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Four steps to manage the changes to professional firm profit allocation

The ATO's release of PCG 2021/4 changes everything.

The guidelines which set out the ATO's compliance approach from 1 July 2022 regarding the allocation of profits from professional firms are going to have a dramatic impact on individual professional practitioners (IPPs) around Australia.

And with many accounting firms unaware of the changes, many IPPs will not receive the help they need to determine the right amount of tax they will need to pay, leaving lazy firms open to blame from unhappy clients.

Fortunately, we have prepared the following guide for assisting firms in dealing with the enormous changes to proactively help their clients.

1. Understand the guidelines

PCG 2021/4 is focused on arrangements where taxpayers redirect their income, which includes professional services, from a business or activity to an associated entity, so that the outcome is that they significantly reduce their tax liability.

To determine whether the PCG applies, two ‘gateways’ are used to evaluate whether an arrangement has a sound commercial rationale and does not include certain high-risk features.

An arrangement that shows a lack of commercial rationale may seem more complex than necessary to achieve the relevant commercial objective or appear to serve no real purpose other than to gain a tax advantage. While high-risk features may include financing arrangements relating to non-arm’s length transactions, involve multiple classes of shares and units, or misuse the superannuation system.

If the gateways are satisfied, a risk assessment framework can then be used to rate IPP arrangements to determine the type of compliance attention that the ATO will likely undertake. If the ATO identifies arrangements that do not pass the gateways, it may consider applying anti-avoidance provisions under Part IVA or other integrity rules.

The risk assessment framework then uses three measurement factors and an associated scoring table to assign a "traffic light" rating of low (green), moderate (amber), or high (red) risk. These include:

- Factor 1: The proportion of profit entitlement from the whole firm group returned in the hands of the IPP
- Factor 2: The total effective tax rate for income received from the firm by the IPP and associated entities
- Factor 3: The remuneration returned in the hands of the IPP as a percentage of the commercial benchmark for the services provided to the firm

The ATO has stated that IPPs in the amber zone will likely trigger further analysis by the ATO, while for those in the red zone, ATO reviews are likely to be commenced as a matter of priority.

2. Educate your Clients

Using the ChangeGPS VPP email you can clearly explain to clients that as a result of these PCG changes, their options to allocate professional firm profits across family members and entities will be reduced and their family group's overall tax payable in 2023 and future years will increase.

As a result, they can be fully prepared and can carefully plan for it.

In addition, our Value Plan Price email allows your firm to ensure its clients know that your proactive assistance can give them peace of mind that the way their professional firm profits are allocated will satisfy the ATO and not draw audit attention.

They also provide clients with a clear understanding of exactly what work is necessary, the cost, and what decisions they are required to make.

By giving clients everything they need to navigate the ATO's PCG 2021/4, your firm can also ensure it does not take the blame if they choose not to take your recommendations.

3. Demonstrate the changes

Ensure your team have the right tools and resources to fully understand the changes and be able to effectively deliver to clients.

Use ChangeGPS TaxPlan to create the various scenarios, so your firm can easily and clearly show clients the impact of the ATO's guidelines.

With our new automated planner, it is possible to create an unlimited number of scenarios adjusting profit allocations across any number of entities.

TaxPlan also makes it possible to create a comprehensive list of comparisons between the ATO's green, amber, and red zones, along with an original baseline.

While ChangeGPS TaxFlow can then provide a detailed 12-month forecast of a client's tax payable.

4. Deliver an Advice Report

Finally, with the ChangeGPS automated advice report, you can provide clients with everything they need to understand the guidelines, as well as make an informed decision on how to proceed with their future tax payments.

The report details comprehensive background information on PCG 2021/4, including its legal status as a guide for how the ATO wants to administer tax laws. Whilst clearly providing all of the relevant tax calculations and scenarios that articulate a client's options moving forward.

It also provides clients with a succinct summary of the tax payable to fall within the ATO's risk zones, along with explicit instructions to decide on which zone is appropriate for them. And where necessary, plan for the additional funds required.

Clients will need to plan to review their professional firm profit allocations annually to ensure that they remain within the green zone or are aware of the risks if they accept falling into the amber or red zones.

PCG 2021/4 is set to have dramatic consequences for Australia's financial, legal, medical, engineering, and other consulting services professionals. Yet for accounting firms, it presents a pertinent opportunity to show clients just how well-prepared and valuable your assistance is.

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Book a discovery call to learn how ChangeGPS can help your Firm.

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