ARTICLE *Value of trusts*

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Structuring the business as a trust can offer a general practice several advantages.

The best tax planning is not schematic or transaction-based. It's easy, inexpensive and won't raise the eyebrows of the Australian Tax Office (ATO). We are talking about trusts.

Trusts are one of many ways in which you can run a practice and they stack up very well against the alternatives: companies, individuals (sole trader) and partnerships.

Two types of trusts are particularly well suited for use in general practice.

Personal services income trusts
Smaller practices that don't engage other fee earners, and which don't have significant plant and equipment, are generally best served by a personal services income (PSI) trust. This type of trust doesn't allow flexible income distributions and requires all medical income to go to the GP who generated it.

The PSI trust helps shield the GP from negligent acts or omissions by other GPs, takes advantage of the concessional car fringe benefits tax rules and facilitates the genuine employment of related persons.

The PSI trust also gets GPs out of the pay-as-you-go withholding tax cycle and streamlines their accounting, since there is no need to make sure the trust 'breaks even' every year in the same way a company does.

Business trusts
Business trusts offer a number of tax advantages. Practices that engage other fee earners, or have significant plant and equipment and meet the ATO's definition of a business, would reap the most benefits from using a business trust.

A business trust is usually a garden-variety family trust, but multiple-owner practices may use a unit or hybrid trust. Business trusts allow flexible income distributions because medical income does not have to go to the GP who generated it.

The ATO accepts business trusts provided the definition of a business is met and one of three additional tests is satisfied: the first test says the business trust will be accepted if the average rate of tax paid on medical income is at least 30% (equal to the company tax rate), the second test says the amount distributed to the owner-GP must be at least equal to the amount paid to the most highly remunerated non-owner-GP, and the third test says the amount distributed to the owner GP must be at least 50% of their patient billings.

The fact the ATO has decreed that only one of these test needs to be met makes it easier for doctors to comply with the rules. The three new tests apply in the financial year ending 30 June 2016 (this tax year).

A business trust will allow doctors who were paying average tax rates of more than 30% to lower their average rate by distributing to lower tax rate beneficiaries.

Business trusts don't just reduce tax, however; they can make service trusts redundant, reducing complexity, costs and accountants' fees. Business trusts work even if there are no tax advantages.

How to make the change
Changing a practice from a company, individual or partnership structure to a trust-based setup is usually relatively simple, but owner-GPs would be well advised to seek some guidance before they make any such changes (refer to breakout for more information).

Capital gains tax has to be considered, but this will likely not be an issue since general practice goodwill values are low and various tax concessions apply under the Federal Government's small business tax concessions regime. The ATO's public rulings accept that a practice can change to a trust-based structure without breaching the anti-tax-avoidance rules.

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ATO opinion

The last few years have seen the ATO conduct a wide-ranging review of the basis of taxing professional practice income, which included some medical practice audits. The ATO subsequently released guidelines, *Assessing the risk: allocation of profits within professional firms*, in 2014.

These guidelines apply to all professionals, not just GPs, include the three business tests noted above and confirm that the familiar public rulings for doctors' incomes still apply.

The guidelines' most important public ruling for GPs is 'IT 2369' (dated 20 June 1991). This ruling was negotiated by the Australian Medical Association (AMA) and sets out the ATO's rule of thumb that a general practice is a business if it has at least as many non-owner material fee earners as it has owners on an equivalent full-time basis. 'Fee earners' includes practitioners other than doctors.

PSI and business trusts continue to be accepted by the ATO, but doctors with business trusts must ensure they meet one of the three tests set out above before they lodge their 2016 tax returns.

Helpful resources

Australian Securities and Investments Commission– Your business structure (http://asic.gov.au/for-business/your-business/your-business-structure)

Taxpayers Australia– Business structures: choosing the right business structure www.taxpayer.com.au/KnowledgeBase/10185/Small-Business-Tax-Super/Business_structures#Trusts)

Australian Government: Business– Key aspects of a trust (www.business.gov.au/business-topics/business-structures-and-types/business-structures/trust/Pages/default.aspx)

Australian Tax Office– Assessing the risk: allocation of profits within professional firms (www.ato.gov.au/business/starting-your-own-business/in-detail/professional-firms/Assessing-the-risk--allocation-of-profits-within-professional-firms)

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