

THROMBOSIS IN THE CASH FLOW
Professional Incomes in a Depressed Economy

By IAN R. PHILLIPS, LL.B., F.C.A.

Delivered at a Meeting of the Medico-Legal Society held on 30 April 1983 at 8.30 pm at the Royal Australasian College of Surgeons, Spring Street, Melbourne. The Chairman of the Meeting was the President Mr. D. W. Rogers.

AT the end of a day, the financial reward for work is cash and the present value of future cash flows. There is no other measure: all else is either irrelevant or subordinate to cash.⁵

The maximisation of a professional's cash flows must be worked at and managed as vigorously and as skilfully as the professional activity that generates those cash flows. As cash flow is the life blood of the business, its management must begin with broad planning considerations affecting the size and structure of the practice and end with containment of the penultimate event prior to the enjoyment or investment of the cash flow, the payment of income tax.

It is the same as an orchard. Its location and size and layout must be planned. The varieties must be selected and the trees tended, fertilised and pruned. When the crop is ready, it must not be left on the trees: the fresh fruit must be brought home and protected from worms and rot. It might be unkind to compare the Deputy Commissioner of Taxation to a worm but the analogy to cash flow holds good. This paper addresses these management issues.

A recent article in the "Harvard Business Review" concludes:

"Lawyers are not considered good managers nor are they easy to manage. Legal management requires special skills, but they can be learned when the goals and commitment are clearly stated and strongly felt."¹

This can be applied to virtually all professions—those whose primary goals and commitments are to their work and only secondarily to the emerging profits. "Look after the clients (or patients) and the profits will look after themselves" is the traditional view but I suggest cash is too important to be left to luck. It is like expecting a prize crop of Granny Smiths in the wilderness. Tough times can lead to new pressures and a new awareness that you, your work, your client and ultimately your profession, are not properly served unless your practice management is efficient and progressive.

The evidence of the thrombosis in the cash flow of lawyers who practise as solicitors is more strongly apparent than among barristers and in medicine generally. The downturn in conveyancing income in recent times is officially stated in N.S.W. to be as high as fifty per cent and the decline overall to be of the order of twenty-five per cent.² The Law Institute of Victoria agrees that these figures are not inappropriate here, although official surveys have not yet been concluded.

At the humbler end of the scale, the generally recessed economy results in deferral of legal matters—the new will is put off, the action for a divorce settlement is abandoned. There is a growth in do-it-yourself legal packages, a trend that will no doubt continue, whilst there is the competition from legal aid agencies and, in some jurisdictions, quasi-legal, quasi-professional operators in conveyancing, income tax returns and so on. Further, there is the interference from government in the fee-setting processes resulting, I understand, in a projected move away from *ad valorem* fees for conveyancing.

There is also some additional competition from newly admitted solicitors, although it seems fair to say that it is these practices that are worst affected by the depressed economy. Despite this, the Director of Finance of the Law Institute of Victoria estimates that the required ratio of solicitors in the society is one for each eight hundred Victorians. On current growth rates, by 1986, there will be one solicitor for each six hundred and fifty to six hundred and seventy Victorians.³ Even so we have a way to go—in 1979 the United States of America had close to half a-million lawyers in a population of two hundred and fifteen million.⁴ The reason for this increase lies, no doubt, in the expansion in numbers graduating from Australian law schools. My own firm is currently interviewing a significant number of law/commerce graduates seeking positions in the accounting profession because they see the law closed to them.

The most significant concern for lawyers and particularly for the larger firms of solicitors engaged in commercial work and corporate litigation, is the growing awareness by their clients that legal fees are susceptible to reduction if the client takes an aggressive attitude. My opening quote came from an article in the "Harvard Business Review" three months ago entitled "Managing Your Lawyers"⁵ which cites the example of Xerox Corporation reducing its outside legal costs from twelve million to three million dollars over five years⁶ and Playboy which dropped its costs fifty per cent in two years. The article states "one inescapable conclusion: a company can lower the cost of legal services without lowering quality or coverage". Perhaps this aggressive attitude to legal costs has yet to reach this country, but I believe it will, if it is not already here.

