

LAWYERS IN PRACTICE AND THE GST SOLICITORS IN SOLE PRACTICE OR SMALL FIRMS

This article discusses how the GST will effect the legal practice of solicitors. The article is for practitioners whose legal practice has an annual (or projected annual) turnover less than \$1 million or, if more than that, is correctly accounting for income tax on a cash basis.

This article is intended merely to give a framework or overview of the new system as it effects the smaller solicitor's practice. Legal services are supplies for the purposes of GST. There is still much uncertainty as to the detail of the GST's operations in many areas including its interaction with other tax legislation. It is essential to keep an eye on the changes and clarifications as they occur. The article is up to date to 1 November 1999. The website at www.taxreform.ato.gov.au/ is very good and it also directs you to further sources of information.

The first matter currently effecting your practice is registration. The forms and associated explanatory materials should be available by the time you read this article. You need to have an Australian Business Number (ABN) to be able to be registered for GST. I will discuss some of the options concerning registration for GST. The second matter is to understand how the GST will effect your practice as a solicitor. This article will briefly deal with these matters and give some general hints for practice as a lawyer (including as an employee) in a GST environment. The third matter is to put bookkeeping or accounting systems in place to account for GST and monitor cashflow issues. For this, you will presumably seek your accountant's advice, or, if running a small practice and you are aware of the GST issues effecting your practice and you are computer literate, you might feel confident to use one of the software packages.

Registration

GST is only paid by registered entities or those that are required to be registered. You will recall that the GST is generally not intended to be a cost to business. Generally, where there is a GST liability, such as on your legal services to your clients, that cost will be passed on by increasing the cost of your services to the client.

Where goods, services or other taxable supplies are acquired by your practice and

The Law Society is currently preparing a program of seminars and publications for the Territory's legal profession to assist with the introduction of the GST on 1 July, 2000.

This article is the first in a series on the GST to be featured in *Balance*.

have GST added to the cost, there is generally an input tax credit available to offset the additional cost. Where the goods or services are only used partly for your business, the credit is apportioned. Only registered entities are entitled to claim input tax credits.

It is not your business that is registered but the entity that provides the legal services. As solicitors practice through different types of entities, it is those entities which will need to register. So if you practice in partnership, it is the partnership that registers. If you practice in your own name, then you register your own name. By the way if the entity runs more than one business it should seek specific advice. If you practice as a corporation, then that entity registers.

Almost all solicitors or their practice entities will have to register. Some very small practices will have a choice. If your practice's gross annual turnover and projected annual turnover is less than \$50,000, you can choose not to register for GST. You should still apply for an ABN. In that case you will not be required to pay GST and so can keep your fees down but you will not get any input tax credits and so you will need to pay the additional expense yourself and presumably will need to increase your fees to that degree. This choice will rarely be appropriate to new practices (except possibly in the first few months) because of the projected annual threshold. Where your legal practice uses several entities such as companies or trusts, then unless they satisfy the grouping provisions, each will be registered (if the annual threshold is reached). Services provided by them to your legal practice will be liable to GST and so will generally cost more to you. You will be entitled to an input tax credit for

this additional cost. I recommend you do a budget to understand how these issues will effect your cashflow.

Where the entities (trust, partnership or company) are commonly owned or there is common membership there are voluntary grouping provisions where only one entity needs to be registered and inter group transactions are not subject to GST or input tax credits. The rules for grouping require that each entity be a member of the same 90 per cent group, have the same accounting period (such as to 30 June each year) and are all accruals or cash income taxpayers. The effect of grouping is the group is treated as a single entity for GST purposes. You should seek professional advice if your various practice entities are entitled to be grouped.

An employed solicitor does not have an enterprise. Therefore you cannot register for GST. You do not charge GST on your legal services to your employer. Some goods you buy (such as books) and costs of professional subscriptions and insurance premiums will cost more due either directly or indirectly to GST. As you are not registered for GST (at least as far as your practice as a solicitor), you will not get any input tax credits. These items will cost you more. Effectively the cost of these goods and services are cheaper for your employer due to the availability of input tax credits to purchase the item or service.

When is GST paid to the ATO?

For legal practices with a turnover of less than \$1 million or which are properly accounting for income tax on a cash and not accruals basis, the timing of the liability to GST and the right to obtain input tax credits is the same as that of barristers at the independent bar. This was dealt with in the November Bulletin. Note that you (or your firm) can be a cash GST taxpayer and an accruals income taxpayer because the tests are different.

