

Taxation Treatment of Solicitors' Disbursements & Recoupments

Following the release of Taxation Ruling TR97/6 which dealt with the Taxation treatment of Solicitors' Disbursements and Recoupments and article* appeared in the May issue of the NSW Law Journal, commenting on the ruling. The Australian Taxation Office has taken exception to a number of points raised in the article and feels a particular need to address some of these, which it does in the following article.

Taxation Ruling TR 97/6 was released on 26 March 1997. This Ruling sets out the Australian Taxation Office (ATO) views on the tax treatment of solicitors' disbursements and recoupments. The Ruling was commented on in the *New South Wales Law Society Journal* volume 35 No 4 May 1997.

The above article referred to the Ruling as compelling 'a new regime of accounting for many practitioners'. The Ruling should not be read as compelling a new regime of accounting, but as setting out the ATO views to clarify an area of the law. Solicitors who, considering their individual circumstances, are properly assessable on a receipts basis or treat disbursements and their recoupments as non-taxable items (because they are incurred as agent or are in the nature of loans) should continue to lodge returns on that basis.

Taxation Ruling TR 97/6 was issued in response to a number of requests from solicitors who requested the ATO's view on how disbursements and their recoupments should be treated for the purpose of taxation. All these above requests were from solicitors who treated disbursements as being deductible and recoupments assessable and wished us to confirm this practice as being a correct interpretation of the law. Following these requests we made enquiries of various bodies representing solicitors (including the Law Council of Australia) as to the current commercial practices of solicitors in regard to the taxation treatment of disbursements and recoupments. These enquiries and an examination of the relevant case law showed that, as a general rule, disbursements and recoupments were and should be, for the purposes of taxation, treated as assessable income and allowable de-

ductions.

Following on from these enquiries and an examination of the case law it was decided to issue a general Taxation Ruling setting out our views as to how disbursements and recoupments made in the ordinary course of a solicitor's business should be treated for the purpose of taxation. TR 97/6 was released in draft form in September 1996, and comment invited from interested parties.

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Generally the comments received on the draft Ruling were that the Ruling was welcomed as clarifying a complicated area of the law. All comments received were considered and replied to.

It is recognised that where solicitors change the method by which they treat disbursements and recoupments there will be costs of compliance, and in some instances these may be substantial. However, where the commercial practices and contracts between a solicitor and his or her clients show that the solicitor is acting as an agent for the client and/or making a loan, the Ruling does not apply. Accordingly, for these solicitors, the treatment of disbursements as not deductible and recoupments as not assessable may be correct. Solicitors should not change the method by which they treat disbursements or recoupments without

consideration of their individual commercial practices and contracts.

In most cases there will be, over time, little difference in the taxable income of solicitors irrespective of which method they adopt for the treatment of disbursements and recoupments. In the absence of any specific arrangement to reduce or avoid tax it would be accepted as a proper interpretation of the law that where a solicitor has previously, by agreement or convention and in accordance with their normal practices, treated disbursements as not deductible and recoupments as not assessable, disbursements and recoupments are made as agent or are in the nature of loans. In such circumstances, disbursements and recoupments need not be included in calculations of taxable income.

Also, at paragraph 22 of the Ruling, the following statement is made: "Where, in the normal course of business, a bill could be rendered in a year of income it is not accepted that a professional person can defer assessment of income simply by deliberately refraining from billing until after the close of the income year". This sentence should only be read in the context of a solicitor deliberately refraining from rendering a bill and not applying where a bill cannot be rendered because of normal business considerations. For example, if a solicitor's normal business practices that bills are rendered 3 days after work is completed (because of the logistics of totaling hours and disbursements etc) work completed, on, say, two days before the end of the financial year but not billed until one day after the next financial year would not be derived.

* A copy of the article is available from the Law Society.