How can an accountant create order out of this chaos?

Perhaps it is appropriate to see how the accounting profession has responded to some of the challenges I have mentioned. In the accounting world, fee pressures have come earlier, because perhaps an audit is seen by client management as an expense foisted on them by statute: it can scarcely be compared to having your arm sewn back. The response has been to sell services more aggressively and to be as efficient in practice management as possible. There is a distinct tendency towards bigness to improve the range of services, to motivate partners and staff better and to rationalise costs. And there is an unrelenting pressure to maximise cash flow by reducing work that is not recoverable at full rates. Paradoxically, this also assists the cost-containment aims of the client.

The principles of containment of legal costs recommended to management in the "Harvard Business Review" article are as follows:

Develop a policy statement regarding the use of outside counsel, setting forth the company's expectations concerning billing, and stating any prohibitions or requirements. Send a letter of retention to all outside counsel, embodying the policy statement as well as the particular issues involved in the case.

Define the scope of any legal problem referred to an outside firm as narrowly and precisely as possible. Otherwise, the law firm may cast a wider net than the problem requires. If corporate executives don't define the problem clearly, the law firm will have to perform the definition function, and the ensuing intrafirm discussions themselves may produce many billable hours.

Request estimates of the work and cost to be involved. Many large corporate legal departments take this step and find that such estimates help narrow the range of legal issues to be covered and serve as a standard with which to judge whether subsequent bills are reasonable. Estimates provide a measure of discipline for a client's law firm and for the client company itself.

Insist on a detailed breakdown of legal bills. While an accounting of every minute of every lawyer's time is unnecessary, the client should not accept a bill for, say, \$40,000 for 'general professional services' or \$60,000 for 'legal advice related to' a property purchase. Furthermore, the client should not hesitate to question a bill that seems unreasonable. The firm can provide on demand time sheets covering the lawyer's activities. (Most law firms enter such data on a computer nowadays.)

Assign responsibility for the coordination and supervision of the outside law firm's activities, especially during complex or fast-moving litigation.

Avoid second-party purchases of legal services. In many transactions, financial institutions will insist on using their own law

firm even though a client company pays the bill. In cases like this, it is important to request a cost estimate detailing the work that is to be done. These measures can only become effective if control of outside counsel is centralised. Once such controls are in place, the general counsel can delegate responsibility according to the nature of the business.

Provided managers act with tact and courtesy, there is no reason why law firms should resist sound management practices. Managers should never forget who pays the bills.¹¹

Applying those recommendations in the accounting environment, it is found that clearly stated, agreed definition of the terms and scope of the assignment are helpful to both the accountant and the client. It is also usual in large assignments to give estimates of fees and for the prior agreement of payment of the basic fees on an instalment basis as the work is done. Naturally, adjustment for extra work not contemplated at the outset is subjected to detailed analysis at the end of the assignment. Clear-cut chains of communication are important and should be sought for the benefit of both parties. It is difficult to extract fees in situations where instructions have come from a range of sources. If the person authorising the bill doesn't know of the service, watch out!

It might be noted that this concern is not limited to solicitors: barristers in the commercial areas are equally vulnerable. Headlined litigation scoreboards showing "Litigants 0: Lawyers 2" suggest that cost-accounting and computer-directed critical path analysis may eliminate some litigation by rationalising settlement decisions.⁷ There is also a trend towards non-judicial tribunals at which the parties represent themselves or are represented by lay people. The bar is further squeezed on opinion work and other work in chambers by the pressure to reduce costs by the client and the expansion of services by the solicitors.