The ATO will send you a Business Activity Statement for each entity each 3 months. You will fill in the many blanks and send a cheque for the net GST you owe and your Pay as You Go (PAYG) income tax payment. If you are respon-

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sible for Fringe Benefits Tax, that is also included. Provisional Tax is to be abolished from 1 July 2000.

The effect of GST on solicitor's fees

They will need to increase to maintain the current net profit. There is no provision in the GST laws to allow you to automatically pass on the cost. It must be done by agreement with the client. Some clients which are not registered for GST (such as private clients) will expect you to absorb the cost. The GST is meant to be passed on to the consumer. The cost of most services including all legal services are intended to increase.

Fees will probably need to increase by close to the full 10 per cent to maintain current income. The savings from the removal of sales tax for small practitioners will probably be minimal. Items such as luxury cars (costing more than \$55,134) will not be cheaper due to addition of the luxury car tax on top of the GST. There are restrictions in getting input tax credits on the purchase of cars for a few years so the savings will be less than anticipated. Also, with the delay or failure in removing most state taxes and the additional compliance costs there may be little net savings. I have seen an estimate of 8 to 9 per cent as the increase in fees expected from solicitors.irate clients can be expected to complain to the ACCC and so you should be prepared to justify your fee increase. It would be wise to seek advice from your accountant as to a proper rate of increase of fees for your particular practice.

Scale Fees, Legal aid, and fixed cost agreements

The simple rule is if you can not or do not increase your fees you will be out of pocket. This is because you will still be liable to pay GST whether you can increase your fees or not. So cost agreements will need to be changed to enable you to pass on the additional cost of the GST. Where you are bound to charge scale fees, unless they increase you are the loser. Note that the fact you can not pass on the GST does not prevent your business client (if registered for GST) from claiming an input tax credit. GST will be 1/11 of the cost of your

legal services. If your fees are \$1400, GST of 1/11 is \$127.27. You will have to pay this amount. If you can vary your fees, to maintain net income of \$1400 you will charge \$1400 plus \$140, a total of \$1540. You will pay \$140 GST.

Whether there will be an increase in legal aid rates will depend on the political strength of the lobbying parties. One thing to remember in the inevitable dispute is that the GST is paid to the States (after collection costs by the ATO).

Solicitors as agents of clients in dealings with barristers

Is a solicitor who briefs a barrister acting as an agent of the client? If yes, the barrister is providing the legal service to the client and not the solicitor. As a solicitor has no legal right to the moneys held in trust until the client authorises its disbursement, either to the solicitor or firm as payment of fees or to the barrister, it is most likely that the solicitor will just pass the fee note to the client and pay the barrister as the client's agent. This is the easiest approach. The alternative is; the service is provided to the solicitor who will then claim the input tax credits in the quarter after payment of the barrister's fees and then add the barristers fees to his or her own and charge GST on the whole amount. I expect the ATO will clarify this matter.

Other client disbursements

Similar issues arise with other disbursements. Assuming GST is payable on medical reports (and I think it will be, because reports are not treatment), I think it is likely the solicitor is also acting as agent. However when it comes to photocopying or other services especially where provided by associated entities, it is the reverse. I think photocopying and possibly courier fees will be treated as supplies to the solicitor and not as supplies to the client. Again I expect the ATO will clarify the proper treatment of these "disbursements".

Pro Bono work and work for your associates

I mentioned last month that pro bono work is not subject to GST but you will be entitled to input tax credits on the costs of supplies you use in performing the work. Where you charge less than full

rates, the GST will be based on what you charge not any deemed market value of the services. This assumes it is bona fide pro bono work for a client who is not a relative or other type of associate (which is very widely defined). It also assumes you receive nothing from a third party for the work you did and do not receive property instead of cash. When you do legal work for an associate, there are rules deeming consideration at GST exclusive market value unless the associate is entitled to a full input tax credit.

Work in progress at 30 June 2000

It is not necessary to send all your bills out on 30 June 2000. This is especially the case if you are an accrual taxpayer (for income tax purposes) because you will create a large and unfunded tax liability for the current financial year. What is necessary is to be able to clearly identify the services you provide after that date. Where the client's cost is directly based on time recording, this will not be a problem. Where a client has retained you to perform one service such as prepare a mortgage and you have not completed it at 30 June, it is more difficult. If you can properly split the services, for example into drafting and settling, then your exact progress should be noted.

By the way, be careful of any attempt to avoid the GST by prepayments or other schemes. There are specific transitional rules and strong anti-avoidance rules to prevent avoiding GST liabilities.

Disclaimer

The information contained in this paper does not constitute professional advice and must not be relied upon as such.

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