


CR 2013/64 - Income tax: allowable deductions: fees paid to Management Expertise Finance Pty Limited by a non-working partner in a pharmacy partnership under an Outsourcing Deed

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Class Ruling

Income tax: allowable deductions: fees paid to Management Expertise Finance Pty Limited by a non-working partner in a pharmacy partnership under an Outsourcing Deed

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ⓘ This publication provides you with the following level of protection:

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant 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.

If you rely on this ruling, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you – provided the Commissioner is not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

What this Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the relevant provision identified below applies to the defined class of entities, who take part in the scheme to which this Ruling relates.

Relevant provision

2. The relevant provision dealt with in this Ruling is section 8-1 of the *Income Tax Assessment Act 1997* (ITAA 1997). All subsequent legislative references are to the ITAA 1997 unless otherwise indicated.

Class of entities

3. The class of entities to which this Ruling applies comprises the non-working partners of a pharmacy partnership who enter into an agreement with Management Expertise Finance Pty Limited as trustee for the Management Expertise Unit Trust (Manex) for the provision of services in the nature of Outsourcing Requirements to the pharmacy partnership.

Qualifications

4. The Commissioner makes this Ruling based on the precise scheme identified in this Ruling.

5. The class of entities defined in this Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 8 to 25 of this Ruling.

6. If the scheme actually carried out is materially different from the scheme that is described in this Ruling, then:

- this Ruling has no binding effect on the Commissioner because the scheme entered into is not the scheme on which the Commissioner has ruled; and
- this Ruling may be withdrawn or modified.

Date of effect

7. This Ruling applies from 1 July 2013. However, this Ruling will not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of this Ruling (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

Scheme

8. The following description of the scheme is based on information provided by the applicant.

Note: certain information has been provided on a commercial-in-confidence basis and will not be disclosed or released under Freedom of Information legislation.

9. The Blooms Group (Blooms) operate a pharmacy chain with affiliated pharmacies (the Blooms pharmacies) located in New South Wales and Queensland.

10. Blooms pharmacies are typically operated as a partnership of at least one or two pharmacists who will be working in the pharmacy (working partners) and a non-working partner who will also be a pharmacist (NWP). The NWP is a representative of Blooms.

11. The NWP may be the NWP in more than one Blooms pharmacy partnership.
12. Each pharmacy partnership is approved to operate a pharmacy business under the relevant State legislation.¹
13. In relation to each pharmacy partnership, the working partners and the NWP enter into a Partners Outsourcing Deed (Partners Deed) whereby the NWP agrees to provide the partners Outsourcing Requirements which are goods, services and facilities described in Item 6 of the Reference Schedule to the Partners Deed or otherwise agreed in writing (the services). 'Partners' are defined in the Partners Deed to be 'the NWP and the Working Partners in their capacity as partners in the operation and conduct of the Pharmacy Business'.
14. In order to provide the required services to the partners under the Partners Deed, the NWP enters into a Manex Outsourcing Deed (Manex Deed) with Manex, as allowed under the Partners Deed.
15. Under the Manex Deed, Manex agrees to provide the services to the pharmacy partnership in fulfilment of the NWP's obligations to provide the services under the Partners Deed.
16. The Outsourcing Requirements to be provided under the Manex Deed are specified in the deed to be:
 - ... those goods, services and facilities described in Item 4 of the Reference Schedule or as shall otherwise be agreed in writing between the NWP and Manex from time to time to be provided by Manex to the NWP under this Deed as sub contractor to the NWP for the purposes of enabling the NWP to fulfil his or her obligations under the Partners Outsourcing Deed; ...
17. On or before the commencement date of the Manex Deed, Manex must provide the NWP with written advice of the level of fees estimated to be payable for the next 12 months (the Manex fee). The level of fees must be calculated on a commercial arm's length basis, and must not be calculated by reference to either the profit or income of the pharmacy partnership or the income which the NWP receives from the pharmacy partnership.
18. In the event that the NWP disputes the estimate of the Manex fee payable, the determination of the fees will be referred to an independent accounting expert.
19. The Manex fee is paid by the NWP by monthly instalments, with the first payment made on the commencement date of the Manex Deed and subsequent payments made in arrears.
20. Manex must prepare and send a monthly invoice for the actual fees payable by the NWP for the provision of the services provided. The actual fees payable in any month will depend on the actual services provided by Manex under the Manex Deed in that month.

¹ *Pharmacy Business Ownership Act 2001 (QLD); Health Practitioner Regulation National Law (NSW).*

21. The NWP is liable to pay Manex interest on any amount of unpaid fees.
22. Under the terms of the Manex Deed, the NWP must accept the delivery of the services from Manex and must not accept the delivery of similar services from a third party.
23. Manex, however, may provide services the same as, or similar to, the services to other entities.
24. Similar to the Manex Deed, the Partners Deed requires the NWP to advise, in writing, the estimated level of fees payable by the pharmacy partnership to the NWP for the next 12 month period (the NWP fee).
25. The NWP will not apply a mark-up to the Manex fee when calculating the NWP fee payable under the Partners Deed. That is, the NWP fee (payable by the pharmacy partnership to the NWP) will equate to the Manex fee (payable by the NWP to Manex).

