


IT 2531 - Income tax : administration companies and trusts - level of salaries for working directors/employees carrying out administrative duties for professional practices

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TAXATION RULING NO. IT 2531

INCOME TAX : ADMINISTRATION COMPANIES AND TRUSTS -
LEVEL OF SALARIES FOR WORKING DIRECTORS/EMPLOYEES
CARRYING OUT ADMINISTRATIVE DUTIES FOR PROFESSIONAL
PRACTICES

F.O.I. EMBARGO: May be released

REF

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F.O.I. INDEX DETAIL

REFERENCE NO: SUBJECT REFS: LEGISLAT. REFS:

I 1011213 ADMINISTRATION COMPANIES
 - SALARY LEVELS
 - ADMINISTRATIVE DUTIES
 ADMINISTRATION TRUSTS

OTHER RULINGS ON TOPIC : IT 25, IT 119, IT 276, IT 2067,
 IT 2277, IT 2494, IT 2503

PREAMBLE

The purpose of this Ruling is to express some official views on administration and combined administration/service companies, in particular the duties that are considered to be of an administrative nature and factors that should be taken into account in determining the salary levels considered appropriate for the working director/employee of those companies.

2. This Office has accepted for some time that professional practitioners such as medical practitioners, legal practitioners, accountants, engineers, architects, etc., may establish administration companies to provide duties of a non-professional and administrative nature to their practices. The incorporation of an administration company provides a practitioner with access to employer-sponsored superannuation. This is achieved by the administration company employing the practitioner as a working director to carry out the administrative duties of the practice for a proportion of that director's total working time.

3. Where a combined administration/service company (or trust) is being used, it is necessary to ensure that the two basic functions being carried out by the company (or trust) remain clearly defined and the requirements of paragraph 7 of Taxation

Ruling No. IT 2494 are followed.

4. This Ruling is not intended to disturb agreements as to salary levels made previously by this Office where those agreements generally follow the principles set out in this Ruling.

RULING

5. As stated earlier, the incorporation of an administration company has as its purpose, so far as income tax is concerned, the provision of employer-sponsored superannuation benefits for the working directors. For such a company to be acceptable for this purpose there must be no element of income diversion and the superannuation contributions must be made to a complying superannuation fund (i.e., the Insurance and Superannuation Commissioner has given a notice in relation to the fund under sections 12 or 13 of the Occupational Superannuation Standards Act 1987 stating that he is satisfied that the fund satisfied, or should be treated as if it had satisfied, the superannuation fund conditions in relation to the year of income).

6. The usual requirement that the shares in an administration company not held by the professional practitioner are to be held by similarly qualified professionals as nominees for the professional practitioner is, in practice, not always able to be satisfied. Where it is not practical to satisfy this requirement, the holding of a share or a position of director by someone other than the professional practitioner is acceptable for income tax purposes only where it is allowed by the relevant law or by-laws and there is no diversion of income to that person.

7. In addition, it would be expected that after all the administration company's income and deductions including working directors' salaries and superannuation contributions were accounted for, there would be no income to be taxed in the hands of the company. Where, in circumstances similar to those envisaged at paragraphs 7 and 8 of Taxation Ruling No. IT 2503, the administration company disclosed a taxable income, the company should distribute all its taxable income to the professional practitioner by way of franked dividend in the following year. Paragraphs 12 to 14 of Taxation Ruling No. IT 2503 will also apply to administration companies.

8. The remuneration paid to each director/employee of the company must be reasonable in terms of section 109. The level of remuneration is to be determined on the genuine administration type duties actually performed by each professional practitioner in the conduct of the practice.

9. The following factors should be taken into consideration in determining the "realistic" number of hours which each director/employee spends on administration functions:

- i. careful scrutiny of the duties which each practitioner is claiming to perform to ensure that duties of a professional nature are not included;

- ii. the nature and size of the practice e.g., the number and classification of staff employed, staff/practitioner ratio, net practice income;
- iii. whether an office manager is employed and if the practice has other service entities such as service trusts or service companies; and
- iv. the total practitioner time spent on administration and the seniority of each practitioner. Whilst it is expected that in some practices all practitioners spend an equal time in administration, it is acknowledged that the more senior a practitioner becomes the more time he or she is likely to spend in carrying out administrative functions. Therefore, the payment of a higher salary by the administration company to senior practitioners compared to that paid to those who are more junior may be justified. However, the principle that salaries be determined on a factual basis is paramount.

