CPA Australia Ltd
ABN 64 008 392 452

Level 20, 28 Freshwater Place
Southbank VIC 3006 Australia

GPO Box 2820 Melbourne
VIC 3001 Australia

P 1300 737 373
Outside Aust +613 9606 9677

cpaaustralia.com.au

Mr Dean Karlovic
Director, Private Wealth
Australian Taxation Office

Email: Dean.Karlovic@ato.gov.au

15 May 2026

Dear Dean,

Draft PCG 2026/D2 Application of Part IVA to property development arrangements involving long-term construction contracts - ATO compliance approach

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 176,000 members in over 100 countries and regions. We make this submission in response to the ATO's consultation on **Draft Draft PCG 2026/D2 Application of Part IVA to property development arrangements involving long-term construction contracts - ATO compliance approach**

on behalf of our members and in the broader public interest.

We support the PCG's aim of identifying arrangements where land ownership and development activities are separated - typically between related parties, to create artificial tax advantages.

Executive summary

CPA Australia considers Draft PCG 2026/D2 to cast the compliance net too widely over related-party property development arrangements and to risk capturing ordinary commercial structures that reflect genuine legal and business separation. We are particularly concerned about the:

- breadth of the Red Zone
- absence of an intermediate Amber Zone
- retrospective application to existing long-term arrangements
- cash flow pressures from taxing unrealised or unpaid amounts
- inconsistencies with established legal principles and recent case law.

Key recommendations

We recommend a more balanced framework that recognises genuine commercial drivers, applies prospectively, permits milestone-based recognition where appropriate, preserves statutory trading stock choices, and better reflects the commercial substance of standard special purpose vehicle (SPV) structures.

We recommend the following to improve the draft PCG:

- Introduce an intermediate Amber Zone for arrangements with genuine commercial drivers, rather than a binary Green/Red framework.
- Apply the final PCG prospectively only, or grandfather existing long-term arrangements to avoid retrospective outcomes.
- Allow milestone-based income recognition where it better aligns tax outcomes with actual cash receipts and commercial practice.

- Provide safe harbours for statutory trading stock choices, including the cost method, where structures are commercially driven.
- Recognise the group resource model for SPVs and accept that commercial substance may exist at the group level rather than in each entity separately.
- Aligning the PCG more clearly with recent case law, including Morton's Case, particularly for passive landowners and mere realisation scenarios.

Specific comments

We make the following comments and key points on the draft PCG:

- PCG 2026/D2 adopts an overly broad approach by treating related-party property development arrangements as a single economic activity, despite legitimate commercial and legal separation of entities.
- The Red Zone criteria are too wide and may capture ordinary commercial arrangements, particularly where timing mismatches, interposed entities or group loss use arise for non-tax reasons.
- The absence of an intermediate risk Amber zone creates a binary framework that may label common industry structures as high risk by default.
- Applying the compliance approach to existing long-term arrangements raises concerns about retrospectivity, fairness and administrative overreach.
- The Green Zone settings may force taxpayers to recognise income without corresponding cash receipts, creating significant cash flow pressure and taxing paper profits.
- The draft PCG appears inconsistent with established legal principles on derivation, separate entity treatment, trading stock elections and recent case law, including *Morton*'s Case.
- There is a risk the PCG undermines legitimate commercial practices such as asset protection, project risk quarantining and standard SPV structures.

If you have any queries, contact me at jenny.wong@cpaaustralia.com.au or Bill Leung, Tax Technical Advisor on bill.leung@cpaaustralia.com.au.

Yours sincerely,

Jenny Wong
Tax Policy Lead

Detailed discussion

Introduction

Draft PCG 2026/D2 represents a significant escalation in the ATO's scrutiny of Property Development Agreements (PDAs), particularly those involving related parties and long-term construction contracts. Released alongside **Taxpayer Alert TA 2026/1**, the Guideline targets structures the ATO perceives as "contrived" to defer income or exploit tax losses.

The primary issues and concerns we have surrounding this PCG centre on its broad application, the subjective nature of the "Red Zone" criteria and lack of an “Amber” zone, and the potential for commercial arrangements to be unfairly caught in the Part IVA net. They are explained in detail as follows:

1. The "single economic activity" fiction

The ATO’s concern is that taxpayers are splitting what is "in substance" a single economic activity into separate entities (Landowner versus Developer) to bypass trading stock rules. The ATO’s core technical premise in the PCG is that related-party Property Development Agreements (PDAs) should be viewed as a "single economic activity."

