


***TD 2011/D10 - Income tax: When considering the application of subsection 159GZZZQ(2) of the Income Tax Assessment Act 1936 to an exiting vendor practitioner-shareholder by a 'no goodwill' incorporated professional practice, will the Commissioner consider that the buy-back price is less than the market value of the shares merely because the price is calculated not to reflect the underlying goodwill of the company?***

 This cover sheet is provided for information only. It does not form part of *TD 2011/D10 - Income tax: When considering the application of subsection 159GZZZQ(2) of the Income Tax Assessment Act 1936 to an exiting vendor practitioner-shareholder by a 'no goodwill' incorporated professional practice, will the Commissioner consider that the buy-back price is less than the market value of the shares merely because the price is calculated not to reflect the underlying goodwill of the company?*

This document has been Withdrawn.  
There is a [Withdrawal notice](#) for this document.



---

## Draft Taxation Determination

---

Income tax: When considering the application of subsection 159GZZZQ(2) of the Income Tax Assessment Act 1936 to an exiting vendor practitioner-shareholder by a ‘no goodwill’ incorporated professional practice, will the Commissioner consider that the buy-back price is less than the market value of the shares merely because the price is calculated not to reflect the underlying goodwill of the company?

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

This publication is a draft for public comment. It represents the Commissioner’s preliminary view about the way in which a relevant taxation 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.

You can rely on this publication (excluding appendixes) to provide you with protection from interest and penalties in the following way. If a statement turns out to be incorrect and you underpay your tax as a result, you will not have to pay a penalty. Nor will you have to pay interest on the underpayment provided you reasonably relied on the publication in good faith. However, even if you don’t have to pay a penalty or interest, you will have to pay the correct amount of tax provided the time limits under the law allow it.

### **Ruling**

1. No, the Commissioner will accept in calculating the market value of the share in applying subsection 159GZZZQ(2) of the *Income Tax Assessment Act 1936* (ITAA 1936),<sup>1</sup> that the goodwill of the company can be taken to have no value.
2. This approach will apply only for dealings done at arm’s length for admissions to, and exits from, the professional practice by practitioners. Associated transfers, buy-backs and cancellations of shares in the company must occur in the natural ‘ebb and flow’ of natural person practitioner-shareholders into and out of the company and the circumstances of the firm and all the practitioner-shareholders must accord with the approach explained in this Determination.

---

<sup>1</sup> All legislative references are to the ITAA 1936 unless otherwise indicated.

3. Where a 'no goodwill' professional partnership has incorporated or a new 'no goodwill' incorporated professional practice has commenced, the following features must be displayed by the incorporated professional practice (the company) in order for it to qualify as a 'no goodwill' company for the purposes of this draft Determination:

- (a) The original shareholders in the company are all natural person practitioners who previously held a fractional interest in the 'no goodwill' partnership prior to the restructure (or would have been eligible to hold a fractional interest had the practice first operated as a partnership);
- (b) The provision of a share or shares to the practitioner shareholder at the time of incorporation and in the post-incorporated environment must be reflective of that person's status as an active practitioner in the practice and must be held by that person both legally and beneficially;
- (c) The company is a proprietary limited company that adopts a constitution or shareholder agreement, or both, that regulates the basis
  - for admission to shareholding; and
  - buy-back, cancellation or transfer of shares in the company; and
  - the amount that is paid for it; and
  - all the shareholders agree to be bound by it; and
- (d) The constitution or shareholder agreement, or both, provide that any share dealing effecting practitioner-shareholders joining or leaving the practice will be attended by an amount of consideration (including possibly nil consideration) calculated on the basis that the value of the goodwill of the company is nil.

4. The Commissioner will accept, in a post-incorporation context in an off-market share buy-back under the *Corporations Act 2001*, an approach analogous to the approach already provided for in *Taxation Ruling IT 2540 Income tax: capital gains: application to disposals of partnership assets and partnership interests*. However this approach will be limited to dealings involving shares in incorporated professional practices which faithfully mirror the same proportional underlying economic ownership transactions and relationships that would have attracted the approach taken in IT 2540 in relation to professional practice partnerships.

**Example**

5. *Professional Practice Co II Pty Ltd is an incorporated professional practice which does not require the practitioner-shareholders to pay a price on admission to the firm that relates to the goodwill of the company, and does not pay any amount to practitioner-shareholders leaving the firm, that relates to the goodwill of the company. Although the practice does not recognise goodwill in dealings between practitioners on admission to and exit from the practice, the firm has goodwill with a value of \$500,000. At the time of the relevant transactions, the firm has other assets of work-in-progress and cash-at-bank with a value of \$200,000. On 1 July 2011 two practitioner-shareholders retire and their shares are bought-back by the company and cancelled, as part of an off-market share buy-back. The buy-back price for the shares is calculated taking into account the value of the other assets, but without regard to the value of the firm's goodwill, consistent with the firm's status as a 'no-goodwill' incorporated professional practice. The Commissioner will accept for the purposes of subsection 159GZZZQ(2) that the buy-back price of the shares (calculated taking into account the value of the other assets) is not less than the market value of the shares.*

**Date of effect**

6. When the final Determination is issued, it is proposed to apply both before and after its date of issue. However, the Determination will 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 Determination (see paragraphs 75 to 77 of Taxation Ruling TR 2006/10).