Apart from participating in the general slowing up of payment of debtors in which thirty-day accounts pay ninety days and ninety-day accounts not at all, the foregoing remarks have little application to the medical profession, other than concern about the capacity of the community to accommodate, in profitable practice, the new practitioners admitted each year. In the "Bulletin" of 19 April 1983, the following observation was made:

"When Dr. Peter Karmel conducted an inquiry into the medical demands of Australia in 1973, he found that the ratio was one doctor to 721 people. That was high by the standards of comparable countries. Karmel said that the doctor/population ratio should reach one to 567 by 1991. It has reached that figure already and

each year, about 1200 new medical practitioners graduate into the market-place."⁸

There may also be some legitimate concern about work being done outside of the medical profession as such. Yet there are other factors at work here, notably the deferral of optional or elective treatment by the uninsured pending the introduction of Medicare in eight or nine months time. Whether the floodgates open as a result is too early to tell, but it is certainly not the policy of the present Federal Government to allow medical incomes to balloon out. The official ALP Health Care policy states boldly:

"The user plays little part in determining health costs. The typical and usually the only contribution made by the user is the decision to make an initial visit to the G.P. or the local hospital outpatients' department. The critical and potentially expensive decisions, the pattern of treatment, the referral to a specialist, the recommendation for laboratory and X-ray examinations, the admission to hospital, the prescription of medication — are then made by G.P.'s, specialists and critical determiners of cost in the health area, and they should be the prime objectives of cost containment policies."⁹

and later:

"Labor will seek to build into the health system restraints on medical fees; and make conditional the use of public health facilities on the observance of fee restraint. Equally the provision of subsidies to the private sector will be dependent on their contribution to similar goals. Labor will continue to argue for fee discounting for increased utilisation of medical services; will seek through the insurance system to maintain computer monitoring profiles on all doctors and support the further development of effective accreditation, peer review and hospital audit systems. Labor will seek, too, to develop certificate of need criteria for high technology developments in public and private facilities. In co-operation with the States and the medical profession, a Labor government will revise the present medical benefits schedule, adjusting charges in the light of technological developments and modifying relativities particularly where they provide incentives for inappropriate and costly alternative procedures. All this stems from Labor's belief that in the field of curative medicine, at least cost containment will be most effective through pressure on the supply side, by encouraging restraint by the providers of health care services—doctors, specialists, hospital administrators and hospital proprietors."¹⁰

In this area, the word 'restraint' seems a euphemism for a straight-jacket. Thus, if nothing else, the proposed system will interfere with

the decision making process and even if usage is not affected (as I suspect it will be), administration costs will rise in tune with the bureaucracy.

Further, there may be expected direct interference with fee levels—note the words “fee discounting for increased utilisation” and “computer monitoring” adjustment of “charges in the light of technological developments and modifying relativities”. Further, doctors in specialist practice have real concerns about the cost of medical equipment and the effect on their cash flow of leasing and maintenance charges. In these circumstances, it is clear that for the present and immediate future, cash, the life blood of professional business, will not be made so easily, its circulation will be sluggish and more will be drained off by the taxation system.

The list of control measures mentioned above makes sense. The professional would do well to recommend them to the client for their mutual benefit and that applies *mutatis mutandis* to the medical profession as well. There is little on the list you would not do when contracting with a builder for a home improvement. One step that you would take before extending your house is to seek competitive quotes. It has not yet come to this in the legal or medical professions to my knowledge—I certainly have never hawked my appendix or pregnant wife up and down Collins Street—but major Australian companies are now putting their audit out to competitive tenders and BHP recently sought tenders for the supply of taxation services from nine leading accounting firms. There are two reasons for this. First the breakdown in traditional loyalties and second, the cost savings that can result. It has long been said in the big eight accounting firms that quoting for the audit of say, General Motors, is easy—the fee is x% less than of the present auditor. To illustrate the trend, it was recently reported that in the United States, there were fifty per cent more audit changes in 1982 than the previous year and an increasing percentage of those were won by the big eight.¹² In other words, the big are continuing to get bigger. Only 17 of Fortune magazine's top 500 U.S. companies are not audited by the big eight.

