TD 2011/D9 - Income tax: Employee share schemes: If a share in a 'no goodwill' professional practice company is acquired by a practitioner-shareholder (or a new practitioner-shareholder), will the Commissioner accept, for the purposes of determining whether that acquisition was at a discount within the meaning of subsection 83A-20(1) of the Income Tax Assessment Act 1997, that the goodwill of the company can be taken to have no value?

Draft Taxation Determination

Income tax: Employee share schemes: If a share in a 'no goodwill' professional practice company is acquired by a practitioner-shareholder (or a new practitioner-shareholder), will the Commissioner accept, for the purposes of determining whether that acquisition was at a discount within the meaning of subsection 83A-20(1) of the *Income Tax Assessment Act 1997*, that the goodwill of the company can be taken to have no value?

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Ruling

1. Yes, the Commissioner will accept, for the purposes of determining whether that acquisition was at a discount within the meaning of subsection 83A-20(1) of the Income Tax Assessment Act 1997 (ITAA 1997),[1] that the goodwill of the company can be taken to have a value of nil.

2. This approach will apply only for dealings done at arm's length for admissions to, and exits from, the professional practice in the natural 'ebb and flow' of natural person practitioner-shareholders into and out of the company. For the approach to apply, all practitioner-shareholders must agree to follow the approach explained in this draft Determination.

[1] All legislative references are to the ITAA 1997 unless otherwise indicated.

3. Where a 'no goodwill' professional partnership has incorporated or a new 'no goodwill' incorporated 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. That is, the Commissioner will adopt an approach that is consistent with the approach taken in *Taxation Ruling IT 2540 Income tax: capital gains: application to disposals of partnership assets and partnership interests* in relation to professional practice partnerships, when calculating the market value of a share, in a 'no goodwill' company for the purposes of subsection 83A-20(1). However, this approach will be limited to dealings in shares in incorporated professional practices which faithfully mirror the same proportional underlying economic ownership transactions and relationships which would have attracted the approach taken in IT 2540 in relation to professional practice partnerships.

Example

5. *Professional Practice Co Pty Ltd is an incorporated professional practice which does not require 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's net assets excluding goodwill have a value of $200,000. On 1 July 2011 two practitioner-shareholders retire and their shares are redeemed for an amount calculated by reference to the value of the firm's net assets excluding goodwill. On the same day a new practitioner-shareholder is admitted to the firm. The Commissioner will accept for the purposes of subsection 83A-20(1) that the market value of the shares acquired by the new practitioner-shareholder will be the amount calculated by reference to the firm's net assets excluding goodwill at the time of acquisition, so that no discount is taken to arise.*

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

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. In professional partnerships recognising goodwill, when a new partner is admitted they are usually 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 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 they are 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 Australian Taxation Office 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' 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 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 transferred to another shareholder (or back to the company in a share buyback) or cancelled (either by a reduction in capital or following a share buyback).

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. This draft 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 consequences (TD 2011/26) and the share buyback implications (TD 2011/D10). The draft Determination does not cover issues associated with the incorporation itself or any other type of restructure of the practice.

Division 83A – Employee share schemes

13. Division 83A was enacted on 14 December 2009 and applies to ESS interests acquired on or after 1 July 2009. The objects of the Division are set out in section 83A-5 and include:

> (a) to ensure that benefits provided to employees under *employee share schemes are subject to income tax …

14. An ***ESS interest*** in a company includes a beneficial interest in a share in a company, pursuant to paragraph 83A-10(1)(a), and subsection 83A-10(2) provides that an ***employee share scheme*** is a scheme under which ESS interests in a company are provided to employees, or associates of employees (including past or prospective employees) of the company.

15. Subsection 83A-20(1) relevantly provides that Subdivision 83A-B will only apply to a share if it is acquired under an employee share scheme at a discount.

16. Whilst discount is not defined, a share is taken to have been acquired at a discount if the market value of the share at the acquisition time is greater than the consideration given to acquire the share.

17. Thus, where the consideration given for a share is equal to the market value of the share at the acquisition time

- the share will not be acquired under an employee share scheme at a discount within the meaning of subsection 83A-20(1); and
- Subdivision 83A-B will not apply to the share.

Post-incorporation

18. Where a ‘no goodwill’ incorporated professional practice satisfies the conditions described in this draft Determination and the parties deal at arm’s length, the Commissioner will accept, for the purposes of determining whether an acquisition of shares is at a discount within the meaning of subsection 83A-20(1), that the goodwill of the company can be taken to have a value of nil irrespective of the actual value. This will mean that in the case of a ‘no goodwill’ incorporated professional practice where the approach described in paragraphs 2 to 4 of this draft Determination applies, and the consideration paid reflects the market value of net assets excluding goodwill, the Commissioner will accept that the shares have not been acquired at a discount for the purposes of subsection 83A-20(1).

19. Where the incorporated professional practice does not continue to satisfy the conditions described in paragraphs 2 to 4 of this draft Determination, or the parties share dealings cease to be arm’s length, the post incorporation approach cannot continue to be applied. Accordingly this approach will not apply in respect of any non-arm’s length acquisitions or any acquisitions of shares in that company for any period during which even one share is held whether legally or beneficially otherwise than in the way described.

20. It would not be expected that arrangements of a kind that would ordinarily be regarded as arm’s length dealings in shares in a professional practice company would suffer any compromise to such arm’s length status merely because the dealings were for suppressed consideration on account of the company being a bona fide ‘no goodwill’ professional practice company.

Appendix 2 – Your comments

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

2. 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

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

Due date:	**25 November 2011**
Contact officer:	**Wai On Lam**
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Telephone:	**(08) 8208 1066**
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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

IT 2540; TR 2006/10;
TD 2011/26; TD 2011/D10

Subject references:

- employee share scheme

Legislative references:

- ITAA 1997
- ITAA 1997 Div 83A
- ITAA 1997 83A-5
- ITAA 1997 83A-10(1)(a)
- ITAA 1997 83A-10(2)
- ITAA 1997 Subdiv 83A-B
- ITAA 1997 83A-20(1)

ATO references

NO:	1-1V6F8I
ISSN:	1038-8982
ATOlaw topic:	Income Tax ~~ Assessable income ~~ employee share schemes