- **The issue:** Many property groups use separate entities for legitimate non-tax reasons, such as asset protection, meeting financier requirements, or ring-fencing project specific risks.
- **The friction:** By treating these as a single activity for Part IVA purposes, the ATO may be disregarding the legal and commercial reality of distinct corporate structures that have been industry standard for decades.
- **Technical position:** Australian tax law is fundamentally based on the separate entity principle. Each company or trust is a distinct taxpayer with its own tax profile.
- **Our view:** Unless the group is formally "consolidated" under Part 3-90 of the *Income Tax Assessment Act 1997* (ITAA 1997), the Commissioner has no technical basis to "merge" the income of a developer and the deductions of a landowner. Treating them as one unit for risk assessment effectively ignores the legal reality that they are separate taxpayers with separate obligations.

2. High-risk "Red zone" triggers

The PCG creates a "Red Zone" for arrangements that exhibit certain features. However, these triggers are often seen in genuine commercial projects:

- **Timing mismatch:** If the developer claims deductions for construction costs progressively but only recognises income from the landowner upon completion (a common feature of "fee on completion" contracts), the ATO flags this as high risk in the draft PCG.
- **Related party interposition:** The use of a "buffer" developer entity between the landowner and an external builder is often viewed as artificial by the ATO if the developer lacks significant independent capacity.
- **Group loss utilisation:** If the "artificial" losses generated by the timing mismatch are used to offset other income within the broader economic group, it is an immediate Red Zone trigger.

3. Absence of an "Amber" (intermediate) zone

Unlike other ATO guidelines (such as those for professional firms or intangible assets), PCG 2026/D2 introduces a strict binary risk assessment framework, i.e. only provides for Green (Low) and Red (High) zones.

- **The problem:** If an arrangement does not fit the strict, narrow criteria of the Green Zone, it is automatically classified as a high-risk Red category, increasing the likelihood of ATO scrutiny.

- **Our view:** This "binary" approach fails to account for the variety of legitimate commercial reasons a project might not feature progress payments or progressive income recognition. It essentially labels common industry structures as "high risk" by default, even if they lack any actual "contrived" or "artificial" elements.

4. Retrospective impact and "evergreen" scrutiny

- **Retrospective application:** Unlike some ATO guidelines that apply only to new arrangements, PCG 2026/D2 is intended to apply to both new and existing PDAs. That is, it will cover arrangements entered into before its date of issue, exposing longstanding, existing development structures to sudden Part IVA audits and potential penalty assessments. This is highly problematic for taxpayers who established long-term structures years ago for legitimate asset protection or financing purposes, as they may now find themselves retroactively classified as high-risk. Many PDAs are multi-year, rigid legal structures that cannot be easily amended.
- **The issue:** Projects that were structured years ago based on then current interpretations of **TR 2018/3** (regarding long-term construction contracts) may now find themselves in the "Red Zone," requiring taxpayers to either restructure or prepare for an audit, through no change in their own behaviour, but rather a shift in the ATO's compliance posture. Taxpayers entered into these long-term contracts (often 5–10 years) based on TR 2018/3.
- **Our view:** Applying a new risk framework retrospectively to legally binding contracts that cannot be easily amended is viewed as an "unreasonable" exercise of the Commissioner's power under administrative law. This violates the principle of natural justice and the doctrine of legitimate expectations.

5. Procedural fairness

The ATO should consider the draft PCG against administrative equity and legitimate expectations.

- **The issue:** Taxpayers have relied on the ATO's established position in TR 2018/3 for nearly a decade.
- **Our view:** Forcing a retrospective "risk" classification on existing, legally binding PDAs may be viewed as unconscionable or an overreach. The PCG is departing from a long-held representation where a taxpayer has acted to their detriment by entering into say, 10-year development contracts. This calls into question:

    i. procedural fairness in the issuance of compliance products,
    ii. the Commissioner's obligations under the Taxation Administration Act 1953 regarding taxpayer reliance on rulings, and
    iii. the retrospective application of a new compliance framework to long-term binding contracts is bad administration.