10. A rule of thumb which may assist in supporting the time said to be spent by a practitioner on administrative duties, particularly in the legal and accounting professions, is:

Total time minus Chargeable Professional Duties
 Minus Non-Chargeable Professional Duties
 (e.g., professional reading, self
 improvement)
 minus Private Matters (e.g., personal matters)
 minus Social Commitments

11. The duties performed by a practitioner that do not require the use of his or her professional training and skills will, generally speaking, constitute administrative work. It may be useful to have regard to the duties that a professional practitioner would reasonably have an arm's length non-professional person perform on his or her behalf.

12. As a guide to assist in the determination of administrative duties undertaken, set out below are examples of the types of duties considered to be administrative and professional for various professional practitioners (lists may be adapted accordingly for the profession in question):

- i. Administration Duties
 - a. Selection and recruitment of non-professional staff;
 - b. Supervision and training of staff with respect to non-professional work and practices;
 - c. Personnel duties such as salaries, superannuation, study arrangements, leave rosters, leave records (e.g., sick, holiday and long service leave),

workers compensation, group tax, payroll tax, and other office record keeping;

- d. Financial duties such as dealings with banks and other financial institutions for practice finance and overdraft facilities, preparation of practice accounts, bank reconciliations (practice accounts, bank reconciliations (practice trading accounts), payment of creditors, billing of clients, debtor control, control of partner's drawings, general practice bookkeeping, maintenance of ledgers, control and review of practice insurances, investment of surplus practice funds;
- e. Clerical duties such as banking, opening mail, filing, copying documents, checking the accuracy of typing, posting of letters, collection from and delivery to the document exchange, travel arrangements, time recording for charging purposes and maintaining statistical information;
- f. Management duties such as organising staff meetings, organising superannuation and fund management, procuring and maintaining office furniture and equipment, and arranging for the provision of office cleaning and other ancillary services; and
- g. Maintenance of a professional library including the circulating and updating of reports from professional reference services.

ii Professional Duties

- a. Selection and recruitment of professional staff;
- b. Supervision of professional staff (e.g., supervision of articled clerk's professional work by a solicitor or supervision of work of locums and nurses by a medical practitioner) and planning professional work schedules;
- c. Attendance at or presentation of continuing professional development courses/seminars and the preparation and presentation of training programmes for professional staff;
- d. Research and consultation (e.g., preparation and advice given by a legal practitioner or the prognosis and diagnosis of a medical practitioner) and professional correspondence;
- e. The professional completion, maintenance and review of a client's record (e.g., recording of a patient's medical history by a medical practitioner);

- f. Evaluation/appraisal of professional equipment, e.g., suitability or otherwise of a piece of medical equipment to perform a specified function; and
- g. Soliciting business.

13. Duties which are required by law to be the responsibility of an individual (e.g., the keeping of Trust Accounts by a solicitor or a company audit by an accountant), to the extent that the individual personally expends time attending to responsibilities relating to those duties, are regarded as professional duties rather than administration duties.

14. The salary to be paid by an administration company to a working director must vary with the factual situation of each case. No monetary amount can be laid down, therefore, to fix with precision what is a reasonable salary for any particular profession. The situation is similar to the reasonableness of amounts for the purposes of sections 65 and 109 in the general run of cases. A useful guideline might be to determine the annual salary which a director could demand as a non-professional if his or her services were valued on an arm's length basis. From this figure may be deduced an hourly rate which when multiplied by the number of hours spent by the working director on administration duties would produce a reasonable salary figure.

15. If it is determined upon a review of the facts that the level of salaries paid to the working directors cannot be justified, then the fee paid by the practice entity to the administration company should be adjusted under subsection 51(1) as it may be assumed that the expenditure was not wholly payable for the services of the administration company but was for some other purpose (F.C. of T v Phillips, 78 ATC 4361; 8 ATR 783).

16 Provided no element of income diversion exists, it should be accepted that a professional practitioner can establish an administration trust (or combined administration/service trust) for the same purposes as outlined for an administration company. For the reason expressed in paragraph 14 above, any adjustment to excessive administration salaries paid by the trust should be made to the fee paid by the practice entity to the administration trust under subsection 51(1).

COMMISSIONER OF TAXATION
18 May 1989

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