


CR 2014/62 - Income tax: private practice arrangement for Medical Practitioners of the Intensive Care Unit of the Royal Melbourne Hospital

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Class Ruling

Income tax: private practice arrangement for Medical Practitioners of the Intensive Care Unit of the Royal Melbourne Hospital

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1 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 provisions identified below apply to the defined class of entities, who take part in the scheme to which this Ruling relates.

Relevant provisions

2. The relevant provisions dealt with in this ruling are:

- section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997)
- section 8-1 of the ITAA 1997
- section 17-5 of the ITAA 1997
- section 45-120 of Schedule 1 to the *Taxation Administration Act 1953* (TAA)
- section 45-205 of Schedule 1 to the TAA
- section 97 of the *Income Tax Assessment Act 1936* (ITAA 1936)
- section 101 of the ITAA 1936

Class of entities

3. The class of entities to which this Ruling applies comprises Medical Practitioners (the Doctors) of the Intensive Care Unit of the Royal Melbourne Hospital (RMH), who enter into a Private Practice Agreement.

Qualifications

4. The Commissioner makes this Class Ruling based on the precise arrangement identified in the Class 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 18 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 to 30 June 2018. The Ruling continues to apply after 30 June 2018 to all entities within the specified class who entered into the specified scheme during the term of the Ruling. 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.

9. All of the Doctors have entered into contracts of employment with the RMH. Their salary and conditions of employment are in accordance with their Employment Agreement.

10. The Employment Agreement provides the Doctors with limited entitlements to engage in private practice using the RMH Intensive Care Unit (RMH ICU) facilities. The terms and conditions of the use of the RMH ICU facilities for the purposes of private practice are governed by the Private Practice Agreement as well as the Employment Agreement. The Private Practice Agreement is to be read in conjunction with the Employment Agreement to which it pertains. Among other matters, the Private Practice Agreement outlines access rights to RMH facilities and staff, priority of patients and billing processes.

11. In attending to private patients in the RMH utilising the RMH's infrastructure and resources, the Doctors are providing a service to patients in the Doctors' private practice and not in their capacity as an employee of the RMH.

12. Whenever a patient enters the RMH ICU the billing code of only one of the Doctors who treat the patient (usually the first doctor to see the patient) is the billing code used by all Doctors within the ICU who treat the patient on that day.

13. To facilitate the equitable distribution (in accordance with services provided by each Doctor) of fees paid solely under one doctor's provider number, the Doctors (or a legal representative) have settled a Trust with the executive members of the ICU acting as trustees.

14. During the currency of the Employment Agreement, and in accordance with the terms of the Private Practice Agreement, the Doctors must pay over all private practice fees to the trustees of the Trust.

15. The Doctors have appointed a third party medical billing service as their agent to render and collect accounts on their behalf, on the condition that the medical billing service pays over all private practice fee income derived by the Doctors to the Trust.

16. Under the Trust Deed the Doctors become presently entitled to the trust income when the trustee makes a resolution in writing to distribute income.

17. The trustee has the power to make interim distributions of the net income of the Trust Fund. It is anticipated that the fees will be disbursed quarterly to the Doctors in accordance with the agreed calculation method based on the medical roster for that quarter.

18. The beneficiaries of the Trust are as follows:

- Primary beneficiaries – medical practitioners from time to time entitled to conduct private practice with the ICU of RMH.
- Charitable beneficiaries – including RMH.
- Default beneficiaries – each primary beneficiary, distribution determined using the following formula:

$$\text{Distribution} = A ((B + C) / D)$$

Where:

A = the Net Income of the Trust for the period.

B = the number of appointments of the Primary Beneficiary at the ICU during the period.

C = the number of after hours on-calls of the Primary Beneficiary at the ICU during the period.

D = the number of appointments and after hours on-calls of all Primary Beneficiaries at the ICU during the period. **Note:** certain information has been provided on a commercial-in-confidence basis and will not be disclosed or released under Freedom of Information legislation.

Ruling

Private practice income

19. The private practice fees derived by the Doctor from undertaking private practice work are assessable income of the Doctor under section 6-5 of the ITAA 1997 when it is collected by the Billing Service on behalf of the Doctor.

20. The assessable income does not include any Goods and Services Tax (GST) component of the private practice fees by virtue of section 17-5 of the ITAA 1997.

Deductibility of amounts paid to the Trust

21. A deduction is allowable under section 8-1 of the ITAA 1997 to the Doctor for the amounts payable to the Trust under the terms of their Employment Agreement and Private Practice Agreement.

PAYG instalments – instalment income and instalment rate

22. The private practice fees of the Doctor, billed under the Private Practice Agreement, form part of the Doctor's instalment income as defined in subsection 45-120(1) of Schedule 1 to the TAA.

23. If the Doctor is a quarterly payer, they may choose to vary their instalment rate in accordance with section 45-205 of Schedule 1 to the TAA.

Trust income

24. Where the trustee of the Trust exercises their discretion to pay or apply income of the Trust to or for the benefit of the Doctor, the Doctor is deemed presently entitled to this income under section 101 of the ITAA 1936.