6. Conflict with case law: *Morton* and *Harvey*

The ATO's "single economic activity" theory contradicts recent and historical judicial precedents:

- **The Morton defence (2026)[1]:** The Full Federal Court recently held in *Morton's Case* that a landowner who enters a PDA and remains passive while the developer assumes all risk is "not" carrying on a business or profit-making enterprise. We submit that PCG 2026/D2 ignores this by trying to tax the landowner and developer as a single unit, regardless of their distinct legal and commercial roles.
- **The Harvey vs Harvey (1970)[2] argument:** This case established that improvements (accretions) made to land held by a landowner but used by a partnership typically belong to the landowner in equity. The PCG assumes these accretions should be taxed progressively as if they were partnership profits. This contradicts the property law reality that the increase in value has not accrued to the developer or partnership for tax purposes.

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[1] *Commissioner of Taxation v Morton* (2026) FCAFC 31
[2] *Harvey v. Harvey* (1970) HCA 120 CLR 529

7. The equity doctrine of accretion

The most significant equitable argument rests on the High Court precedent of *Harvey vs Harvey* (1970).

- **The principle:** This case established that where a person (like a developer) improves land belonging to another (the landowner), those improvements, and the resulting increase in value, attach to the land as "accretions".
- **Our view:** In equity, these accretions belong to the landowner by virtue of their freehold title, not to the developer or a “de facto” partnership.
- **Conflict with PCG:** We submit the ATO’s attempt to tax the developer on a “progressive” share of this value assumes the developer has a beneficial interest in the growth of the asset. Equity suggests otherwise: the developer has a contractual right to a fee, but no proprietary interest in the land’s value until a legal triggering event occurs.

8. Green zone: The “taxing paper profits” problem (cash flow strain)

A significant concern is that the “Green Zone” (low risk) requirements are stringent and often force a mismatch between tax liability and cash flow.

- **Extremely narrow “Green zone” (low risk) parameters:** To avoid ATO scrutiny, taxpayers must fall into the PCG’s “Green Zone”. Taxpayers are essentially required to eliminate any timing benefits.
- **Progressive recognition:** This effectively forces the developer to invoice and recognise income progressively throughout the project. That is, developer income recognition on a percentage-of-completion basis (often adhering to TR 2018/3), or forces the landowner to account for annual increases in trading stock, i.e., uplifts in land value using the market selling value or replacement value methods rather than the cost method. This is even if the contract does not provide for progress payments and says they are not paid until the end.
- **Liquidity crisis:** This strips away legitimate cash-flow deferrals that naturally arise from standard commercial contracts where payment is tied to project completion. This creates a significant “dry tax” problem and cash flow strain and forces developers to pay tax on “accrued” income, i.e., “paper profits” years before they receive any actual cash from the project completion. This has potential to cause severe liquidity issues of development groups, especially for smaller or mid-sized family-owned developers.

9. The concept of “derivation” (section 6-5)

The ATO’s preference for the “percentage of completion” method for developers conflicts with the legal definition of income derivation.

- **The law:** Under the “Arthur Murray” principle, income is generally only derived when there is a present legal entitlement to the money.
- **Our view:** In many PDAs, the developer has no legal right to payment until the end of the project. Forcing “progressive recognition” of income for tax purposes where no legal debt has been created (and no cash received) is argued to be a departure from the fundamental operation of Section 6-5.

10. Conflict with commercial reality and asset protection

- **Industry position:** The property industry commonly uses interposed developers to separate the valuable underlying asset (the land) from the inherent operational and litigation risks of construction (insolvency, contractor disputes, defect claims). We are concerned the ATO is conflating standard, prudent asset protection and financing mechanisms with tax avoidance.
- **Conflating commercial practice with tax avoidance:** It is standard industry practice to separate landholding entities from development entities, e.g., SPVs to ring-fence financial and legal risk. The PCG treats the

separation of these activities as an inherent tax risk if it results in deferred income recognition, placing a heavy evidentiary burden on private groups to prove the commercial substance of their developer entities.

11. Separation of legal and beneficial interests

We submit that the ATO is conflating economic substance with equitable ownership.

- **The issue:** Even if a landowner secures the developer's loans (a "Red Zone" indicator), this does not create a resulting or constructive trust that gives the developer a beneficial interest in the land.
- **Our view:** In equity, a guarantee is a secondary liability, not a transfer of ownership. By labelling these arrangements as "contrived," the PCG ignores the equitable reality that the landowner remains the sole beneficial owner of the capital asset throughout the development process.