Bigger is not necessarily better, but increases in size and scale lead to more opportunities for specialisation and as a result, clients are able to obtain a wider range of services from the one firm, eliminating the need for outside referrals and so adding further to the concentration and relative profitability of those firms. One product of size is the need for sophisticated management control systems. The principles behind these systems have relevance to all professions. The fundamental concept is to plan, to act on the plan, and to measure the

results against the plan. The application of this process to cash flow management is obvious, I would hope.

Budgeting calls for effort: it calls for forethought: it calls for making uncomfortable choices. It calls for a through-going review of your business environment, of your mix of services, of the costs of providing those services, and of your resources necessary to achieve the levels of service anticipated.

Whilst your accountant can help, the budget will be most effective only if you set your own goals. For those with access to office computers, I recommend your use of planning packages readily available. This is an excellent way of getting 'hands on' experience with the computer and breaking down the mystique that surrounds them whilst maximising for you the benefit of the planning process. Calculations resulting from different scenarios can be seen immediately with these programs and the effect on the ultimate cash flow is shown dramatically and positively. A plan, by itself, is a meaningless exercise in wishful thinking. The other steps that are required are commitment and measurement.

How do you get commitment in a professional practice? With a small number of partners, it may be possible to get this commitment by involving all partners in the decision-making process. With more than three or four, this will usually only work if the lowest common denominator is adopted—scarcely the best outcome. Partnerships of equal partners are unwieldy things to manage. What is required is the ceding of responsibility by partners to one of those number—a managing partner—or at least a small committee of partners. The process is one of giving up of powers and responsibility rather than delegation. That does not mean the managing partner is not accountable to the partners as proprietors, but he is not accountable to them as managers. This echoes the managerial arrangements in a company. It is ironic that those practices that choose to incorporate frequently require the perpetuation in the company of the inefficiencies and managerial duplication present in the traditional partnership.

If one partner has the managerial responsibility for the budget, how does he obtain commitment from other partners? Part of the answer is to have each partner prepare, within the overall plan, the budget of those key controls applicable to him and the staff under his direction. The corollary to this is to provide for carrots and sticks in the form of unequal partnership cash shares. Equality of profit sharing is an ideal but one which is rarely achieved as, in reality, partners do not contribute equally. Why then should their rewards be equal? If the budget is as important as I suggest, then the rewards of each part-

ner should be governed by his performance measured against the budget set by himself as part of the overall plan.

What are the key controls in a professional practice? They are: utilisation of time, control of work in progress, billing variances, early billing and collection, and cost control.

Utilisation of Time

A system that shows you the level of productive work achieved by each person is fundamental as a management control device in any business where services are sold. Only if the professional resources of the practice are utilised effectively will the practice be effective. Only if the utilisation of professional resources is measured will you know how effective is the practice.

Immediately a system to measure utilisation is suggested, many professionals "switch off". "My charges are not based on time spent. My fees are governed by the government or the agreed scale of fees or whatever." This demonstrates a misunderstanding of the function of a time utilisation system. Few professions are in the happy position of washing machine repairmen in being able to charge for every hour spent on a job. Fees are set often weighing many factors, of which the time spent is only one. The real function of a time and cost system is to establish the "cost" of jobs so that the most profitable lines of work can be pursued and the less profitable abandoned, discouraged or at least given less emphasis.

Time and cost utilisation systems need not be complex, depending on the needs of the practice. For example, there is little virtue in a general medical practitioner attempting to obtain an analysis of the profitability of each patient but there would be some advantage to a clinic in being able to evaluate the relative profitability of different types of services, or in some circumstances, different classes of patients.

The accumulation of time charges, with a proper separation between billable and non-billable categories, is the keystone of practice management. It provides data that will be: useful in determining the billing rates for each professional, helpful in determining staffing requirements, desirable for estimating fees, needed for controlling work in progress, and used as a basis for allocating work.