25. The income of the Trust to which the Doctor becomes presently entitled is assessable income of the Doctor under section 97 of the ITAA 1936.

Commissioner of Taxation

30 July 2014

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.*

Private practice income

26. Section 6-5 of the ITAA 1997 provides that an amount is assessable income if it is income according to ordinary concepts (ordinary income).

27. The term 'ordinary income' is not defined in the legislation. However, it is well established that this term includes amounts received as a reward for providing personal services.

28. As part of the private practice arrangement between the Doctor and the RMH, the Doctor attends to private patients in the RMH. The Doctor utilises the RMH's infrastructure and resources whilst performing this role. The Doctor is however providing a direct service to these patients as part of their own private practice and not in their capacity as employee of the RMH.

29. The amount paid by or on account of a patient is a reward for services provided by the Doctor and is assessable as ordinary income of the Doctor under section 6-5 of the ITAA 1997.

30. The decision in a Board of Review case¹ supports the conclusion that the fees are assessable as ordinary income of the Doctor. In that case, it was held that private patient fees received by a hospital on behalf of a salaried doctor as a result of accounts issued in the doctor's name by the hospital acting as his agent, were assessable to the individual doctor as ordinary income. The amounts were included in the assessable income of the doctor in the year in which the payments were made by the patient.

The GST component

31. The amount included in assessable income under section 6-5 of the ITAA 1997 excludes any goods and services tax (GST) component. Section 17-5 of the ITAA 1997 ensures that an amount is treated as not being assessable income (or exempt income) to the extent that it consists of an amount relating to:

- GST payable on a taxable supply;
- increasing adjustment in the GST payable on a supply; or
- an increasing adjustment that relates to an acquisition and arises in circumstances that give rise to a recoupment that is included in assessable income.

¹ Taxation Case T44 86 ATC 366.

Deductibility of amounts paid over to the Trust

32. Section 8-1 of the ITAA 1997 provides that you can deduct from your assessable income any loss or outgoing to the extent that it is incurred in gaining or producing assessable income and is not:

- capital, private or domestic in nature;
- incurred in gaining or producing exempt income; or
- prevented from being deductible by another provision in the ITAA 1997.

33. In the Full Federal Court decision in *Service v. Federal Commissioner of Taxation*² the taxpayer was allowed a deduction for directors' fees he paid over to the employer in accordance with a contractual arrangement he had with his employer. The Court concluded that the directors' fees paid to the employer were outgoings incurred by the taxpayer in gaining or producing his assessable income of salary from the employer and potential income from superannuation benefits. In reaching its decision, the Court noted that a number of propositions had been established within existing case law to help determine if a deduction was allowable under the former equivalent provision in the ITAA 1936, namely subsection 51(1):

First, ...the language of the section requires there to be a connection between the loss or outgoing on the one hand and the assessable income on the other. ...

Secondly the reference in the subsection to 'the assessable income' does not ... relate to the income of a particular year of income any more than it relates to a particular item of income, but to assessable income generally: *cf AGC (Advances) Ltd v. Federal Commissioner of Taxation* (1975) 132 CLR 175 at 196-8; 75 ATC 4057 at 4071; 5 ATR 243 at 259-60 per Mason J.

Thirdly, where the subsection refers to the loss or outgoing being incurred in gaining or producing the assessable income, this means 'in the course of' gaining or producing assessable income: *Amalgamated Zinc (de Bavay's) Ltd v. Federal Commissioner of Taxation* (1935) 54 CLR 295 at 303 per Latham CJ, at 309 Dixon J.

Fourthly, the question whether a particular outgoing was incurred in gaining or producing the assessable income looks to the 'essential character' of the expenditure itself, rather than to the purpose for which an item of expenditure has been incurred. ...³

34. Under the Private Practice Agreement, the Doctor is required, as a condition of employment with RMH, to pay over to the Trust all fees arising from private practice. Consequently, the expenditure will be incurred at the moment the private patient fees are received. On being paid over, the fees become the property of the Trust.

² (2000) 97 FCR 265; [2000] FCA 188; 2000 ATC 4176; (2000) 44 ATR 71.

³ *Service v. Federal Commissioner of Taxation* (2000) 97 FCR 265 at paragraphs 50 to 53; 2000 ATC 4176 at 4185-4186; (2000) 44 ATR 71 at 81.

35. In the circumstances, the payment over to the Trust of the fees derived from private practice has the essential character of expenditure incurred in gaining or producing the Doctor's assessable income from RMH.

Non-commercial loss provisions

36. Depending on the particular circumstances of a Doctor conducting a private practice under the Private Practice Agreement, Division 35 of the ITAA 1997 – Deferral of losses from non-commercial business activities – may have application. If the Doctor makes a loss from this business activity and does not meet one of the tests set out in Sections 35-30, 35-35, 35-40, or 35-45 of the ITAA 1997, or the Commissioner has not exercised the discretion set out in section 35-55 of the ITAA 1997, then the loss deferral rule in subsection 35-10(2) of the ITAA 1997 will apply.