12. Overlap with *Morton's Case*

- **Capital realisation:** The timing of this PCG is notable following the Full Federal Court decision in *Morton*. While *Morton* dealt with whether a landowner was "carrying on a business", the PCG uses the General Anti-Avoidance Rule (Part IVA) to attack the structure of the arrangement regardless of the landowner's status.
- **Our view:** We submit the ATO is using Part IVA as a "catch-all" because it is finding it difficult to win cases on substantive provisions (like the trading stock rules or the "carrying on a business" test) in complex PDA scenarios.

13. Defending commercial substance (the Part IVA test)

For Part IVA to apply, the dominant purpose of the arrangement must be to obtain a tax benefit.

- **The issue:** The separation of land ownership from development activities is rarely "contrived." It is driven by:
  - **Insolvency protection:** Quarantining the land from construction-related lawsuits.
  - **Financing requirements:** Lenders often require land to be held in a clean entity.
  - **Asset protection:** Keeping the family-owned land separate from the high-risk "build" entity.
- **Our view:** If these commercial purposes are the "dominant" reason for the structure, Part IVA cannot legally apply, regardless of whether the structure falls into the ATO's "Red Zone."

14. Part IVA: The "alternative postulate" problem

To apply Part IVA (the general anti-avoidance rule), the ATO must identify a "tax benefit" under Section 177C. This requires an "alternative postulate", a prediction of what the taxpayer would have done if the "scheme" did not exist.

- **Technical position:** We submit that the "counterfactual" world would look nearly identical to the current structure.
- **Our view:** Even without a tax motive, developers would use SPVs and separate land-holding entities for asset protection and bank finance requirements. If the "non-tax" reasons for the structure are the same, there is no "tax benefit" to cancel. We submit the PCG's assumption that parties would otherwise "merge" or pay tax progressively is a technically flawed counterfactual.

15. A heightened evidentiary burden

The PCG places a heavy "evidence requirement" on taxpayers. If a structure defers income, the taxpayer must maintain robust, contemporaneous documentation proving the dominant purpose of the structure was commercial (e.g., specific banking covenants or legal risk quarantining) rather than tax driven.

16. Partnership versus Joint Venture ambiguity

- **ATO position:** The ATO frequently infers that these related-party separations are, in substance, general law partnerships carrying on a joint business.
- **Our view:** We submit this "look through" approach blurs established legal boundaries between distinct corporate entities and relationships.

17. The lack of fiduciary "business in common"

The ATO's "Red Zone" criteria often assume that a Property Development Agreement (PDA) creates a partnership for tax purposes.

- **The principle:** For a partnership to exist in equity, there must be a relationship of mutual agency and fiduciary duty where parties carry on a business "in common."
- **Our view:** Most modern PDAs are explicitly drafted to exclude partnership. Equity respects the "independent contractor" status of the developer. If the developer bears the risk and the landowner is passive (as seen in *Morton*'s Case), there is no "community of interest" sufficient to merge their tax identities.
- **Impact:** If no partnership exists in equity, we submit the ATO cannot legally "look through" the entities to apply a single profit-recognition model.

18. Undermining statutory elections (Trading Stock)

Tax law currently allows a taxpayer to choose between valuing trading stock at cost, market selling value, or replacement value.

- **The problem:** The PCG effectively treats the use of the cost method by a landowner as a risk indicator (Red Zone) unless the developer is simultaneously recognising income.
- **Industry view:** This is viewed as a "backdoor" attempt to limit a taxpayer's statutory right to choose the cost method, essentially using a compliance guideline to override a clear legislative choice provided by the ITAA.
- **Legal standing:** A PCG is an administrative tool, not law. It cannot technically override a statutory choice granted by Parliament. Using Part IVA audit to force a taxpayer to choose "Market Value" over "Cost" is argued to be an unlawful fettering of the Commissioner's discretion. The PCG effectively "penalises" the choice of the cost method by labelling it a high-risk ("Red Zone") indicator.
- **Our view:** We submit administrative guidelines (PCGs) cannot legally override a statutory election. Arguing that the exercise of a specific right granted by Parliament constitutes "tax avoidance" is a significant legal stretch that may fail the "dominant purpose" test in Part IVA.

19. The CGT vs. trading stock "characterisation" battle

The PCG assumes that the landowner is part of a "property development business" and that the land is trading stock.

