAA); and
- section 45-205 of Schedule 1 to the TAA.

Class of entities

3. The class of entities to which this Ruling applies is the specialist medical practitioners (referred to as salaried medical officers or SMOs) employed in a South Australian Hospital by the Chief Executive of the Department of Health who elect to participate in the Right of Private Practice Deed of Agreement (pay over agreement) offered in the Letter of Offer or Contract Variation letter of offer for a salaried medical specialist. The term 'Hospital' refers to the public hospital specified in the Deed.

Qualifications

4. The Commissioner makes this Class Ruling based on the precise arrangement identified in the Class Ruling.

5. The class of entities defined in this Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 14 to 19 of this Ruling.

6. If the scheme actually carried out is materially different from the scheme that is described in this Ruling, then:

- this Ruling has no binding effect on the Commissioner because the scheme entered into is not the scheme on which the Commissioner has ruled; and
- this Ruling may be withdrawn or modified.

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Date of effect

8. This Class Ruling applies for the income year ended 30 June 2009 and subsequent years.

9. The Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling. Furthermore, the Ruling only applies to the extent that:

- it is not later withdrawn by notice in the *Gazette*; or

- the relevant provisions are not amended.

10. If this Class Ruling is inconsistent with a later public or private ruling, the relevant class of entities may rely on either ruling which applies to them (item 1 of subsection 357-75(1) of Schedule 1 to the TAA).

11. If this Class Ruling is inconsistent with an earlier private ruling, the private ruling is taken not to have been made if, when the Class Ruling is made, the following two conditions are met:

- the income year or other period to which the rulings relate has not begun; and
- the scheme to which the rulings relate has not begun to be carried out.

12. If the above two conditions do not apply, the relevant class of entities may rely on either ruling which applies to them (item 3 of subsection 357-75(1) of Schedule 1 to the TAA).

Previous Rulings

13. Class Ruling CR 2006/24: Income Tax: standard private practice arrangements of salaried medical officers of a South Australian health agency.

Scheme

14. The following description of the scheme is based on information provided by the applicant consisting of:

- Class ruling application and changes to application;
- Rights of Private Practice Deed of Agreement;
- Sample Option A - Letter of Offer for a salaried medical specialist for new or prospective employees;
- Sample Option B - Letter of Offer for a salaried medical specialist for new or prospective employees;
- Sample Option A - Contract Variation letter of offer for a salaried medical specialist for existing employee; and
- Sample Option B - Contract Variation letter of offer for a salaried medical specialist for existing employee.

15. The salaried medical officers (SMOs) are employees of the Chief Executive of the Department of Health (or a person designated as the employing authority under the *South Australian Health Care Act 2008* (SA)). The SMO employment conditions are specified in the South Australian Salaried Medical Officers Award, the Department of Health Salaried Medical Officers Enterprise Agreement 2008 (or its successors), the Letter of Offer for a Medical Specialist sent to each SMO and the Department of Health Human Resources Manual.

16. Each SMO has a limited entitlement to participate in a private practice activity. This entitlement is outlined in their Letter of Offer. The SMO, the Employing Authority and the Hospital enter into a Rights of Private Practice Deed of Agreement, which, among other things, requires the SMO to execute a pay over agreement with the Hospital.

17. The pay over agreement involves the SMO providing a consultation service to a private practice patient which produces fees attributable to the SMO. The Hospital provides the facilities in which the SMO undertakes their private practice. The Hospital bills and collects the fees from the private practice patients as agents for the individual SMO. Fees derived from undertaking private practice are acknowledged by both parties to be income derived in the hands of the SMO (clause 5.3 of the Rights of Private Practice Deed of Agreement).

18. Under clause 5.4 of the Rights of Private Practice Deed of Agreement, the SMO, after deriving the fees, is obliged to pay over to the Hospital all the billing fees that arise from this private practice. On being paid over, those amounts become the property of the Hospital.

19. As part of their remuneration package from the Hospital, the SMO receives a private practice component. There are two ways in which the private practice component is calculated depending on the employment conditions agreed between the SMO and the Hospital prior to the commencement or variation of their employment. These are set out in two separate Letters of Offer:

Option A

The SMO receives an amount equal to either 30% or 45% of their base salary depending on which Hospital at which the SMO is employed.

Option B

The SMO receives (after the Hospital retains 4% of the billing fees for professional indemnity insurance and 5% to cover administration costs):

- the balance of the billing fees up to a ceiling of 65% of base salary
- 1/3rd of the balance of the billing fees up to a ceiling of 100% of base salary, and
- 15% of the balance of the billing fees above 100% of base salary.

Ruling

Private practice income

20. The billing fees derived by a SMO under the contract of employment are assessable income of the SMO under section 6-5 of the ITAA 1997 when it is collected by the Hospital on behalf of the SMO.

21. The assessable income does not include any Goods and Services Tax (GST) component of the billing fees by virtue of section 17-5 of the ITAA 1997.

Deductibility of amounts paid to the Hospital

22. A deduction is allowable under section 8-1 of the ITAA 1997 to the SMO for the amounts payable to the Hospital under the terms of the Rights of Private Practice Deed of Agreement.

