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Sally Cummins
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Australian Taxation Office

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10 October 2024

Dear Sally,

Draft Practical Compliance Guideline PCG 2024/D2 – Personal services businesses and Part IVA of the *Income Tax Assessment Act 1936*

CPA Australia is Australia's leading professional accounting body and one of the largest in the world. We represent the diverse interests of more than 173,000 members in over 100 countries and regions. We make this submission in response to The ATO's **PCG 2024/D2 – Personal services businesses and Part IVA of the Income Tax Assessment Act 1936** (PCG) released on 28 August 2024 on behalf of our members and in the broader public interest.

We make the following summary comments and key points for your consideration:

- paragraph 27's assertion that the Commissioner could have been successful in applying Part IVA of the *Income Tax Assessment Act 1936* (Part IVA) to a narrower scheme is unsupported.
- in the PCG, the ATO should clarify and include examples on how the ATO would apply the personal services income (PSI) rules and Part IVA:
- for non-white collar professional businesses such as a tradesperson or a machinery operator.
- where a married couple's business hires an apprentice or an employee.
- where both individuals in a marital relationship are income generators, or they have an income-generating employee.
    - where profits are retained in the business to fund working capital, trading stock, trade debtors or loans.
    - where a silent partner in a start-up business contributes the funds but the other partner is the income-generator.

Please refer to the Appendix for our detailed discussions. If you have any queries, contact Jenny Wong, Tax Policy Lead on jenny.wong@cpaaustralia.com.au or Bill Leung, Tax Technical Advisor on bill.leung@cpaaustralia.com.au.

Yours sincerely,

Ram Subramanian
Interim Head of Policy and Advocacy

Appendix

Detailed discussion

Narrower scheme

In reference to paragraph 39 of the judgment on ***Commissioner of Taxation v Mochkin*** [2003] FCAFC 15, paragraph 27 of the PCG stated "However, Sackville J indicated that it was arguable we could have been successful in the application of Part IVA had the narrower scheme have been argued."

Paragraph 39 (as extracted, with emphasis added in bold) below:

> 39 The scope of the scheme as defined by the Commissioner is of considerable importance in assessing whether the primary Judge's conclusion as to the dominant purpose of the scheme was correct. The Commissioner did not suggest at the trial that he could rely, in the alternative, on a narrower scheme than the Ledger scheme. **It is arguable, for example, that there was a discrete scheme commencing in 1989, whereby the Taxpayer utilised Ledger to distribute its net income as he directed, without regard to the value of the services he provided to that company. The tax benefit obtained by the Taxpayer in connection with such a scheme might have been the diversion of income that he would have derived from the services he provided to Ledger** (whether by way of salary, distribution or otherwise) from himself to other beneficiaries of the No 2 Trust. **The advantage from the Commissioner's perspective of a more narrowly defined scheme is, as Hely J remarked in *Hart,* at 4,626 [85], that:**
>
> *"[t]he more the scheme can be confined to the essential elements by which the tax benefit is obtained, the more likely it will be that the conclusion will be drawn that the dominant purpose for a person entering into a scheme so defined was to obtain the tax benefit."*
>
> **Of course, for the Commissioner to rely on a scheme defined in this way it would have been necessary for him to show, in accordance with *Peabody* and *Hart*, that the definition was not so narrow as to deprive it of all practical meaning.**

We respectfully submit that paragraph 39 did not support the PCG's assertion that Sackville J indicated it was arguable the Commissioner could have been successful in the application of Part IVA had the narrower scheme been argued. Instead, it only pointed out that it was arguable for the Commissioner to apply Part IVA on a narrower scheme and that the Commissioner had to show the scheme defined was not so narrow as to deprive it of all practical meaning.

We submit that PCG should more accurately reflect paragraph 39 of the judgement and further elaborate with examples where a narrower scheme would or would not "deprive it of all practical meaning".

Non-white collar professional examples

The thirteen examples provided in the PCG are all related to white-collar professionals and consultants such as IT, doctors, lawyers, accountants and engineers. Given the ATO has previously issued the related **PCG 2021/4 Allocation of professional firm profits - ATO compliance approach**, it is crucial that the PCG should provide clarity and examples of how the ATO would apply the personal services income (PSI) rules and Part IVA on (non-white collar professional) businesses such as a tradesperson or a (heavy) machinery operator.

Apprentice/employee example

The PCG has examples of husband and wife businesses where the wife provides administration services for the family business. The PCG should clarify and include an example of how the ATO would apply the PSI rules and

Part IVA where the couple employ an apprentice or an employee. Is the scale of the business activity being carried out such that it amounts to a 'business structure' and not be caught in the realm of the PSI and Part IVA rules.

Multiple income-generating individuals

Apart from Example 3, the rest of the examples provided in the PCG are related to a single income-generating individual who provides their personal services. The PCG should provide clarity and examples of how the ATO would apply the PSI rules and Part IVA where there are multiple income-generating individuals in a family business. For example, where both the husband and wife in the business are income generators or where there is an income-generating employee hired in the couple's business. Will the profits of the business be required to be apportioned between the income-generating individuals based on the income they have generated (brought into the business) for the year, and is this apportionment required when both husband and wife are income-generators?

Examples other than capital expenditure

The retention of profits to partly fund capital expenditure was illustrated in example 9 of the PCG. We submit that the PCG should also provide examples of how the ATO would apply the PSI rules and Part IVA where the retention of profits is part of cash flow management to fund working capital, the purchase of trading stock, trade debtors and loans used in the business.

Silent partners in a business

The PCG should provide an example of how the ATO would apply the PSI rules and Part IVA where one partner of the business, i.e. the silent partner contributes the funds and the other partner provides the know-how to starting a business. Will the ATO allow apportionment of income derived by the business between the partners or will the income be solely attributed to the individual who provides the know-how and generates the income?