The outcome of measuring utilisation of professionals is to enable each of them to be measured against the budgeted standard (desirably a standard to which they have a personal commitment) and for the performance of the practice as a whole to be measured against the plan, other years and, where available, other firms.

Control of Work in Progress

This is a simple report that collects the time spent on particular clients or jobs by each professional and multiplies the sum by a specified hourly charge rate for that person. The report to the partner responsible for the client will then enable him to see how the job is progressing, enable him to compare it with a budget and, if agreed, render progress bills. It also enables the prompt billing of completed work and the assessment of the investment in work in progress.

Most importantly, it enables the managing partner (or partners) to see where the delays and difficulties in billing lie. If there is a clot in the cash flow blood stream, this will enable an accurate diagnosis and give the opportunity for corrective treatment. From personal experience, it is clear that the despatch of a telex to the managing partner setting out the number of weeks work in progress unbilled can work wonders in motivation, even without any admonishment.

Billing Variances

The next stage in the control system is to highlight those situations where the fee rendered varies from the utilisation derived standard.

It is not suggested that billing has to derive from the time and cost reports (although it may do, in some cases), but an analysis of variations will show those areas of the practice that warrant expansion, those partners who are too liberal in fee setting, inefficiencies in staff usage, and so on. A variance report has considerable capacity for generating negative feelings, to say the least. It is important that the information is used in a positive way, and not merely to generate endless post mortems. History as such may be bunk, but the proper use of history is to learn from it, or be obliged to relive it.

Collection

Earlier in this paper, some emphasis has been given to early billing—before the event if possible and certainly as soon after the event as is decent. Apart from other considerations, this gives the client a perception of the practice as being efficient and well-run. The general practitioners who render and often collect accounts on the spot have a great advantage. Prompt billing for good service is rarely counter-productive: bill while the memory of the problem and the solution are in the forefront of the client's mind. The most likely reason for delay in billing a particular client or allowing him a discount below standard fees is the lurking suspicion that the job was not up to scratch. Collection of bills rendered is fundamental. All that ultimately matters is cash. Cash is all that you can spend.

Most professionals are not good debt-collectors. Chasing money is not a particularly attractive way of spending time, compared with solving professional problems. Because it is implicitly a conflict situation, most will avoid it if possible, delegate and generally duck responsibility. Nevertheless, if there is a problem, you should know about it and the earlier the better. Make sure that your staff make you aware of problems in this area. Often data processing methods, whether manual or electronic, can be the key to success or failure in improving the management of accounts receivable. There are often simple and straightforward solutions, the cost of implementation of which is dwarfed by beneficial results. Again, the system must monitor collections, provide regular reports to measure against budget and to highlight exceptions to the norm.

Cash flow awareness is not an easy thing to instil in all the members of a partnership. Yet it is clear that profits cannot be drawn and spent until they are received. Of course short term fluctuations can be taken up in the bank balance but that is a short term solution at best. Awareness of the importance of cash flow can be heightened if the accounting of firm profitability and hence profit shares, is done solely on a cash basis. This should be done even though taxable income is determined on a different basis and management accounts incorporating work in progress may be used. One accounting firm I know of went so far as to pay out its bank balance to partners at the end of each month so that the partners' housekeeping money each month was dependent upon cash collections. The firm was soon very efficient at early billing and collection.

The control systems are all directed towards management of fee income. When the need for good financial management has been recognised, measurable benefits will accrue from the control mechanism: the professional staff has become better utilised and, therefore, more profitable and more satisfied with their work; fees are better controlled and therefore more easily collected; fees are billed at rates that provide a fair compensation to the principals of the practice; reduced investments in work in progress and in receivables have resulted in reduced working capital requirements; and this reduced working capital requirement has translated itself into reduced requirements for borrowing or requests for additional capital contributions from the principals.