Ruling

26. The fees to be paid by the NWP to Manex for the provision of the services in the nature of Outsourcing Requirements, will be deductible to the NWP under section 8-1, provided that the fee paid is a commercial arm's length fee for actual services provided.

Commissioner of Taxation

7 August 2013

Appendix 1 – Explanation

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

27. For an outgoing to be an allowable deduction, the outgoing must be incurred in gaining or producing assessable income, or necessarily incurred in carrying on a business for the purpose of gaining or producing assessable income.

28. Therefore, before considering whether the Manex fee will be deductible to the NWP, it is first necessary to consider whether the NWP fee received by the NWP is assessable income.

Section 6-5 – income according to ordinary concepts

29. Subsection 6-5(1) provides that the assessable income of a taxpayer includes income according to ordinary concepts (ordinary income).

30. The legislation does not provide specific guidance on the meaning of income according to ordinary concepts. However, a substantial body of case law exists which identifies likely characteristics.

31. In *GP International Pipecoaters Pty Ltd v. Federal Commissioner of Taxation*², the Full High Court stated:

To determine whether a receipt is of an income or of a capital nature, various factors may be relevant. Sometimes the character of receipts will be revealed most clearly by their periodicity, regularity or recurrence; sometimes, by the character of a right or thing disposed of in exchange for the receipt; sometimes, by the scope of the transaction, venture or business in or by reason of which money is received and by the recipient's purpose in engaging in the transaction, venture or business.

32. Amounts that are periodical, regular or recurrent, relied upon by the recipient for their regular expenditure and paid to them for that purpose are likely to be ordinary income, as are amounts that are the product in a real sense of any employment of, or services rendered by, the recipient. Amounts paid in substitution for salary or wages foregone or lost may also be ordinary income.

33. Ultimately, whether or not a particular receipt is ordinary income depends on its character in the hands of the recipient. The whole of the circumstances must be considered and the motive of the payer may be relevant to this consideration.

² *GP International Pipecoaters Pty Ltd v. Federal Commissioner of Taxation* (1990) 170 CLR 124,138; 90 ATC 4413, 4420; (1990) 21 ATR 1, 7.

34. The Partners Deed is an agreement between the NWP and the working partners, whereby the NWP agrees to provide the partners with the Outsourcing Requirements as set out in Item 6 of the Reference Schedule to that Deed. Therefore it is accepted that the NWP fee to be received by the NWP is ordinary income as it is a regular receipt for specific services provided under the Partners Deed.

35. Accordingly the NWP fee to be received by the NWP is assessable income of the NWP under section 6-5.

Section 8-1 – general deductions

36. Section 8-1 allows a deduction for losses or outgoings to the extent that they are incurred in gaining or producing assessable income, or are necessarily incurred in carrying on a business for the purpose of gaining or producing assessable income.

37. However, a deduction is not available under section 8-1 where the losses or outgoings are of a capital, private or domestic nature, or are incurred in gaining or producing exempt income, or another provision prevents the taxpayer from deducting them.

38. Ordinarily, expenditure incurred in obtaining the supply of goods or services from another party under a contract will be characterised by reference to the contractual benefits passing to the taxpayer under the contract and the relationship that those benefits have to the taxpayer's income earning activities or business.

39. Under the back-to-back deeds entered into by the NWP, the NWP receives a fee for the provision of the services in accordance with the Partners Deed. Furthermore, the NWP is required to subcontract the provision of those services to Manex for payment of the Manex fee.

40. The services to be provided to the partners under the Partners Deed and Manex Deed are necessary in the conduct of the pharmacy partnership's business. Although an estimate of the fees to be paid is determined twelve months in advance, the amount of fees actually paid on a monthly basis is adjusted to reflect the actual services provided during that month.

41. The nature of the fee to be paid by the NWP to Manex is not of a 'capital, private or domestic nature'.

42. As discussed in paragraphs 29 to 35 of this Ruling, the NWP fee received by the NWP is assessable income of the NWP.

43. Accordingly, the fee to be paid by the NWP to Manex, pursuant to the Manex Deed, is an outgoing incurred in gaining or producing the NWP's assessable income and will be deductible to the NWP under section 8-1, provided that the fee paid is a commercial arm's length fee for actual services provided.

Appendix 2 – Detailed contents list

44. The following is a detailed contents list for this Ruling:

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10

Subject references:

- Deductions & expenses
- Income
- Producing assessable income

Legislative references:

- ITAA 1997
- ITAA 1997 6-5
- ITAA 1997 6-5(1)

- ITAA 1997 8-1

- TAA 1953

- Pharmacy Business

Ownership Act 2001 (QLD)

- Health Practitioner Regulation
National Law (NSW)

Case references:

- GP International Pipecoaters
Pty Ltd v. Federal
Commissioner of Taxation
(1990) 170 CLR 124; 90 ATC
4413; (1990) 21 ATR 1

ATO references

NO: 1-49S0NSR

ISSN: 1445-2014

ATOlaw topic: Income Tax ~~ Deductions ~~ miscellaneous expenses

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