

The number crunching decisions behind ILPs and MDPs

By Denys Stedman

The Legal Practitioners Amendment (Incorporated Legal Practices and Multi-Disciplinary Partnerships) Act 2003: an accountants point of view.

The *Legal Practitioners Amendment (Incorporated Legal Practices and Multi Disciplinary Partnerships) Act 2003* (MDP Amendments) came into effect in the NT on 1st May 2004.

Broadly, the principle effects of the MDP Amendments will be to repeal the *Legal Practitioners (Incorporation) Act* so that no new practices can be incorporated under that Act, and to amend and update the *Legal Practitioners Act* (LP Act), to:

- * Allow legal practices to provide both legal & non legal services, through the auspices of either a Multi Disciplinary Partnership (MDP), or an Incorporated Legal Practice (ILP).
- * Allow non legally qualified persons to be involved in both the ownership and management of either an MDP or an ILP.
- * In the case of an ILP, limit the personal liability of its directors and shareholders in accordance with the general provisions of the Corporations Act 2001.

With the commencement of the MDP Amendments there will now be four forms of legal structure through which a legal practice can be owned and operated;

1. Sole Trader or Partnership operating under Common Law and the Partnership Act;
2. Legal Practice Company (LPC) previously incorporated under the *Legal Practitioners (Incorporation) Act*;
3. An MDP established under the newly amended LP Act;
4. An ILP (newly established or converted from an LPC), under the newly amended LP Act.

The introduction of the MDP Amendments therefore provides an opportunity for any practicing legal practitioner to review the structure of

their practice to determine if perhaps either the MDP or ILP structure would better suit their needs. The decision on which of these structures to use will be determined having regard to such factors as the dynamics of the practice regarding risk and personal liability, partner introduction/retirement and profit sharing, the practitioners desire to access tax deductible superannuation contributions and workers compensation insurance, and the income tax position of the practitioner/s.

The income tax consequences for income derived through the various structures is as follows;

Sole Trader/partner of partnership

Income derived by sole traders or partners of an MDP will be taxed on the same basis as that of income currently derived by the sole trader or partner. This involves including that persons share of the practices net income as their own income to be returned in their personal tax return and taxed at their marginal rate.

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The following table gives some examples of the treatment of various factors under the four permitted structures, which may be useful for you in reviewing your situation.

	Sole Trader or Partnership	LPC	MDP	ILP
Limitation of owners personal liability, and partner to partner liability	Unlimited	Unlimited	Unlimited	Limited to value of shares issued
Non legal qualified owners/directors allowed	No	No	Yes	Yes
Accumulation of Profits	Yes	Minimal	Yes	Yes?
Workers compensation cover for owners	No	Yes	No	Yes
Application of Corporations Law	N/A	Yes	N/A	Yes
Court/Law Society approval or notification prior to commencing practice	No	Court approval	Law Society notification	Law Society notification
Easily transferable equity interests	No	Yes	No	Yes
Legal life of structure	Tied to life of practitioners	Indefinite	Tied to life of practitioners	Indefinite
Fully tax deductible superannuation contributions up to Age Based Limits	Limited to first \$5000 & 75% of excess	Yes	Limited to first \$5000 & 75% of excess	Yes
Provision of employee type benefits (eg. fringe benefits, redundancy, employee share plans) for owners	No	Yes	No	Yes
Distribution of income to non-legally qualified owners	No	No	Yes	Yes

The number crunching decisions behind ILPs and MDPs cont...

Company

In respect of income derived through incorporated practice entities, the Australian Taxation Office (ATO), through the application of Rulings such as IT 25, IT 2503, IT 2639 and IT 2330, effectively assesses income derived by an LPC incorporated under the old LP Act to its shareholders, by ensuring that no significant amount of profits can be retained within the company, forcing them to be paid out to the owner or practitioners as either wages or dividends each year. This therefore means that profits cannot be sheltered within the company and taxed at the company tax rate of 30% (rather than individual marginal rates of up to 48.5%), as is the case with all other companies other than professional practice companies.

Therefore, the only taxation advantage to be gained through the use of this structure to date has been to enable fully tax deductible superannuation contributions (up to the age based limits) to be made for the practitioner each year, rather than the partially deductible amounts (first \$5000 plus 75% of amounts over \$5000 up to age based limits) available to a self employed practitioner.

It is unclear at this stage whether the ATO will attempt to impose this rationale when assessing income derived by newly formed ILPs, or whether they will be allowed to accumulate profits (and therefore shelter income from tax) for tax purposes.

In deciding whether to adopt an MDP or an ILP to run your existing or new

practice, you should always be aware of the potential application of Part IVA of the Income Tax Assessment Act, which contains the anti avoidance provisions. These provisions effectively allow the Commissioner to assess tax on income derived by the company as though it were taxable income of the individual practitioner. It also allows imposition of penalties of up to 200% of the tax concerned. These provisions are often interpreted and applied quite widely by the Commissioner, and therefore it is very important to review them in light of your actual circumstances to ensure they cannot be applied to you. If unsure as to their application it would be prudent to take professional advice and perhaps even seek a Ruling from the Taxation Office as to the tax consequences of such action.①

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personal injury must not solicit or induce a potential claimant involved in the incident to make a claim. A legal practitioner who did this even for the best of motives could be liable to a fine of 500 penalty units and could be guilty of professional misconduct under section 45(2)(aa) of the LPA. This would apply to a legal aid lawyer who was on site at the time and who was asked for advice by an alleged victim.

Even more so, subsection (2) specifically targets health professionals such as doctors and nurses as well as police and even innocent bystanders.

Under section (3) it extends to persons who receive the information in the course of their employment.

Under section 130(3) this does not appear to apply to a solicitor taking instructions provided the disclosure is not likely to result in a potential claimant involved in the incident being induced to make a claim. This wording is arguably ambiguous.

Finally section 103AF prohibits paying for touting of potential clients. A person must not reward another person for soliciting or inducing a potential claimant to make a claim or seek or reward for soliciting or inducing a potential claimant to make a claim. The maximum penalty is again \$5,500 and it can constitute professional misconduct if carried out by a legal practitioner. Section 130AF(1) provides some exemptions including charging a potential claimant a fee for legal services provided to the potential claimant as part of making a claim.

The Law Society will be closely monitoring the operation of these provisions and will not be hesitating to bring any further concerns to the Government.

In the meantime I would urge practitioners to carefully check their operations in the light of the new legislation.①