

**Senate Economics Legislation Committee**

**ANSWERS TO QUESTIONS ON NOTICE**

**TREASURY**

**Australian Taxation Office**

(Budget Estimates 2 June 2005)

**Outcome 2**

**Topic: Service Trusts**

**Written Question Supp W13**

Senator Watson asked:

The accounting and taxation professions have welcomed the Commissioner's comments in relation to service trusts that the audit of prior years would be restricted to material situations and that the general strategy would be to allow people 12 months to get their affairs in order in accordance with the ruling.

However, an area of concern is the retrospective element within the ruling. The Commissioner's comment was that material situations would be service fees over \$1 million and where 50% or more of the gross income of the firm is directed into service fees.

1. With reference to the ruling, should not the comparison be net profit derived by the firm compared to net profit derived by the service entity? In other words, does the net profit of the service entity exceed that of the firm? For example, a professional person deriving a net profit (after service fees) from a practice partnership of \$200,000 with a distribution from a service entity of \$50,000 would be acceptable, whereas a professional earning \$100,000 with a service entity distribution of \$150,000 would be unacceptable.
2. Further, in relation to the safe harbour rates for legitimate fees, does the Commissioner intend to provide specific guidance on what the Commissioner considers to be acceptable commercial mark-ups on expenses such as wages? This would avoid the need for clients to do market research on commercial rates in their region, which is difficult to obtain in some areas.

Answer:

1. The Commissioner's comments about material situations are made in the context of the Commissioner's compliance strategy on the issue. The Commissioner's views on deductibility under the law is dealt with in Draft Taxation Ruling TR 2005/D5.

Situations that have been identified as material are those that the Commissioner regards as indicative of involving high levels of compliance risk due to the relative

**Senate Economics Legislation Committee**

**ANSWERS TO QUESTIONS ON NOTICE**

**TREASURY**

**Australian Taxation Office**

(Budget Estimates 2 June 2005)

and absolute size of the service deduction being claimed. In lesser cases, the Commissioner has adopted a strategy that, in its first stage, involves education and self-regulation to encourage ongoing voluntary compliance.

In terms of this risk assessment process, which forms the basis of selecting cases for further investigation, the Commissioner has adopted certain benchmarks as indicators of risk. These relate to the absolute measure on the level of service fees (set at \$1 million), coupled with a proportionate measure of gross income expended on service fees (set at 50%).

However, our analysis has shown that within the group of taxpayers presenting as a material risk it has been possible to identify those cases where the net profit in the service entity may represent more than 50% of the total profit of the professional firm. In these circumstances, the Commissioner has decided that this test will be added to the >\$1M and >50% gross income tests. It should also be noted that the Commissioner will continue to audit those cases where he has concerns about whether the services have actually been provided.

2. In order to assist service entities and professional firms with the management of their tax risk, and with the implementation of commercial arrangements that would be at an ongoing low risk of audit, the explanatory booklet is expected to indicate what the Commissioner would regard as typical commercial circumstances for service trusts undertaking typical types of activities. Within those circumstances, the Commissioner will be attempting to identify acceptable commercial mark-ups.