The installation of a practice management system is a job for your accountant. He should be able to advise you on the systems available and their application to the particular circumstances of your practice. However before you are committed talk to other practitioners and seek the views of your professional body. The Law Institute of Vic-

toria for example, provides a management advisory service to solicitors. You should be warned however about over-complex systems. Computers can produce a deluge of information which can distract rather than inform. Keep your eye on the key elements and avoid attempts at over-precision and recording of minutiae.

Cost Controls

The budgeting for costs and cash outflows and their subsequent control is generally a more straightforward matter than planning for income and cash inflows. Costs can be contained. Consider the economies of relocating part of your practice in a lower rental area. Consider the opportunity for sharing facilities with other practices, for example, specialist libraries, delivery services, security personnel, over-load facilities and so on. Consider the administrative savings from bulk billing—unpalatable though it may be. Consider joint practice, group practice partnership and mergers. Mergers in particular look attractive but cost savings are hard to achieve: usually the main advantages of a merger are those associated with 'bigness'.

Finally, consider the worm in the apple: give thought to rationalising your income tax expense—but not too much. It is not unfair to say that much of the prominence of the medical profession in the upsurge of tax avoidance in the 1970s was due to the surprise of medicos in receiving provisional tax assessments in times of rising incomes. Effective tax schemes are scarcely marketed today. Indeed many would agree with the comment found in an American book entitled "The Medical Office—Organisation and Management":

"If the doctor manages to invest some of the money in a 'tax shelter' program (legal), it is nearly always a program that either keeps taking money each year . . . or it becomes a bad investment and he loses it outright. Thus, this money is not spendable."¹³

This volume incidentally, was the only book on medical practice management to be found in the Brownless Medical Library at Melbourne University.

The disillusionment with tax schemes is understandable and it is appropriate to spend just a little time in looking at some basic options that may reduce your tax expense.

Tax Options

After the demise of "artificial and contrived" tax avoidance, the tax planning options may be summarised as follows: substitute exempt income for assessable income; substitute capital receipts for

assessable income; substitute deferred assessable income for current assessable income, and substitute assessable income in other hands for your assessable income; investment in projects where deductible expenditures are not subject to tax if recaptured at the end of the project, and maximisation of business deductions and personal rebates. An example or two of each option will help you understand what I mean.

Perhaps the most satisfying way of deriving exempt income is to be appointed Governor General or Governor of a State. That however is a limited option! More frequently encountered examples are the income of approved superannuation funds and income derived and taxed overseas. Superannuation is associated with administration companies and incorporated practices (which I will refer to later). Exempt income from practices in say, Hong Kong, has been fruitful in the past but the aim of the Labor Government is to replace this exemption with a foreign tax credit system which effectively will expose this income to full marginal Australian tax rates.¹⁴

The options for professionals to derive capital receipts are not as limited as may be thought. Some are adept at founding practices and selling out for capital lump sums after a decent period. More frequently however, capital receipts come to older practitioners in the form of goodwill payments from new or younger partners. The problem with this of course, is that their capacity to pay is limited and the payments are not deductible in their hands, making finance a problem. One way around this, where the new partner has worked as an employee for a period, is for the goodwill or capital payment to be financed substantially by a retiring allowance paid to him on the termination of his employment. In this way, it will be found that the Deputy Commissioner of Taxation finances a considerable part of the ingoing.

Deferral of Income

Firstly, if you can account for your income on a cash basis—as distinct from a billings basis—do so. This enables the inflationary increase in the value of debtors to be excluded from assessable income, which is particularly desirable as the debtors are not represented by cash at the year end. If you are on a cash basis and particularly if you are a doctor, bills will be paid before June if patients are anxious to obtain concessional rebates for the cost. There is little that can be done about that. It is rare that it will be in your long term interests to delay billing in order to avoid the receipt of income in a year. On the other hand, those firms accounting on an accrual basis may decide that billing in late June is pointless if the cash will be received no

earlier than if the billing is done on July 1. Of course, the decision in Henderson's Case¹⁵ does not allow this sort of thing to be taken too far.

