IT 2494 - Income tax : cars and other fringe benefits supplied to employee/partners of administration entities

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TAXATION RULING NO. IT 2494

INCOME TAX : CARS AND OTHER FRINGE BENEFITS SUPPLIED TO EMPLOYEE/PARTNERS OF ADMINISTRATION ENTITIES

F.O.I. EMBARGO: May be released

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REFERENCE NO:	SUBJECT REFS:	LEGISLAT. REFS:
I 1010799	PROFESSIONAL PARTNERSHIPS	23F 82KT - 82KZA
	SERVICE, ADMINISTRATION AND PRACTICE	260 PART IVA
	COMPANIES AND TRUSTS	
	SUBSTANTIATION	

PREAMBLE This Ruling considers whether it is acceptable for income tax purposes for administration entities set up to provide administration services to professional practices to provide cars and other fringe benefits to employee/partners i.e., employees of the administration entity who are also partners in the professional practice entity. The same question arises with combined administration/service entities.

2. To avoid any confusion or misunderstanding it is proposed to briefly define what is normally meant by the terms service entity, administration entity and practice entity.

3. The case of FC of T v Phillips 78 ATC 4361; 8 ATR 783 illustrates what is ordinarily meant by a service entity. It is often a family company or trust that is created to handle the provision of premises, plant, equipment, clerical services and so on to a professional practice. Where the service arrangement is a commercially realistic one, it is accepted for income tax purposes. It is important to note that an ordinary service entity does not employ the practitioners nor provide their services to the professional practice to carry out duties that the practitioners are required to carry out under the terms of the practice agreement.

4. Then there are administration entities. These operate in association with professional partnerships. An administration company or trust may be set up to provide the administrative services of the partners to the partnership. The partnership pays to the administration company or trust an appropriate amount for the administrative services of the partners plus an amount necessary to provide for superannuation benefits in respect of the partners' administration salaries.

5. Administration entities are a somewhat artificial arrangement. Under the partnership agreement the partners could

well be required to perform the administrative duties for the partnership which are claimed to be transferred to the administration entity. Notwithstanding this, administration entities were put forward, and accepted, some years ago for the sole purpose of enabling employee/partners access to superannuation benefits available under the former section 23F.

6. The administration entity pays the employee/partners' salaries commensurate with the administrative/managerial services provided by them to the professional partnership and this provides the basis for the calculation of superannuation benefits. In the generality of cases, the salary is only a fraction of what the practitioner might otherwise receive as a distribution of practice profits. The fee for the administrative services generates neither a profit nor a loss in the administration entity. The net result is that the practitioner's taxable income is reduced only by the amount of the superannuation contribution, a result which of itself and without more, would not lead to a consideration of whether section 260 or Part IVA ought to be applied.

7. Some professional practitioners have also sought to combine the features of administration and service arrangements under the one entity. In the past, it has been accepted that professional practitioners may be employed by a combined service/administration entity - but only on the clear understanding that:

(i) the salaries paid to the practitioners do not exceed amounts which would be considered reasonable in the context of an administration arrangement having regard to the administrative functions performed by the practitioners;

(ii) there is no mark-up on the amount paid by the professional practice to the service entity in respect of administration salaries and superannuation contributions; and

(iii) the arrangements are otherwise bona fide.

8. Then there are practice entities, i.e., a business activity is carried on by a company or trust and the taxpayer becomes an employee of the entity. This is not a service arrangement, it is simply the transfer of a business activity formerly conducted by a sole trader or a partnership to another entity. Taxation Ruling Nos. IT 2121 and IT 2330 discuss the taxation consequences of family companies and trusts.

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9. As stated above, the sole justification for accepting administration entities is to enable employee/partners access to superannuation benefits. They were accepted on the clear understanding that the remuneration paid would consist solely of a reasonable amount of salary for administrative/managerial duties and that the salary would form the basis for the calculation of superannuation benefits. Salary for superannuation purposes is defined in Taxation Ruling No.

IT 2067 and it clearly does not include fringe benefits.

10. Administration entities that provide cars and other fringe benefits to employee/partners are not acceptable for income tax purposes. The same approach should be adopted for combined service/administration entities where such entities provide fringe benefits to employee/partners. However, there is no objection to practice entities providing fringe benefits as part of an employee's remuneration package.

11. Where administration entities or combined service/administration entities provide fringe benefits to employee/partners they are going beyond the provision of superannuation benefits and in many cases are receiving a tax advantage. Taking the provision of cars as an example, a tax advantage arises where the professional practice obtains a deduction for the full cost of the administration or service fee which reflects the full cost of the provision of cars to employee/partners and such cars are used by the employee/partners partly for private purposes. This is so, notwithstanding, the payment of fringe benefits tax. Where such tax advantages are present the view is taken that there would be grounds to apply Part IVA.

12. It is not uncommon for a professional partnership to provide cars to partners to enable them to carry out partnership duties. Often such cars are leased from a service or combined service/administration entity. This arrangement can be accepted provided any fringe benefits arising from the use of the cars are not being provided in respect of any employment duties the employee/partner performs for the service or combined service/administration entity. In other words the right to use the cars for private purposes is provided solely because of the partner's membership of the professional partnership. In these circumstances no fringe benefits tax liability in respect of the cars arises for the service or combined service/administration entity.

13. Where a professional partnership provides cars to partners, the cost to the partnership - including any leasing and/or service charges paid to a service or combined service/administration entity - is a "car expense" as defined in subsection 82KT(1). The partnership would be entitled to claim income tax deductions to the extent to which such "car expenses" are incurred in deriving the assessable income of the partnership. Any private use of the cars by the partners is not an allowable deduction. The actual business expenses method which includes the keeping of a log book could be used to substantiate such claims or, where relevant, the partnership could adopt one of the alternative methods for claiming car expenses provided for in sections 82KW and 82KX.

14. Administration entities and combined service/administration entities have an opportunity to cease providing fringe benefits to employee/partners no later than one month from the date of this Ruling. In the context of what has been stated in paragraph 12, service entities and combined

service/administration entities may continue to lease cars to a professional partnership provided the cars are treated by the taxpayers concerned as being provided pursuant to the service arrangement and not as a fringe benefit linked to the carrying out of administration or other duties of an employee/partner.

COMMISSIONER OF TAXATION
11 August 1988