


# ***TD 2011/26EC - Compendium***

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## **Ruling Compendium – TD 2011/26**

This is a compendium of responses to the issues raised by external parties to draft TD 2011/D3 – Income tax: capital gains tax: will the Commissioner accept that the shares in a 'no goodwill' incorporated professional practice have a market value of nil when considering the application of subsection 116-30(1) of the Income Tax Assessment Act 1997 to an admission or exit of a practitioner-shareholder from the practice for no consideration?

This compendium of comments has been edited to maintain the anonymity of entities that commented on the draft ruling.

### **Summary of issues raised and responses**

| Issue No. | Issue raised  | ATO Response/Action taken   |
|-----------|---|---|
| 1         | <p><b><u>1. The scope of the TD is too limited</u></b></p> <ul style="list-style-type: none"> <li>- <b>Given the limited scope of the TD in its current form, this should be made abundantly clear in the draft TD.</b></li> </ul> <p><u>Related issues raised</u></p> <p>1.1 IT 2540 and the draft TD are only relevant to subsection 116-30(1) and are not intended to cover subsection 116-30(2) or the factual circumstances that give rise to an arm's length dealing. It is not intended that falling outside the scope of the TD should enliven a presumption that market value will be substituted. This distinction is not sufficiently clear in the TD. Given the limited scope intended by the draft TD in its current form, we suggest that this is made abundantly clear in the drafting of paragraph 13 and paragraph 13 should be given greater prominence.</p> <p>1.2 The draft TD should include a statement to the effect that the issue raised in the draft TD will only arise when the 'non-goodwill' company/partnership in fact has goodwill i.e. if the company/partnership has no goodwill, then the draft TD is of no relevance.</p> | <p>1.1 The concessions in IT 2540 and TD 2011/26 only apply to subsection 116-30(1) – see paragraph 14, however paragraph 5 has been inserted and clarifies that the approach on 116-30(1) does not adversely affect any analysis for the purposes of 116-30(2).</p> <p>1.2 All companies and partnerships have goodwill irrespective of whether it is ignored for the purposes of entry and exit of practitioners. IT 2540 and TD 2011/26 apply to professional practices that have goodwill but entering and exiting partners are not required to make a payment, or make an immaterial payment in respect of it.</p> |

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|           | <p>1.3 Is concerned that the TD describes its approach as an administrative practice, as the purpose of a public ruling is to outline the Commissioner's view on how a taxation law applies (section 358-5 of Sch 1 of the TAA), rather than to set out an administrative practice.</p> <p>1.4 If the treatment in the TD is retained in the final TD, we recommend that a discussion of the context and the Commissioner's basis for adopting its limited approach to accepting no-goodwill incorporation professional practices be included.</p> <p>1.5 Is limited in scope as it only deals with the implications of entry and exit of partners from a partnership. Specifically, it only deals with the entry of 'lateral partners' from other firms and does not consider the treatment of employee solicitors that are invited to become partners in an incorporated practice.</p> <p>1.6 The TD should be extended to cover non-corporate structures that are taxed as companies such as corporate limited partnerships.</p> <p>1.7 The requirement in paragraph 2(d) of the TD that the company adopts a constitution or shareholders agreement regulating admissions and surrenders/transfers of the shares in the company is not problematic. It should be clarified, however, that the agreement referred to in the second sentence of paragraph 4 of the TD is the constitution or shareholder agreement and not some separate agreement regarding the tax outcomes of dealings between them.</p> | <p>1.3 Agree – paragraph 3 of TD 2011/26 has been reworded to reflect the fact that the Commissioner is ruling based upon certain assumptions.</p> <p>1.4 Disagree – the context and limitations of the Commissioner's approach are set out in paragraph 3 of TD 2011/26.</p> <p>1.5 Consideration is being given to the development of ATO view material to address the treatment of employee share scheme issues.</p> <p>1.6 TD 2011/26 is limited to 'no goodwill' partnerships that incorporate. If it was considered that the approach should be extended to other non-corporate structures, separate ATO view products would be required.</p> <p>1.7 Agree- paragraph 3(d) of TD 2011/26 has been reworded.</p> |