A variant of this theme is to look at arrangements which lessen income in the high income earning years before retirement but which provide income in the lower earning years after retirement. Some pension schemes work this way, partners in effect paying out pensions to their predecessors in consideration for the receipt of similar post-retirement pensions from their successors.

Income Splitting

The non-aggregation of family incomes in Australia has led to considerable energy being directed to the splitting of the breadwinner's income with his wife and children. From many social and business points of view, the resulting distortion to ordinary activities is most unsatisfactory but these devices have resulted in most satisfactory reductions in the levels of tax paid by professionals and their families. That does not mean that the arrangements used were not attacked by the Taxation Department. The writer endured six years of adverse assessment before the service trust concept was finally accepted by the Commissioner following court decisions in my favour (Phillips v. Federal Commissioner of Taxation¹⁶). The assignment of partnership income was pioneered by a Perth solicitor, Mr. Everett, after a debate of seven years leading to the High Court.¹⁷ It is unfortunate that Dr Peate who went further than any in this area was a victim of his times.¹⁸

The arrangements used for income splitting are not particularly attractive to the Commissioner or, one supposes, to the present government. The attempts to curtail the scope of the Everett decision are well known. Perhaps the government may re-introduce surcharges on income from property or attempt to tax diverted income at the rates applicable to the highest income earner in the family, as it proposes with trust income passing to children.¹⁹ If this does come to pass, we will be reduced to returning to the salaried wife arrangement popular with doctors a decade ago. It seems unlikely to me that the income earned directly by wives will be taxed in conjunction with their husband's income, given the rather aggressive stance of women's politics on such matters.

Tax Shelters

'Tax Shelters' are the sort of buzz words that make investors and the tax assessors prick up their ears. Those marketed with emphasis

on the tax benefits rather than commercial benefits are almost doomed to a long and protracted battle with the Tax Office.

It is not unreasonable for the Commissioner to attack those arrangements that will be most costly to him, even if he has little law on which to rely. For example, I do not think that his current attack on highly geared real estate investments will be universally successful and as a matter of the proper exercise of an administrator's duty, he has, no doubt, gone too far in many cases, but as a cash flow management technique for the government it is likely to be highly successful and therefore from some perspectives, appropriate.

So check your tax sheltered investments against the following touchstones: does the benefit have current political acceptance e.g. Australian film investment; is the benefit well known, e.g. Primary production investment; is the investment a reasonable business proposition over time without the tax deduction or capital gain benefits, e.g. real estate rental investments; does the proposal lend itself to individual investment or is syndication necessary, e.g. purchase of an aircraft compared with syndicated cotton investment, and are the tax benefits proportionate to the capital and effort involved.

These points may assist in obtaining an adjustment free assessment: they also probably reflect my innate (but not, I hope, inane) conservatism. That does not mean that aggressive postures should not be taken where there are good technical grounds for so doing. But regard must be had to the war of attrition that may tarnish the ultimate victory.

Minimisation of Non-Deductible Expenditure

This principle scarcely bears comment. It should be self-evident that, for example, if interest is incurred on a business loan and on a private housing loan, the latter should be reduced first. One point may be made, however. Partnerships are sometimes advised to keep things like car leasing costs out of the partnership books because equality is upset.²⁰ This penalises the partners overall as the costs may be wholly deductible if claimed in the partnership, but only partly so if claimed by individual partners. The problem lies however in the fixation with profit shares being equal or a certain proportion. The answer is to adjust those costs back against individual profit shares so that equity is preserved among partners whilst still bearing the cost as a partnership expense against the partnership income.

Incorporation

Now that you have it, do you want it? The tax benefits of incorporation are to be seen almost wholly in the availability of superannuation

deductions, leading, it was supposed, to the transmogrification of the income into deductible contributions and eventually into substantially tax-free receipts on retirement. Now, the coach looks like turning into a pumpkin. The warning signs have been there for some time; both the Asprey²¹ and Hancock²² Committees argued that the treatment of lump sum retiring allowance is too generous.