PAYG instalments

37. A Doctor who has been given a PAYG instalment rate from the Commissioner is liable to pay PAYG instalments on business and investment income to provide for their income tax liability under section 45-15 of Schedule 1 to the TAA.

38. Some Doctors may be required to pay quarterly PAYG instalments calculated as the product of their 'instalment rate' by their 'instalment income' under Section 45-110 of Schedule 1 to the TAA.

Instalment income

39. Billing fees from private patients to a Doctor participating in the Private Practice Agreement are ordinary income in accordance with section 6-5 of the ITAA 1997.

40. Subsection 45-120(1) of Schedule 1 to the TAA contains the general rule that 'instalment income' for a period includes ordinary income. An exception to this rule is provided by paragraph 45-120(3)(a) of Schedule 1 to the TAA which provides that certain withholding payments are not included in instalment income. Withholding payments include a payment from which an amount must be withheld under the PAYG withholding provisions in Division 12 of Schedule 1 to the TAA.

41. As the Private Practice fees derived by the Doctor for his or her services to private practice patients are not considered to be withholding payments, the fees are included in the Doctor's 'instalment income' and are subject to the PAYG instalment system.

Variation to the instalment rate

42. Doctors who are already within the PAYG instalment system, will, in the first year of their participating in the Private Practice Agreement, be required to pay instalments in respect of their billing income.

43. A Doctor's instalment rate will be re-calculated after their first income tax assessment on entering into the Private Practice Agreement. This is to reflect the fact that the billing income will be wholly negated by the pay over agreed to in the Private Practice Agreement.

44. However, section 45-205 of Schedule 1 to the TAA allows a quarterly payer to vary the instalment rate applied to instalment income by choosing a different instalment rate. As a result, Doctors who are quarterly payers will be able to vary the instalment rate applied to their instalment income to reflect that, due to them being required to pay over all the fees received, their net income for the relevant period will be nil.

45. It should be noted that under section 45-230 of Schedule 1 to the TAA the Doctor will be liable for the general interest charge if the varied instalment rate is too low. However, the Commissioner may remit the general interest charge if satisfied that because of special circumstances it is fair and reasonable to do so in accordance with section 45-240 of Schedule 1 to the TAA.

Trust income

46. The Trust to which the private practice fees will be payable is a discretionary trust.

47. As stated above, the trustee of the Trust has the power to make interim distributions of the net income of the Trust Fund. It is anticipated that the fees will be disbursed quarterly to the Doctors in accordance with the agreed calculation method based on the medical roster for that quarter.

48. Where the trustee of the Trust exercises their discretion to pay or apply income of the Trust to or for the benefit of the Doctor, the Doctor is deemed presently entitled to this income under section 101 of the ITAA 1936.

49. Unless the Doctor is under a legal disability, the income of the Trust to which the Doctor becomes presently entitled is assessable income of the Doctor under section 97 of the ITAA 1936

50. The Ruling section provides a detailed explanation of the Commissioner's decision. Therefore, no further explanation is warranted.

Appendix 2 – Detailed contents list

51. 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:

- business income
- deductions & expenses
- health professionals
- medical practitioners
- PAYG instalment income
- PAYG withholding

Legislative references:

- ITAA 1936
- ITAA 1936 51(1)
- ITAA 1936 97
- ITAA 1936 101
- ITAA 1997
- ITAA 1997 6-5
- ITAA 1997 8-1
- ITAA 1997 17-5
- ITAA 1997 Div 35
- ITAA 1997 35-10(2)
- ITAA 1997 35-30
- ITAA 1997 35-35
- ITAA 1997 35-40
- ITAA 1997 35-45
- ITAA 1997 35-55
- TAA 1953
- TAA 1953 Sch 1 Div 12
- TAA 1953 Sch 1 12-35
- TAA 1953 Sch 1 45-15
- TAA 1953 Sch 1 45-110
- TAA 1953 Sch 1 45-120

- TAA 1953 Sch 1 45-120(1)
- TAA 1953 Sch 1 45-120(3)(a)
- TAA 1953 Sch 1 45-205
- TAA 1953 Sch 1 45-230
- TAA 1953 Sch 1 45-240
- Copyright Act 1968
- Financial Management Act (NT)

Case references:

- *AGC (Advances) Ltd v. Federal Commissioner of Taxation* (1975) 132 CLR 175; [1975] HCA 7; 75 ATC 4057; 5 ATR 243
- *Amalgamated Zinc (de Bavay's) Ltd v. Federal Commissioner of Taxation* (1935) 54 CLR 295; [1935] HCA 81
- *Service v. Federal Commissioner of Taxation* (2000) 97 FCR 265; [2000] FCA 188; 2000 ATC 4176; (2000) 44 ATR 71
- Taxation Case T44 86 ATC 366

Other references:

- Employment Agreement for Specialists within the ICU of the RMH.
- Private Practice Agreement for Specialists within the ICU of the RMH.
- Intensive Care Trust Deed of Settlement

ATO references

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