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| 2         | <p><b><u>2. The TD attempts to narrow the scope of IT 2540 rather than expand its application to situations where professional practices incorporate</u></b></p> <ul style="list-style-type: none"> <li>- <b>The TD reflects a narrowing and not a clarification of IT 2540.</b></li> </ul> <p><u>Related issues raised</u></p> <p>2.1 The TD purports to express a view on when IT 2540 may be relied upon which is not apparent on the face of that ruling and which is not a view previously been expressed by the ATO – paragraphs 15 and 16 – i.e. that the approach in IT 2540 only applies to acquisitions/disposals of partnership interests by natural person practitioners who are active in the business.</p> <p>2.2 If the narrowing is the intended result this should only be done after further consultation and should only apply prospectively to professional practices commenced after the release of the finalised ruling.</p> <p>2.3 Paragraphs 16 and 17 of the TD attempt to restrict the application of IT 2540 to situations in which all of the 5 conditions outlined in paragraph 17 of the TD are satisfied. We find no support for any of these five conditions within the text of IT 2540.</p> | <p>2.1 Disagree: Whilst IT 2540 was written at a time when some professional industries could incorporate, they were not capable of practicing as partnerships which included entities other than natural person partners. Therefore, the limitation inherent in the professional practices addressed in the IT 2540 did not need to be apparent on the face of the IT 2540 because context mandates that limitation.</p> <p>As noted in paragraph 18 of TD 2011/26, IT 2540 only applies to acquisitions and disposals of partnership interests by natural person partners who are active in the business. This limitation was inherent in IT 2540 as it was written in 1989 which was a time when only natural persons could be partners in professional practices.</p> <p>2.2 Disagree – the limited application to natural person active practitioners has always been in place. Further consultation is not required.</p> <p>2.3 Disagree – paragraph 18 of TD 2011/26 sets out the restrictions on the application of the concessional treatment in IT 2540. Paragraph 19 merely extends the same conditions that existed in IT 2540 to a post incorporation environment.</p> |

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|           | <p>2.4 Very few partnership dealings would ever satisfy all 5 of the conditions in paragraph 17 of the TD.</p> <p>2.5 The final TD should explain the reasons why the Commissioner believed that the CGT treatment applicable to dealings in interests in professional partnerships should not always correspond with those applicable to incorporated professional practices rather than arguing that IT 2540 contains implicit restrictions that do not actually appear within IT 2540.</p> <p>2.6 The scope of application of the TD is unduly narrow and, as a result, may not reflect the appropriate paradigm or provide the certainty required the capital gains tax treatment of practitioners who practice through an ILP.</p> | <p>2.4 The ATO has taken into account all the comments received and considers that the conditions in total can be satisfied for some taxpayers.</p> <p>2.5 Disagree – given the ATO does not accept that the approach in IT 2540 to partnerships applies differently to the new TD on incorporation professional practices, no explanation of the alleged differences can be provided.</p> <p>2.6 The ambit of the TD has been extended and other ATO view products are being developed to address other issues associated with, and other means by which the practice can be exited.</p> |
| 3         | <p><b><u>3. The Commissioner has no basis for restricting the application of the TD to incorporated professional practices where only natural person practitioners can be shareholders</u></b></p> <ul style="list-style-type: none"> <li>- <b>There is no apparent basis for this restriction.</b></li> <li>- <b>This requirement inappropriately denies access to the administrative practice in circumstances outside of the control of the partner/shareholders or where a particular partner/shareholder has acted contrary to the constitution/shareholders agreement.</b></li> </ul>   |   |