Just what the outcome will be is not clear but I, for one, am not banking on receiving my accumulated superannuation tax-free in 2003 or whenever. That does not mean however, that a deduction now is unjustified even if it only goes to purchase a pension or annuity on my retirement.

Nevertheless, if the superannuation benefits are diluted further, incorporation will lose its attraction from a tax viewpoint. Whilst the Commissioner's attitude is still formative a simple assignment of partnership income carries immediate advantages and seems preferable to me than putting so many eggs in the superannuation basket.

Because income tax is a major cost it warrants planning and management—but no more so than the rest of your practice. It seems to me that if many professionals devoted the same energy to the administration of their practice and the maximisation of their cash flow as they do to reducing this one cost, income tax, there would be many more apples in the basket at the end of the day and a good deal fresher, too!

I urge you to take responsibility for the management of your practice—delegation to an office manager or nurse should not mean abandonment of responsibility. Monitor the key controls frequently, be interested, be active. If your cash circulation is sluggish, seek out the thrombosis—you may not have far to look for the clot.

FOOTNOTES

- ¹ A. H. Chayes, and others, 'Managing your Lawyers', *Harvard Business Review* (January-February 1983), pp. 84-91.
- ² 'The Decline in Conveyancing', *Law Society Journal* (February 1983), pp. 9-11.
- ³ Susan Crook, 'Coping with the Squeeze: Learning from the 70's', *Law Institute Journal* (January/February 1983), p. 97.
- ⁴ Chayes, p. 84.
- ⁵ Chayes, p. 91.
- ⁶ Robert S. Banks, 'Companies Struggle to Control Legal Costs', *Harvard Business Review* (March/April 1983) pp. 168-170.
- ⁷ Samuel E. Bodily, 'When Should You Go to Court', *Harvard Business Review* (May-June 1981), p. 103.
- ⁸ *The Bulletin*, 19 April, 1983, p. 24.
- ⁹ Australian Labor Party, *Labor's New Health Plan* (1983), p. 8.
- ¹⁰ Australian Labor Party, *Labor's New Health Plan* (1983), p. 9.
- ¹¹ Chayes, p. 88.

- ¹² *Public Accounting Report*, (U.S.), (March 1983), pp. 4-6.
- ¹³ Elaine M. Reschke, *The Medical Office, Organisation and Management* (2nd edn, 1980), p. 81.
- ¹⁴ Australian Labor Party, *A Fairer Taxation System, ALP Policy on Tax Avoidance*, (August 1982), p. 14.
- ¹⁵ *Henderson v. Federal Commissioner of Taxation* 70 A.T.C. 4016.
- ¹⁶ *Phillips v. Federal Commissioner of Taxation* 77 A.T.C. 4169, 78 A.T.C. 4361.
- ¹⁷ *Everett v. Federal Commissioner of Taxation* 77 A.T.C. 4478, 78 A.T.C. 4595, 80 A.T.C. 4076.
- ¹⁸ *Peate v. Federal Commissioner of Taxation* (1966) 116 C.L.R. 38.
- ¹⁹ Australian Labor Party, *A Fairer Taxation System, ALP Policy on Tax Avoidance*, (August 1982), p. 14.
- ²⁰ Felicity Baverstock & Donald Eve, *Practice Management*, (Australia, 1980), p. 50.
- ²¹ K. W. Asprey & Others, *Taxation Review Committee, Full Report*, (January 1975), pp. 361-367.
- ²² K. Hancock & Others, *National Superannuation Committee of Enquiry, Final Report*, (1977).

FURTHER REFERENCES

- Reginald L. Jones & H. George Trentin, *Management Controls for Professional Firms*, (New York, 1968).
- Francis F. Manning (ed.), *Medical Group Practice Management*, (Cambridge, Mass., 1977).
- David Andrews, *Better Management of the Legal Practice*, (Melbourne, 1982) (Law Council of Australia).