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## ATO clarifies position on service trusts

For some considerable time now, dentists have been seeking clarity regarding the Australian Tax Office's position on service trusts as a legitimate way to operate their dental practices. Ongoing discussions have been taking place between the ATO, The Australian Dental Association and a small group of interested accountancy firms to bring some understanding to the issue and a set of guidelines from which dentists can safely move forward. Now, at last, the clarification dentists have been seeking has come through.

The Bongiorno Group has been one of the few accountancy groups involved in discussions with the ATO and the Australian Dental Association on this important issue. Tony Bongiorno, Founding Partner of the Bongiorno Group, outlines the position of the ATO to Michael Schildberger of Business Essentials.

**Michael Schildberger:** Tony Bongiorno, dentists have been waiting for a long time for clarification about service trusts – so it's good news that the ATO has spoken up at last?

**Tony Bongiorno:** Yes Michael, the good news is that the Australian Tax Office has given some clarity on their thinking after many rounds of discussions as to how dental practitioners can use service trusts going forward. Their thinking is contained in a draft fact sheet, soon to be replaced with a fact sheet which will eventually be published on the Australian Tax Office Website.

**Michael Schildberger:** So where do we begin?

**Tony Bongiorno:** Michael, the guidelines are fairly clear. The ATO has effectively said that it's okay for dentists to set up a service trust to run and operate their entire practice, but not in the same way service trusts operated in the past, where they used to mark up on costs. That method was very common years ago and relied on an old case called Phillip's Case. That method should no longer be used and is no longer appropriate.

**Michael Schildberger:** So how will service trusts now operate in the future?

**Tony Bongiorno:** The ATO has suggested that, depending on the range of services being provided by the service trust or service entity and the equipment that it owns, the service fees could range between 40% and 60% of the owner dentist's gross patient fees. So if the service entity, say a typical service trust, provides all services to the owner dentist including (but not limited to) collecting fees, maintaining patient records, staff wage, rent and generally paying 100% of the gross practice costs, a service fee of say 60% of patient fees could be justified. It's important to note however that if, for any reason, the trust hasn't provided all these services, then the service fee percentage must be reduced accordingly.

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**Michael Schildberger:** Under these circumstances, who owns the equipment and who pays the rent?

**Tony Bongiorno:** A good question, Michael. The service trust would own all plant and equipment, such as autoclaves, CEREC machines and the like, and it would pay the rent to the landlord out of that service fee of say 60%. The landlord could be the practitioner's superannuation fund or it could be a totally unrelated party. Whichever the case, it's important that a lease agreement is in place to document the service entity as the tenant. It's also important to note that where laboratory fees are involved, a slightly different treatment is used to calculate the applicable service fee.

**Michael Schildberger:** In practical terms, could you give us an example of how this would work?

**Tony Bongiorno:** Yes, let's take a step-by-step approach. Step one: do the numbers to see if the service trust is applicable to your situation. Ask yourself whether or not you can justify the use of a service trust working on a relevant percentage of, say, 60%. Step two: if you feel you can justify this, a service agreement needs to be prepared, clearly setting out all the terms and conditions and the relationships between the parties. Then make sure that you strictly abide by this agreement. Amongst other things, the agreement should clearly state the services being provided and when the fees should be paid. Step three: this typically would be how the service trust would work. Operationally, 100% of the patient fees would be banked into the service trust, collections being part of the services provided by this trust. At the end of each fortnight or month, the service trust would then have two options. It could pass on to the dentist and any other independent dentists, 100% of their respective patient fees and then simultaneously invoice them for services provided during that time. That might be the 60% figure that we talked about plus GST, recognising of course the appropriate treatment for laboratory fees. Alternatively, the trust could do it another way. It could deduct the service fee of 60% plus GST and send a net figure to the dentist of 40% less GST. That's called a Recipient Created Tax Invoice. Either way, the net result is the same.

**Michael Schildberger:** Who pays for items such as income protection insurance, subscriptions, conferences and alike?

**Tony Bongiorno:** They're not regarded as practice expenses, so the practitioner would pay for expenses such as disability insurance, superannuation, conference fees, ADA subscriptions and so on and that would be paid out of their 40% net.

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**Michael Schildberger:** If the trust makes a profit, what happens to that?

**Tony Bongiorno:** If the practice has followed all of the above, is sure that the service trust can be justified and that the service fee paid by the owner dentist to the trust is within the ATO boundaries - and you must stick to those boundaries - the income of a service trust will be treated as business income. This means that the profits can be distributed to trust beneficiaries, typically family members. I must add that the ADA and our firm, with three other firms, have been very active in dealing with the ATO for nearly two years on this issue to get a result. Whilst nothing is ever perfect, it's a very positive step and I must say the ADA is to be commended on its effort in helping dentists in this area, because it wouldn't have happened without their input.

**Michael Schildberger:** Well, it's obviously very significant and very relevant, so in conclusion?

**Tony Bongiorno:** In conclusion, we have clarity at last. So now, dentists should sit down with their relevant advisor and work through the services being provided to see if a service trust is relevant to their practice and can be justified. If they tick the box on that, then the practice must, must, must arrange the relevant legal documentation soon afterwards.

I'll mention one last thing. The final ATO guidelines will be issued hopefully in September 2009 and it's important to note, once again, the slightly different treatment of laboratory fees. It's also important to note that there may be some minor variations to what we've talked about here but this is the general thrust and the direction in which the ATO is proposing to deal with service trusts and dentists going forward. We have confirmed in writing with the ATO our intention to present this draft to dentists as we've done today. Finally, the ATO has indicated that they would not be happy to see a locum dentist being charged a different rate by the service trust to that being charged to the principle dentist. For example, they don't want the principle dentist charged, say, 70% and a locum charged 40%.

**Michael Schildberger:** Yes, it's good to see that the ATO has allowed you to announce it in this way.

**Tony Bongiorno:** Yes, we're very happy and again, I thank the ADA especially for the input that they've had in getting this to fruition.

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