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|           | <p>3.1 During the consultation it was indicated that the ATO concern is that there is a greater ability for income splitting in the incorporated environment and the TD (at paragraphs 4 and 19) thus wishes to limit the application of the ruling to situations where the individual beneficially owns the shares.</p> <p>3.2 In the absence of any suggestion of personal exertion income issues, a professional practice is thought to present an unacceptable risk to the revenue when it is using a common business structure available to all other businesses? The Commissioner should point to the specific provisions which in his view preclude the use of such structures.</p> <p>3.3 If the TD is to remain with such a condition attached, we consider the Commissioner should consider whether denying access to the administrative approach to all shareholders in all circumstances where an entity that is not a natural person practitioner becomes a shareholder will not be an appropriate sanction in all cases. For example:</p> <ul style="list-style-type: none"> <li>○ If despite being contrary to the constitution of a practice company and/or any shareholders' agreement, a natural person practitioner disposed of the beneficial interest in their shares to a family company without the knowledge of the practice company; or</li> <li>○ The family court ordered the transfer of some of the shares in a practice company to a spouse; or</li> <li>○ A partnership which "rolls over" into a corporate entity where some partners have pre-existing Everett assignment in place would no longer be able to access the concession as the subdivision 122-B rollover will require the shares in the company to be held in the same manner as the interests in the partnership.</li> </ul> | <p>3.1 Disagree- the ATO makes no comment on the use of various business structures by professional practices that incorporate. However, the ATO view in TD 2011/26 is limited to those arrangements that satisfy the conditions in paragraph 3.</p> <p>3.2 Disagree- the ATO makes no comment on the use of various business structures by professional practices that incorporate. However, the ATO view in TD 2011/26 is limited to those arrangements that satisfy the conditions in paragraph 3.</p> <p>3.3 After TD 2011/D3 is finalised consideration will be given to issuing other ATO view material to address these situations</p> <ul style="list-style-type: none"> <li>○ disposal to family company</li> <li>○ transfer pursuant to court order</li> <li>○ pre-existing Everett assignment, and</li> <li>○ rectification.</li> </ul> |

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|           | <p>3.4 Providing the practice company rectifies the situation within a reasonable period after receiving notice, shareholders who exit during the interim period should not be denied access to the administrative practice, or at most only the shareholder who has acted contrary to the TD should be sanctioned.</p> <p>3.5 There is no apparent legal or commercial basis for this requirement, other than a vague statement at paragraph 16 about the changes to the regulatory environment that has taken place since IT 2540 was issued. The discussion also does not discuss how those regulatory changes are relevant to the CGT principles outlined at paragraph 13 of IT 2540.</p> <p>3.6 As the market value of a share is a question of fact many taxpayers will find it difficult to understand (without further clarification) how the market value of a share in an incorporated professional practice can differ depending on the identity of the other shareholders.</p> | <p>3.4 Disagree – shareholders seeking protection from the actions of the other shareholders can ensure the shareholding arrangements provide the necessary protections.</p> <p>3.5 Disagree: IT 2540 was written at a time when although some professional industries could incorporate, they were not capable of practicing as partnerships which included entities other than natural person partners. Therefore, the limitation inherent in the professional practices addressed in the IT 2540 did not need to be apparent on the face of the IT 2540 because context mandates that limitation.</p> <p>As noted in paragraph 18 of TD 2011/26, IT 2540 only applies to acquisitions and disposals of partnership interests by natural person partners who are active in the business. This limitation was inherent in IT 2540 as it was written in 1989 which was a time when only natural persons could be partners in professional practices.</p> <p>3.6 Disagree – the TD concerns the limited circumstances in which the Commissioner will accept that the market value of the share is nil. In all other circumstances, the question of market value is one of fact.</p> |

