30 March 2021

Mr Simon Webster
Director - Professional Firms Compliance
Private Groups and High Wealth Individuals
Australian Taxation Office

cc:
Tim Dyce, Deputy Commissioner, Private Groups and High Wealth Individuals, ATO
Jade Hawkins, Assistant Commissioner, Private Groups and High Wealth Individuals, ATO

Dear Simon

PCG 2021/D2 Allocation of professional firm profits – ATO compliance approach

CPA Australia, Chartered Accountants Australia and New Zealand, Institute of Public Accountants, the Business Law Section of the Law Council of Australia and The Tax Institute (together, **the Joint Bodies**) have considered **draft PCG 2021/D2 Allocation of professional firm profits - ATO compliance approach** (**the draft PCG**). The following comments represent our general collective views on the draft PCG, and these will be complemented with more specific, separate submissions from our respective associations, member firms and members.

1. The Joint Bodies support the ATO's efforts to address artificial and contrived arrangements that seek to inappropriately alter taxpayers' tax liabilities.
2. However, in lending that support, we reject three foundational propositions that, explicitly or implicitly, underpin the draft PCG:
    a. There is no general principle of taxation law dealing with, or proscribing, the so-called "alienation of income". That is, absent specific statutory provisions such as the personal services income or general anti-avoidance rules, there is no general principle which brings about the result that the income or profit beneficially derived by a partnership, company or trustee of a trust, that has arisen from the personal exertion or skilled labour of an individual, can be regarded as the profit or income of that individual. It does not matter how involved such an individual may be in the activities from which the income is derived by the entity.
    b. In the context of the ATO proposing a compliance approach to the taxation of income or profits from the provision of services, no proper justification for singling out the services provided by "professional firms" has been provided. It cannot be rationally argued that the income derived by an accounting or law firm is so different to the income derived by, say, a plumbing or management consulting business to permit the ATO to apply compliance resources differently.
    c. There is no general principle of taxation law, and there ought not be a general expectation in administering those laws, that the individual "owner" of a business receives any particular amount of compensation or remuneration for the individual's "efforts, labour and application of skills". That is, absent specific statutory provisions, an "owner" of a business can decide whether to receive nothing, a little, a lot or something in between and be taxed accordingly.

3. The draft PCG is primarily a guide to assess the likelihood of the ATO reviewing the affairs of an individual professional practitioner (**IPP**) and his/her firm with a view to applying the general anti-avoidance provisions in the *Income Tax Assessment Act 1936* (**Part IVA**). However, we observe that the exclusionary "Gateways" and risk assessment framework are not necessarily constructed to align with Part IVA factors. Rather, the draft PCG uses broad, unadjusted measures as proxies for Part IVA risk. As a result, the risk scores reflect neither the nuance or specificity required to properly assess the level of risk. Nor does the draft PCG provide either the ATO or the IPP with assurance that arrangements with high risk scores are, in fact, likely to be those to which Part IVA could be successfully applied.

4. Our view is that "Gateway 1 – commercial rationale" is the closest the draft PCG comes to any conventional consideration of matters relevant to the application of Part IVA but it does so through the abstract notions of "commercial rationale" or "commercially driven". We do not consider this approach to be correct, practical or useful. If "Gateway 1" is intended to be a "shortcut" Part IVA risk assessment tool and it is satisfied, we expect the application of Part IVA by the Commissioner of Taxation would be very difficult except in the most extreme of situations. As such, we question the purpose of the risk assessment framework as its contribution to the practical assessment of Part IVA risk is unclear. Despite the conceptual and practical limitations of "Gateway 1" (which includes the form and quantum of "remuneration paid" as a relevant consideration), we believe that where the IPP can show that they are remunerated on an arm's length basis for the services they provide to the firm, the arrangement should be classified as low risk, all other things being equal.

5. Our view is that "Gateway 2 – high-risk features" may be a useful guide to identifying specific issues that should be considered when risk-assessing the arrangements of an IPP. We understand that it was the ATO's concerns about the identified "high risk features" that led to the suspension of the original guidelines. Other than, perhaps, to serve as examples of arrangements the ATO considers would not pass "Gateway 1", it is unclear why the identified arrangements should feature as an exclusionary gateway to the application of guidelines dealing with the profit allocation of a business.

6. We observe that there has been a significant shift in the risk scoring of arrangements between the suspended guidelines and the draft PCG. Not only is the ATO's basis for that shift not explained, it is not justified by reference to either the apparent rationale for suspending the original guidelines or the Part IVA provisions. A firm that met any one of the tests under the suspended guidelines (which were themselves a simple proxy for assessing Part IVA risk) is now rated as high risk, noting that only one test needed to be passed previously. Further, the effective tax rate thresholds do not factor in the legislated reductions in corporate and individual tax rates. We believe that this will result in a very large number of IPPs across a broad range of firms being classified as moderate or high risk when their arrangements are highly unlikely to trigger Part IVA.

7. The impact of the draft PCG on IPPs and their firms will vary depending on a wide range of factors. We anticipate that these will be further articulated in separate submissions. The Joint Bodies would welcome the opportunity to facilitate further ATO engagement with our members to better understand the challenges and unintended or unreasonable outcomes of the risk assessment framework.

8. Finally, the draft PCG refers to "*the Guideline [being] formulated after consultation with legal and accounting professional bodies*". We wish to clarify that while selected members of the Joint Bodies may have been consulted confidentially during the development of the draft PCG over the past several years, at no time were the associations themselves involved in consultation nor was any detail provided to them, in whole or in part, by the ATO. Therefore, the draft PCG does not reflect the views of the Joint Bodies.

Should you wish to contact us in relation to the above, please contact Elinor Kasapidis, Senior Manager Tax Policy, CPA Australia on 03 9606 9666 or at **elinor.kasapidis@cpaaustralia.com.au** in the first instance.

Yours sincerely,

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