- **The problem:** Many landowners are "mere realisers" of a capital asset (holding the land on capital account). In these cases, the land is a CGT asset governed by Capital Gains Tax under Part 3-1, and not trading stock under Division 70 of ITAA 1997.
- **Our view:** The PCG seeks to apply trading stock logic to capital assets. Under Section 118-20, CGT gains are only reduced by amounts "otherwise assessable" as ordinary income. If the landowner is passive (per the *Casimaty*[3] and *Morton* principles), the increase in value is a capital gain triggered only at the final point of sale, not a progressive revenue gain as the PCG suggests.

20. Disconnect from "lean" SPV models

[3] *Casimaty v Commissioner of Taxation* (1997) 37 ATR 358; 97 ATC 5135, FCA 1388

The ATO's focus on "commercial substance" suggests that developer entities should have their own employees, significant assets, and independent decision-making.

- **The problem:** The industry standard is to use SPVs - separate entities that are often "lean" by design for risk mitigation, asset protection, and financing requirements.
- **Our view:** The ATO's expectation that these entities have independent "substance" ignores the reality of how property development is financed and managed in Australia, where developers often outsource all physical construction and management tasks to specialized contractors.

The Solutions

We submit the ATO draft PCG needs to move its guideline from a binary "Safe or Suspect" model to one that reflects the commercial reality of Australian property development:

1. Introduction of an "Amber zone" (The graduation solution)

The most common solution being proposed is the creation of an Amber Zone.

- **The fix:** Instead of an arrangement being either Green (Low Risk) or Red (High Risk), an Amber Zone would cover structures that have "minor" deviations from the Green Zone (e.g., related-party funding without progress payments) but possess strong non-tax commercial drivers.
- **The logic:** This removes the "technical cliff" by allowing taxpayers to stay out of the Red Zone if they can produce a "Commercial Substance File" justifying their specific structure, i.e., requiring a comprehensive paper trail of contemporaneous board minutes, bank mandates requiring entity separation for risk quarantine, and evidence of distinct operational realities. By documenting the "alternative postulate" and proving that the chosen structure was dictated by insolvency protection or financing necessities rather than tax avoidance, taxpayers can bridge the "technical cliff" and align their projects with both statutory rights and established judicial precedents like *Morton* and *Harvey*.

2. "Grandfathering" for existing arrangements

Because many Property Development Agreements (PDAs) are 5 - 10 year legally binding contracts, they cannot be easily amended to meet the new "Green Zone" criteria.

- **The fix:** We call for prospective application only. This means the PCG would only apply to arrangements entered into after the final Guideline is issued (or after April 1, 2026).
- **The logic:** This prevents the "retrospective penalty" where a project halfway through construction is suddenly labelled "high risk" because of a structure that was standard and accepted under TR 2018/3.

3. Cash-flow alignment (milestone recognition)

The current draft effectively forces developers to pay tax on "economic progress" (accruals) even if they have not received a cent from the landowner.

- **The fix:** Expanding the Green Zone to include Milestone-Based Recognition.
- **The logic:** If the developer recognises income as physical milestones are reached (and paid), rather than a theoretical "percentage of completion," it fixes the liquidity crisis where a company owes the ATO cash it does not actually have in its bank account.

4. Safe harbours for statutory choices (section 70-45)

The PCG currently uses the threat of the Red Zone to discourage landowners from using the Cost Method for trading stock.

- **The fix:** Creating a specific Safe Harbour for the Cost Method where the landowner can demonstrate that the project is financed by a third-party lender who requires the land to be held in a separate, "clean" entity.
- **The logic:** This protects the taxpayer's legal right to choose their valuation method under the ITAA, provided the "split" is required by a bank or for insolvency protection.

5. Redefining "commercial substance" for SPVs

The ATO's draft implies that a developer entity must have its own independent "employees and assets" to be considered genuine.

- **The fix:** Acknowledging the "Group Resource Model".
- **The logic:** In the modern industry, it is standard for a "Head Co" to employ all staff and a "Development SPV" to hold the contract for a specific project. The solution is for the ATO to accept that "substance" can reside at the group level, rather than requiring every single SPV to have its own HR department.

6. Alignment with the *Morton* principles

Following the *Morton*'s decision, there is a need to align the PCG with the court's view of "passive landowners."

- **The fix:** An explicit exclusion from the Red Zone for landowners who satisfy the "mere realisation" test.
- **The logic:** If a landowner is simply selling their land via a PDA and has no "active" role in the construction or management, the PCG should technically concede that they are not carrying on a business and should not be forced into a "progressive income" model.