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|           | <p>3.7 If the Commissioner is concerned about income splitting in a post incorporation environment, the Commissioner should explain why he has the opinion that structures that involve the interests in a professional practice being held by entities other than natural persons is inappropriate, especially given that other types of businesses may be structured in exactly the same manner without attracting the concern of the Commissioner. If the Commissioner believes entities other than natural persons holding shares in an incorporated environment facilitates income splitting, the Commissioner should apply appropriate provisions to the persons that choose to structure their shareholdings in that way, rather than adopt a different application of the market value substitution rule to all dealings in the company's shares.</p> <p>3.8 IT 2540 recognised that an individual partner could achieve income splitting through an Everett assignment and confirmed that the (so called) "concession" in IT 2540 would not apply to that partner (IT 2540 paragraph 29). Importantly however there is no impact on the "ebb and flow" treatment for remaining partners.</p> <p>3.9 There may be valid reasons for practitioners to transfer their shares to a related party which have nothing to do with income splitting. At the very least it is critical that the actions of one practitioner do not imperil the treatment of all the other practitioner shareholders. Any loss of the "concession" (so called) should be visited on that practitioner in relation to his or her shares, consistent with IT 2540.</p> | <p>3.7 Disagree- the ATO makes no comment on the use of various business structures by professional practices that incorporate. However, the ATO view in TD 2011/26 is limited to those arrangement that satisfy the conditions in paragraph 3 and only applies to those few professions where goodwill in the firm is disregarded.</p> <p>3.8 Disagree - Everett assignments still have their own CGT implications quite separate from the consideration of the market value of the goodwill/shares for the practitioner joining or leaving a no goodwill practice.</p> <p>3.9 It is agreed that there may be valid reasons why practitioners transfer shares to related parties however where such a transfer is undertaken, it will not attract the ATO view contained in TD 2011/26.</p> <p>After TD 2011/D3 is finalised consideration will be given to issuing other ATO view material to address these situations:</p> <ul style="list-style-type: none"> <li>○ disposal to family company</li> <li>○ transfer pursuant to court order</li> <li>○ pre-existing Everett assignment, and</li> <li>○ rectification.</li> </ul> |

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| 4         | <p><b><u>4. The Commissioner has no basis for restricting the application of the TD to incorporated professional practices where only active professional partners can be shareholders</u></b></p> <ul style="list-style-type: none"> <li>- <b>This restriction prevents professional practices from having strategic partners where there is a genuine desire to have a no goodwill arrangement.</b></li> </ul> <p>4.1 Natural person practitioner needs further clarification. Larger practices will often have “partners” who do not have direct client facing roles but are involved in the management of the business. It would be appropriate for these parties to be regarded as natural person practitioners although they do not fall with the normal use of the term.</p> <p>4.2 How does section 116-30 operate if paragraph 19 applies? For example, if the practice admits a strategic shareholder, such as someone who brings in considerable work to the practice but is not a practitioner, and in return receives a share of the profits. Additionally, the integrity of the no goodwill arrangement is preserved and there is a shareholders agreement in place that provides only subscription money to be returned on exit. In this situation why does the TD not apply when there is no change in the integrity of the arrangements?</p> <p>4.3 In the circumstances described above, if the TD cannot be relied on then you have to apply section 116-30, which provided the agreement is clear would return the same nil value result. How does the determination provide a different result?</p> | <p>4.1 Agree – paragraph 18 of TD 2011/26 now includes a definition of ‘active partner’.</p> <p>4.2 Agree – paragraph 18 of TD 2011/26 now includes a definition of ‘active partner’.</p> <p>4.3 Disagree - where the ATO view in TD 2011/26 cannot be relied upon, the market value of goodwill is a question of fact and in the context of a professional practice this would be unlikely to be nil.</p> |

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|           | <p>4.4 Partnerships have various organisational models, including arrangements where some partners are engaged full time in administration and practice development. There is no warrant for treating ILPs or their shareholders with these kinds of arrangements any differently.</p>   | <p>4.4 Agree – paragraph 18 of TD 2011/26 now includes a definition of ‘active partner’.</p>   |
| 5         | <p><b><u>5. The TD should be expanded to cover situations where professional practices have employee share acquisition schemes or are subject to a share buyback</u></b></p> <ul style="list-style-type: none"> <li>- <b>If shares in a no goodwill company are regarded as having a nil market value in the circumstances described in the TD then this view should apply to all situations within the Acts where valuation issues would arise; including but not limited to, employee share scheme rules and the share buy back rules.</b></li> </ul> <p>5.1 Practice companies are usually arranged so shares are issued and redeemed on entry and exit as opposed to shares being sold between shareholders. The introduction of employees to equity in such entities should not trigger tax liabilities for such employees.</p> <p>5.2 The exit of partner/shareholders via a share buyback arrangements should not trigger deemed dividends or other adverse consequences under the buyback rules.</p> | <p>5.1 Consideration is being given to the production of ATO view material to address the treatment of employee share scheme and share buyback issues.</p> <p>5.2 Consideration is being given to the production of ATO view material to address the treatment of share buy-back transactions.</p> |