---

**Commissioner of Taxation**26 October 2011

---

## Appendix 1 – Explanation

**①** *This Appendix is provided as information to help you understand how the Commissioner's preliminary view has been reached. It does not form part of the proposed binding public ruling.*

### Professional practices

7. Professional partnerships are traditionally structured in one of two ways, either recognising goodwill or not recognising goodwill in determining whether practitioners have to pay to join the practice. Where a professional partnership recognises goodwill, a newly admitted partner is usually required to pay a purchase price for the acquisition of an interest in the partnership goodwill. When a partner leaves the partnership and their interest is sold either to a newly admitted partner or to the remaining partners, the exiting partner would usually be entitled to receive a payment for their share of the partnership goodwill.

8. 'No goodwill' professional partnerships are often larger partnerships which can have memberships numbering in the hundreds. In these cases, the partners agree that when a new partner is admitted into the partnership the new partner is not required to pay a purchase price for the acquisition of an interest in the partnership goodwill. When the partner leaves the partnership and their interest is sold either to a newly admitted partner or to the remaining partners, the exiting partner would not be entitled to receive a payment for their share of the partnership goodwill.

9. The ATO understands that restrictions have been removed in some professions and professional practitioners are able to incorporate and run their practice through a company. As a result, practitioners may choose to start up as an incorporated professional practice or replicate their 'no goodwill' professional partnership arrangements when restructuring into an incorporated professional practice.

10. By incorporating a professional partnership which replicates a 'no goodwill' professional partnership, a new shareholder in a 'no goodwill' incorporated professional practice would not be required to pay an amount for the shares that reflects merely any underlying goodwill in the company. Similarly, an outgoing shareholder would not be entitled to receive a payment for the shares reflecting the value of goodwill when those shares are bought-back and cancelled by the company.

### Dealings of interests in professional practices

11. A 'no goodwill' professional practice can incorporate from a 'no goodwill' professional partnership or it can incorporate (as a new practice) as a start-up 'no goodwill' company. After incorporation dealings in the shares occur from the natural 'ebb and flow' of practitioner-shareholders into and out of the company. That is, the addition, retirement or expulsion of a practitioner-shareholder from the practice by way of issue, buyback, transfer or cancellation of shares in the company.

12. When a no-goodwill professional partnership restructures into a proprietary limited company, a taxing point will normally arise. Under Subdivision 122-B of the *Income Tax Assessment Act 1997* the former partners may choose rollover relief from possible taxation consequences (in prescribed conditions) where they maintain their proportional underlying economic ownership of the former partnership assets in the company by way of shares equivalent in value to the partnership interests they give up.

13. This Determination is one of three addressing the taxation implications of dealings in shares in incorporated 'no goodwill' professional practices from the natural 'ebb and flow' of natural person practitioner-shareholders into and out of the company, including the Capital Gains Tax (CGT) implications (TD 2011/26) and employee share scheme implications from the issue of shares to employees (TD 2011/D9). The TD does not cover issues associated with the incorporation itself or any other type of restructure of the practice.

### **Division 16K**

14. Division 16K of Part III was enacted in 1990 to deal with changes to the *Corporations Law* that permitted companies to buy-back their own shares.

15. Division 16K applies where a company buys a share in itself from a shareholder. If the share is listed on the stock exchange and the purchase is made in the ordinary course of business of that stock exchange, the buy-back will be an on-market purchase. All other buy-backs are treated as off-market purchases. As the arrangement under contemplation in this draft Determination concerns the buy-back, transfer and cancellation of shares held by natural person practitioners of the proprietary limited incorporated practice, the buy-back will be an off-market share buy-back.

16. The purchase price paid by the company to the shareholder is the amount of money and the value of other property (if any) the shareholder receives as consideration for the buy-back: section 159GZZZM .

17. In an off-market buy-back of shares the difference between the purchase price and the part of the purchase price in respect of the buy-back which is debited against the company's share capital account is taken to be a dividend paid by the company to the seller, as a shareholder in the company out of profits derived by the company on the day the buy-back occurs: section 159GZZZP. Franking credits may be available in respect of that dividend.

18. The balance (being the amount debited against the company's share capital account) will be taken to be a return of capital and will determine both the CGT position of the seller and, for assessable profits or deductible losses, the amount of that gain or loss: section 159GZZZQ. That is, the consideration for CGT purposes and for shares held on revenue account is determined having regard to whether there is a 'reduction amount' for the purposes of subsection 159GZZZQ(3). Ordinarily, that amount is the part of the purchase price that is taken to be a dividend in accordance with section 159GZZZP.