PAYG instalments – instalment income and instalment rate

23. The billing fees of the SMO, billed under the Rights of Private Practice Deed of Agreement, forms part of the SMO's instalment income as defined in subsection 45-120(1) of Schedule 1 to the TAA.

24. If the SMO is a quarterly payer, they may choose to vary their instalment rate in accordance with section 45-205 of Schedule 1 to the TAA.

Private practice component received by SMO as part of their remuneration package

25. The private practice component received by the SMO as part of their remuneration package is considered to be remuneration for the discharge of services under the SMO's employment contract. This payment is assessable income of the SMO under section 6-5 of the ITAA 1997.

Appendix 1 – Explanation

❶ *This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.*

Private practice income

26. Section 6-5 of the ITAA 1997 provides that an amount is assessable income if it is income according to ordinary concepts (ordinary income).

27. The term 'ordinary income' is not defined in the legislation. However, it is well established that this term includes amounts received as a reward for providing personal services.

28. As part of the private practice arrangement between the SMO and their employer, the SMO attends to private patients in the Hospital. The SMO utilises the Hospital's infrastructure and resources whilst performing this role. The SMO is however providing a direct service to these patients as part of their own private practice and not in their capacity as employee of the Employing Authority. The Hospital acts as the agent of the SMO in billing and collecting the fees from the private practice.

29. The amount paid by or on account of a patient is a reward for services provided by the SMO and is assessable as ordinary income of the SMO under section 6-5 of the ITAA 1997.

30. The decision in a Board of Review case reported as Taxation Case T44 86 ATC 366 supports the conclusion that the fees are assessable as ordinary income of the SMO. In that case, it was held that private patient fees received by a hospital on behalf of a salaried doctor as a result of accounts issued in the doctor's name by the hospital acting as his agent, were assessable to the individual doctor as ordinary income. The amounts were included in the assessable income of the doctor in the year in which the payments were made by the patient.

The GST component

31. The amount included in assessable income under section 6-5 of the ITAA 1997 excludes any goods and services tax (GST) component. Section 17-5 of the ITAA 1997 ensures that an amount is treated as not being assessable income (or exempt income) to the extent that it consists of an amount relating to:

- GST payable on a taxable supply;
- increasing adjustment in the GST payable on a supply; or
- an increasing adjustment that relates to an acquisition and arises in circumstances that give rise to a recoupment that is included in assessable income.

Deductibility of amounts paid over to the Hospital

32. Section 8-1 of the ITAA 1997 provides that you can deduct from your assessable income any loss or outgoing to the extent that it is incurred in gaining or producing assessable income and is not:

- capital, private or domestic in nature;
- incurred in gaining or producing exempt income; or
- prevented from being deductible by another provision in the ITAA 1997.

33. In the Full Federal Court decision in *Service v. Federal Commissioner of Taxation* (2000) FCR 265; [2000] FCA 188; 2000 ATC 4176; (2000) 44 ATR 71 the taxpayer was allowed a deduction for directors' fees he paid over to his employer in accordance with a contractual arrangement he had with his employer. The Court concluded that the directors' fees paid to the employer were outgoings incurred by the taxpayer in gaining or producing his assessable income of salary from the employer and potential income from superannuation benefits. In reaching its decision, the Court noted that a number of propositions had been established by the cases to help determine if a deduction was allowable under the former equivalent provision in the *Income Tax Assessment Act 1936*, namely subsection 51(1). Firstly, there had to be a connection between the loss or outgoing and the assessable income (2000 ATC 4186; (2000) 44 ATR 81):

Secondly the reference in the subsection to 'the assessable income' does not ...relate to the income of a particular year of income any more that it relates to a particular item of income, but to assessable income generally: *cf AGC (Advances) Ltd v. Federal Commissioner of Taxation* (1975) 132 CLR 175 at 196-8; 75 ATC 4057 at 4072; 5 ATR 243 at 259-60 per Mason J.

Thirdly, where the subsection refers to the loss or outgoing being incurred in gaining or producing the assessable income, this means 'in the course of' gaining or producing assessable income: *Amalgamated Zinc (de Bavay's) Ltd v. Federal Commissioner of Taxation* (1935) 54 CLR 295 at 303 per Latham CJ, at 309 Dixon J.

Fourthly, the question whether a particular outgoing was incurred in gaining or producing the assessable income looks to the 'essential character' of the expenditure itself, rather than to the purpose for which an item of expenditure has been incurred.

34. Under the Rights of Private Practice Deed of Agreement, the SMO is required, as a condition of employment, to pay over to the Hospital all fees arising from private practice. On being paid over, the fees become the property of the Hospital.

35. In the circumstances, the payment over to the Hospital of the fees derived from private practice has the essential character of expenditure incurred in gaining or producing the SMO's assessable income.