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|           | <p>5.3 In this respect the distinction drawn by the Commissioner that the TD is intended to apply to section 116-30(1) but not section 116-30(2), is not replicated in the employee share scheme provisions nor in the buyback provisions. In both set of provisions, the legislation refers to the market value of particular shares without the distinction between those situations where no consideration is paid and those where some consideration is paid between parties dealing at arm's length (see e.g. sections 159GZZZQ(2) ITAA 1936 and 83A-110(1) ITAA 1997).</p> <p>5.4 An approach analogous to that taken by the Commissioner in CR 2004/42 would appear to be appropriate i.e. that under certain conditions the market for the share is limited and that where a price is stipulated by documents relating to that market, the market value of the share will be taken to be so stipulated.</p> <p>5.5 The market value of the shares in an incorporated professional practice is also relevant for the purposes of the employee share scheme rules in Division 83A of the ITAA 1997 and the off-market share buyback rules in Div 16K of the ITAA 1936.</p> | <p>5.3 The ATO view in IT 2540 and TD 2011/26 only apply to subsection 116-30(1) – see paragraph 14.</p> <p>5.4 Disagree – the Commissioner does not accept that the parties' price necessarily determines the market value.</p> <p>5.5 Consideration is being given to the production of ATO view material to address the treatment of employee share scheme and share buyback issues.</p> |

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|           | <p>5.6 If the market value of shares in a no goodwill incorporated professional practice issued and redeemed on the admission and exit of shareholder/principals could be taken to be higher than the amount of permissible consideration under the constituent documents and/or shareholder agreement, the outcomes under the employee share scheme provisions and the off-market share buyback provisions will be unsatisfactory, given that in a no goodwill practice the market value of the share can never actually be realised by the shareholder/principal. This would result in the taxation system presenting a serious barrier both to the admission and retirement of shareholder/principals.</p> <p>5.7 The final determination should be expanded to cover these issues, and specifically to accept that if the shares in a no goodwill practice are taken to have a nil (or nominal) market value for CGT purposes within the terms of the final TD, then a similar value should apply for other provisions – especially Div 83A of the ITAA 1997 and Div 16K of the ITAA 1936.</p> <p>5.8 A similar, pragmatic approach to CR 2004/42 should be adopted, which in the context of the employee share scheme rules under former Div 13A ITAA 1936 accepted that the market value of shares could be limited to the amount stipulated in the constituent documents.</p> | <p>5.6 Consideration is being given to the production of ATO view material to address the treatment of employee share scheme and share buyback issues.</p> <p>5.7 Consideration is being given to the production of ATO view material to address the treatment of employee share scheme and share buyback issues.</p> <p>5.8 Disagree – the Commissioner does not accept that the parties' price necessarily determines the market value.</p> |

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|           | <p>5.9 Transfers from an outgoing to incoming practitioner shareholder are unlikely to be regular occurrence in the medium to larger legal firms to which the TD is most likely to apply. Rather the likely scenario is an issue of shares to new practitioner shareholders, and a buyback or capital reduction of the shares held by existing practitioner shareholders, occurring at different points in time. These situations raise their own market value deeming issues which should be covered.</p> <p>5.10 New partners come from two sources, internal “promotions” of senior associates and lateral recruits being associates or partners from other firms. Further once the firm incorporates the status of its “partners” will change, and they will become employees (whether or not separately remunerated for their services). While the TD addresses the transfer of shares to a lateral practitioner shareholder, the provision of shares to an employee of a company potentially brings the operation of Div 83A of the ITAA 1997 into play. Ignoring any deferral, where the division applies, section 83A-25 would tax an employee on the difference between the market value of the shares received and the consideration paid for it.</p> <p>5.11 If the market value of shares in an ILP for the purposes of Div 83A is not addressed, then it would potentially result in any employees being taxed on the market value of those shares even though when that person later exits the practice, he or she will not receive any consideration. It is unlikely that any employee would be willing to join a legal practice on this basis. It may also hamper any changes in the equity entitlements of existing practitioner shareholders, which is now a common occurrence in large legal partnerships.</p> | <p>5.9 Consideration is being given to the production of ATO view material to address the treatment of share buy-back transactions.</p> <p>5.10 Consideration is being given to the production of ATO view material to address the treatment of employee share scheme issues.</p> <p>5.11 Consideration is being given to the production of ATO view material to address the treatment of employee share scheme issues.</p> |