19. A special rule in subsection 159GZZZQ(2) applies where the purchase price in respect of a share in an off-market share buy-back is **less** than the amount that would have been the market value of the share at the time of the buy-back if the buy-back did not occur, and was never proposed to occur. In such cases the market value of the share, at the time of the buy-back if the buy-back did not occur and was never proposed to occur, is taken to be the consideration in respect of the sale of the share. In effect, the amount of the deemed increase is taken to be a capital receipt and alters the CGT position of the seller – usually decreasing the capital loss otherwise available. Likewise, the amount of any assessable revenue gain would be increased, and any deductible loss decreased, by the difference between the actual consideration and the substituted amount.

20. The object of the special rule is to exclude the distortionary effect of the buy-back on the share's value for tax purposes by providing that the consideration the shareholder is taken to have received for tax purposes is not to be affected in any way by the share buy-back. As such, subsection 159GZZZQ(2) is an acknowledgement that a buy-back can affect the value of the share being bought back.

### **Post-incorporation**

21. Where a 'no goodwill' incorporated professional practice satisfies the conditions described in the Ruling Section of this Determination, the Commissioner's post-incorporation approach will apply and the Commissioner will accept for the purposes of determining whether the buy-back price is less than the market value of the share, that the buy-back price is not to be taken to be less than the market value of the share merely because the buy-back price is calculated not to reflect the underlying goodwill of the company, irrespective of the actual value of the goodwill. Consistent with paragraph 13 in IT 2540, any consideration paid or received on the acquisition or disposal of a share or shares in an incorporated professional practice will generally be used for Division 16K purposes. This will mean that in the case of a 'no goodwill' incorporated professional practice where the approach described in paragraphs 3 and 4 of this Determination applies, the market value of the share will be accepted as being nil where nothing is paid in respect of underlying goodwill, and any other assets of the company have a nil or negligible value.

22. In circumstances where the 'no goodwill' incorporated professional practice has assets of value other than goodwill and therefore consideration is received on the buy-back of shares, the Commissioner would not conclude that the buy-back price in respect of the off-market share buy-back is less than the market value of share, merely because the consideration for the shares is diminished to the extent of the value of the goodwill which is not recognised between the company and the practitioner-shareholders.

23. Where the incorporated professional practice does **not** satisfy the conditions described in paragraph 3 of this Determination, the Commissioner's post-incorporation approach cannot be applied. All shareholders of the incorporated professional practice will cease to benefit from this approach as a consequence when an entity other than a natural person practitioner acquires a share or shares in that company. The approach will not apply in respect of any dealings in the shares of that company for any period during which even one share is held whether legally or beneficially otherwise than in the way described.

24. *Note: On 12 May 2009, the then Assistant Treasurer and Minister for Competition Policy and Consumer Affairs announced the Government's intention to introduce amendments to the off-market share buyback provisions in response to a Board of Taxation review. He announced that an exposure draft of the legislation will be released for consultation on the Treasury website after consulting on the design of these amendments [Assistant Treasurer and Minister for Competition Policy and Consumer Affairs Press Release 048]. This ruling deals only with the laws as presently enacted and does not extend to the application of those proposed laws.<sup>2</sup>*

---

2

<http://www.dpm.gov.au/DisplayDocs.aspx?doc=pressreleases/2009/048.htm&pageID=003&min=ceb&Year=&DocType=0>

---

## **Appendix 2 – Your comments**

---

25. You are invited to comment on this draft Determination. Please forward your comments to the contact officer by the due date.

26. A compendium of comments is also prepared for the consideration of the relevant Rulings Panel or relevant tax officers. An edited version (names and identifying information removed) of the compendium of comments will also be prepared to:

- provide responses to persons providing comments; and
- publish on the ATO website at [www.ato.gov.au](http://www.ato.gov.au)

Please advise if you do not want your comments included in the edited version of the compendium.

**Due date:** 25 November 2011  
**Contact officer:** Stuart Ducat  
**Email address:** [stuart.ducat@ato.gov.au](mailto:stuart.ducat@ato.gov.au)  
**Telephone:** (02) 6216 1380  
**Facsimile:** (02) 6216 1247  
**Address:** Australian Taxation Office  
PO Box 9977  
Canberra ACT 2601



## References

---

*Previous draft:*

Not previously issued as a draft

*Related Rulings/Determinations:*

IT 2540, TR 2006/10, TD 2011/26,  
TD 2011/D9

*Subject references:*

- cancellation & redemption of securities
- capital gains
- CGT assets
- CGT capital proceeds modification market value substitution rule
- CGT cost base modification market value substitution rule
- CGT event A1 – disposal of a CGT asset
- dividend income

- CGT rollover relief
- CGT replacement asset rollover
- nominal consideration
- partnership restructuring
- purchase of assets
- share buy backs

*Legislative references:*

- ITAA 1936 Pt III Div 16K
- ITAA 1936 159GZZZM
- ITAA 1936 159GZZZP
- ITAA 1936 159GZZZQ
- ITAA 1936 159GZZZQ(2)
- ITAA 1936 159GZZZQ(3)
- ITAA 1997 Subdiv 122-B
- Corporations Act 2001

---

ATO references

NO: 1-3IXUF6F

ISSN: 1038-8982

ATOlaw topic: Income Tax ~~ Entity specific matters ~~ share buy-backs