Non-commercial loss provisions

36. Depending on the particular circumstances of an SMO conducting a private practice under the pay over payment arrangement, Division 35 of the ITAA 1997 – Deferral of losses from non-commercial business activities – may have application. If the SMO makes a loss from this business activity and does not meet one of the tests set out in sections 35-30, 35-35, 35-40, or 35-45 of the ITAA 1997, or the Commissioner has not exercised the discretion set out in section 35-55 of the ITAA 1997, then the loss deferral rule in subsection 35-10(2) of the ITAA 1997 will apply.

PAYG instalments

37. An SMO who has been given a PAYG instalment rate from the Commissioner is liable to pay PAYG instalments on business and investment income to provide for their income tax liability under section 45-15 of Schedule 1 to the TAA.

38. Some SMOs may be required to pay quarterly PAYG instalments calculated as the product of their 'instalment rate' by their 'instalment income' under section 45-110 of Schedule 1 to the TAA.

Instalment income

39. Billing fees from private patients to an SMO participating in the Rights of Private Practice Deed of Agreement under consideration is ordinary income in accordance with section 6-5 of the ITAA 1997.

40. Subsection 45-120(1) of Schedule 1 to the TAA contains the general rule that 'instalment income' for a period includes ordinary income. An exception to this rule is provided by paragraph 45-120(3)(a) of Schedule 1 to the TAA which provides that certain withholding payments are not included in instalment income. Withholding payments include a payment from which an amount must be withheld under the PAYG withholding provisions in Division 12 of Schedule 1 to the TAA.

41. As the billing fees derived by the SMO for his or her services to private practice patients is not considered to be a withholding payment, the fees are included in the SMO's 'instalment income' and is subject to the PAYG instalment system.

Variation to the instalment rate

42. SMOs who are already within the PAYG instalment system, will, in the first year of their participation in the Rights of Private Practice Deed of Agreement, be required to pay instalments in respect of their billing income.

43. An SMO's instalment rate will be re-calculated after their first income tax assessment on entering into the Rights of Private Practice Deed of Agreement. This is to reflect the fact that the billing income will be wholly negated by the pay over agreement mandated by clause 5.4 of the Rights of Private Practice Deed of Agreement and the Letter of Offer or Contract Variation letter of offer for a Medical Specialist.

44. However, section 45-205 of Schedule 1 to the TAA allows a quarterly payer to vary the instalment rate applied to instalment income by choosing a different instalment rate. As a result, SMOs who are quarterly payers will be able to vary the instalment rate applied to their instalment income to reflect that due to the pay over agreement, their net income for the relevant period will be nil.

45. It should be noted that under section 45-230 of Schedule 1 to the TAA the SMO will be liable for the general interest charge if the varied instalment rate is too low. However, the Commissioner may remit the general interest charge if satisfied that because of special circumstances, it is fair and reasonable to do so in accordance with section 45-240 of Schedule 1 to the TAA.

Private practice component received by SMO as part of their remuneration package

46. The Letter of Offer or Contract Variation letter of offer for a Medical Specialist outlines the two proposed methods by which an SMO will be compensated by the Hospital for paying over the billings generated by the SMO's services as a private practitioner.

47. In either case, these amounts are paid as remuneration for the discharge of services undertaken by the SMO in accordance with their employment contract and form part of the salary and wages of the SMO. As a result, these amounts are subject to PAYG withholding under section 12-35 of Schedule 1 to the TAA.

48. The private practice component received by the SMO as part of their remuneration package is assessable income of the SMO under section 6-5 of the ITAA 1997.

Appendix 2 – Detailed contents list

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References

Previous draft:

Not previously issued as a draft

Previous Rulings/Determinations:

CR 2006/24

Subject references:

- business expenses
- business income
- health professionals
- medical practitioners
- PAYG instalments
- PAYG withholding

- TAA 1953 Sch 1 12-35
- TAA 1953 Sch 1 45-15
- TAA 1953 Sch 1 45-110
- TAA 1953 Sch 1 45-120
- TAA 1953 Sch 1 45-120(1)
- TAA 1953 Sch 1 45-120(3)(a)
- TAA 1953 Sch 1 45-205
- TAA 1953 Sch 1 45-230
- TAA 1953 Sch 1 45-240
- TAA 1953 Sch 1 357-75(1)
- Copyright Act 1968
- South Australian Health Care Act 2008 (SA)

Legislative references:

- ITAA 1997
- ITAA 1997 6-5
- ITAA 1997 8-1
- ITAA 1997 17-5
- ITAA 1997 Div 35
- ITAA 1997 35-10(2)
- ITAA 1997 35-30
- ITAA 1997 35-35
- ITAA 1997 35-40
- ITAA 1997 35-45
- ITAA 1997 35-55
- TAA 1953
- TAA 1953 Sch 1 Div 12

Case references:

- AGC (Advances) Ltd v. Federal Commissioner of Taxation (1975) 132 CLR 175; 75 ATC 4057; 5 ATR 243
- Amalgamated Zinc (de Bavay's) Ltd v. Federal Commissioner of Taxation (1935) 54 CLR 295
- Service v. Federal Commissioner of Taxation (2000) FCR 265; [2000] FCA 188; 2000 ATC 4176; (2000) 44 ATR 71
- Taxation Case T44 86 ATC 366

ATO references

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