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|           | <p>5.12 What is the ATO position on part of a partner's share of profit being replaced by a salary post incorporation? Will employees be required to pay arm's length salaries or what was previously a partner's profit share now to be paid as a dividend?</p> <p>5.13 An issue in relation to the application of the employee share scheme rules in Div 83A of the ITAA 1997 is whether an employee has received a discount under the ESS – that discount being determined by reference to the market value of the interest acquired less the consideration paid by the employee for the interests.</p> <p>5.14 Where the analysis turns on whether interests in a company are issued, or bought back, or rights in those interests are changed, at less than market value there may be implications for the value shifting rules in Div 725 of the ITAA 1997.</p> | <p>5.12 The ATO has no view on whether dividends or salaries should be paid.</p> <p>5.13 Consideration is being given to the production of ATO view material to address the treatment of employee share scheme issues.</p> <p>5.14 The taxation outcome of these types of arrangements will depend upon the facts and are outside the scope of TD 2011/26.</p> |
| 6         | <p><b><u>6. The TD will have no practical application as all practices holds assets other than goodwill</u></b></p> <ul style="list-style-type: none"> <li>- <b>The requirement results in the TD having no practical application. At a minimum practice entities will hold such assets as debtors, WIP and cash at bank.</b></li> </ul> <p>6.1 A practice entity may own shares in a range of corporate entities which for part of their broader business e.g. corporate trustees of a service entity, a company with an Australian Financial services licence needed for certain types of work.</p>   | <p>6.1 Agree – paragraphs 3 and 20 of TD 2011/26 have been reworded.</p>   |

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|           | <p>6.2 Unrecorded intangible assets, such as trade marks, trading names and other intellectual property are likely to exist.</p> <p>6.3 Paragraph 2(c) of the draft TD should be modified to recognise the broader concept of practice assets. Without this modification it may be perceived that the Commissioner is lacking an understanding of the operation of professional services businesses.</p> <p>6.4 It is appropriate to extend the concession where the company holds these other assets which have an inherent and unbreakable link to the goodwill of the practice.</p> <p>6.5 As a result of ATO view on service entities (TR 2006/2), professional practices have transferred activities and assets previously held by service entities back into the partnership or incorporated company practice. No indication was given that this would lead to loss of the tax treatment contained in IT 2540. Partners should not be punished for responding to ATO initiatives in other areas.</p> <p>6.6 By excluding the ability to hold other assets in para 2(c) the ATO commercially restricts a professional practice operating through a single entity structure. That is, if the professional practice introduces to the company structure the assets typically associated with a service entity, the company will be excluded from the operation of the draft TD.</p> | <p>6.2 Agree – paragraphs 3 and 20 of TD 2011/26 have been reworded.</p> <p>6.3 Agree – paragraphs 3 and 20 of TD 2011/26 have been reworded.</p> <p>6.4 Agree – paragraphs 3 and 20 of TD 2011/26 have been reworded.</p> <p>6.5 Agree – paragraphs 3 and 20 of TD 2011/26 have been reworded.</p> <p>6.6 Agree – paragraphs 3 and 20 of TD 2011/26 have been reworded.</p> |

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|           | <p>6.7 Even practices that use service entities will hold assets such as cash at bank, work in progress and debtors. The practice will also hold a range of intangible assets that may or may not be recorded on the balance sheet.</p> <p>6.8 The requirement that the company hold no assets other than goodwill seems to imply that the Commissioner believes that goodwill is an asset that can exist on its own, which is contrary to <i>FCT v Murray</i> 98 ATC 4585 and TR 1999/16.</p> <p>6.9 Existing partnerships will have assets other than goodwill. These will ordinarily be practice related assets such as contractual rights (particularly under legal retainers), work in progress and debtors. Although most partnerships would not own office equipment of the like (which is usually held in a service entity) it is not necessarily universal.</p> <p>6.10 At the very least the practice will have work in progress and debtors. It may also be the case that assets such as business premises, fit-out of business premises, furniture and fittings, cash on hand or at bank, contractual rights and office equipment may be owned by the professional practice.</p> <p>6.11 In the case of a practice that has operations overseas, which is becoming increasingly common, it may be shares held in overseas operating entities or that assets are held in overseas jurisdictions.</p> | <p>6.7 Agree – paragraphs 3 and 20 of TD 2011/26 have been reworded.</p> <p>6.8 Agree – paragraphs 3 and 20 of TD 2011/26 have been reworded.</p> <p>6.9 Agree – paragraphs 3 and 20 of TD 2011/26 have been reworded.</p> <p>6.10 Agree – paragraphs 3 and 20 of TD 2011/26 have been reworded.</p> <p>6.11 Agree – paragraphs 3 and 20 of TD 2011/26 have been reworded.</p> |

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|           | <p>6.12 The fact that some assets are held by a no goodwill professional practice as a necessary consequence of the undertaking of its business, should not prevent any dealing with the shares (or other interests) in that professional practice being treated as at arm's length. As indicated at paragraph 13 of the draft determination, if some value is placed the interest to reflect what, if any, value may be in the underlying assets, then on the basis that the parties are dealing at arms length, that value should be respected for CGT purposes.</p>   | <p>6.12 Agree – paragraphs 3 and 20 of TD 2011/26 have been reworded.</p>  |
| <p>7</p>  | <p><b><u>7. It is unclear how the TD will apply to professional practices whose balance sheet reflects a value for goodwill even though no payment is made or received for goodwill by entering or exiting partners</u></b></p> <ul style="list-style-type: none"> <li>- <b>The Commissioner should clarify this requirement as it is currently too imprecise to have practical application.</b></li> </ul> <p>7.1 The paid up capital is not a proxy for the value of goodwill. The accounting entries recorded by a company in relation to its transactions have no relevance to the issue in the draft TD.</p> <p>7.2 A no goodwill practice company can acquire other “goodwill” practices and will record a value for goodwill in its balance sheet, whilst remaining a “no-goodwill” practice as the term is generally understood.</p> | <p>7.1 Agreed – as long as the entering and existing of partners is reflective of the ebb and flow of the practice, the ATO view in TD 2011/26 will apply.</p> <p>7.2 Agreed – paragraphs 3 and 20 of TD 2011/26 have been reworded.</p> |

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|           | <p>7.3 Unsure as to the meaning of “kept intact”. The coming and going of partner shareholders may involve the issue and redemption of shares. Can it be confirmed that this would not be seen to be impinging on this requirement.</p> <p>7.4 In the context of the <i>Corporations Act</i> the reference to “paid up capital” should perhaps be “share capital”, if it needs to be present at all.</p> <p>7.5 This requirement does not make sense, as a company’s paid up capital or share capital usually bears no relationship to the value or existence of goodwill in any event.</p> | <p>7.3 Agreed – TD 2011/26 is an ATO view which is limited to practices that satisfy the conditions in paragraph 3.</p> <p>7.4 Agreed – wording changed to ‘share capital’.</p> <p>7.5 Agree – paragraphs 3 and 20 of TD 2011/26 have been reworded.</p> |
| 8         | <p><b><u>8.1 The TD should accept that all dealings between professional partners are on an arms length basis and the TD should therefore be expanded to cover situations where either</u></b></p> <ul style="list-style-type: none"> <li>- <b><u>no consideration is paid for goodwill,</u></b></li> <li>- <b><u>nominal consideration is paid for goodwill, or</u></b></li> <li>- <b><u>goodwill is recognised using a set formula</u></b></li> </ul>   | <p>8.1 Disagree – TD 2011/26 is not a ruling on ‘arm’s length dealings’ however paragraph 5 has been inserted addressing circumstances where some consideration is paid.</p>   |

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|           | <p><b>8.2 The TD should be expanded to cover subsection 116-30(2)</b></p> <ul style="list-style-type: none"> <li>- <b>In many cases, dealings in shares in an incorporated professional practice will be for a nominal amount of consideration, therefore subsection 116-30(1) is often in applicable. The TD should be expanded to cover subsection 116-30(2) so as to provide more practical guidance on when dealings in the shares of a no goodwill incorporated professional practice are on an arm’s length basis – consistent with the guidance provided in IT 2540.</b></li> </ul> <p>8.3 Paragraph 13 of IT 2540 is clearly relevant to subsection 116-30(2) of the ITAA 1997, given its clear reference to “any consideration”, as opposed to nil consideration) being accepted for CGT purposes, provided that the partners are dealing at arm’s length (arm’s length dealing being an issue that is relevant for subsection 116-30(2), not for subsection 116-30(1)).</p> <p>8.4 Paragraph 18 appears to be incorrect where it states that provided the conditions in paragraph 2 are satisfied “...any consideration paid or received on the acquisition or disposal of a share or shares in an incorporated practice will be used for Part 3-1 purposes in determining the cost base or capital proceeds of those shares.” This statement cannot be correct in the context of the TD which is limited in scope to 116-30(1) – because if any consideration is provided for the shares, subsection 116-30(1) cannot apply. Taxpayers therefore cannot rely on the statement in paragraph 18 for guidance on the application of subsection 116-30(2) as it falls outside the binding section of the TD.</p> | <p>8.2 Agree – paragraph 5 has been inserted addressing circumstances where some consideration is paid.</p> <p>8.3 Agree – paragraph 5 has been inserted addressing circumstances where some consideration is paid.</p> <p>8.4 Agree – paragraph 5 has been inserted addressing circumstances where some consideration is paid.</p> |

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|           | <p>8.5 While it is recognised that the constitution or shareholder agreement might provide that “no or an immaterial payment is to be made for acquiring a share, disposing of a share or any change to the profit distribution entitlements attached to a share in the company” (paragraph 2(e)), the determination itself is limited to situations where “no amount is received as capital proceeds or paid as a cost base” (paragraph 2(e)).</p> <p>8.6 The determination only addresses section 116-30(1) of the ITAA 1997 and issues of market value do not arise where consideration is received – provided parties are dealing at arm’s length (section 116-30(2) ITAA 1997). At the consultation it was suggested that, while it would generally be accepted that practitioners entering and exiting a legal practice on a ‘no goodwill’ basis are dealing at arms length, neither IT 2540 nor the proposed determination would specifically address whether or not that is the case.</p> <p>8.7 If the TD were to discuss the CGT provisions more holistically, then it will be apparent that there are situations where market value can be deemed even though consideration is paid and/or parties are dealing at arm’s length. In this regard, section 159GZZZQ of the ITAA 1936 provides that in determining the consideration for a buy-back (including for the purposes of parts 3-1 and 3-3 of the ITAA 1997), the seller is taken to have received an amount equal to the market value of the share if the purchase price less than that amount. Likewise, section 116-30 of the ITAA 1997 provides for the market value consideration to be imputed in relation to the cancellation of shares in the context of CGT event C2.</p> | <p>8.5 Clarification is provided by new paragraph 5 addressing circumstances where some consideration is paid.</p> <p>8.6 Clarification is provided by new paragraph 5 addressing circumstances where some consideration is paid.</p> <p>8.7 Disagree – the ATO does not accept that provisions that operate on a different basis to the CGT rules can assist with the interpretation of how the CGT provisions apply.</p> |

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|           | <p>8.8 The “concession” (so called) could properly be recast in the following terms:</p> <p>“A dealing in shares between shareholders in an incorporated professional practice, or between a shareholder and the incorporated professional practice, but for which no or a nominal amount is paid or received, is accepted as being arm’s length (unless there are circumstances which indicate the contrary) and the market value of such shares in nil (where nothing is paid or received) or the nominal amount (where a nominal amount is paid or received).</p> <p>8.9 Recognition of goodwill using set formula. Some partnerships, particularly small to medium practices, recognise goodwill using a set formula. This ought to be accepted by the ATO as being an arm’s length dealing that reflects market value.</p> | <p>8.8 Clarification is provided by new paragraph 5 addressing circumstances where some consideration is paid.</p> <p>8.9 Clarification is provided by new paragraph 5 addressing circumstances where some consideration is paid.</p> |