Practical Compliance Guideline compendium – PCG 2025/5

Relying on this Compendium

This Compendium of comments provides responses to comments received on Draft Practical Compliance Guideline PCG 2024/D2 *Personal services business and Part IVA of the Income Tax Assessment Act 1936*. It is not a publication that has been approved to allow you to rely on it for any purpose and is not intended to provide you with advice or guidance, nor does it set out the ATO's general administrative practice. Therefore, this Compendium does not provide protection from primary tax, penalties or interest for any taxpayer that purports to rely on any views expressed in it.

Summary of issues raised and responses

Issue number	Issue raised	ATO response
1	**Partnerships** It is recommended that the final Guideline addresses genuine partnership situations and 'husband and wife' partnerships.	Partnerships are not a focus of the Guideline. However, paragraphs 16 and 17 of the final Guideline describe the Commissioner's long-standing compliance approach to spousal partnerships.
2	**Application** The final Guideline should be applied prospectively rather than retrospectively.	The final Guideline has effect both before and after its date of issue. We have a long-standing view on the treatment of personal services income (PSI) and the potential application of Part IVA of the *Income Tax Assessment Act 1936* (Part IVA). Existing judicial decisions and guidance such as Taxation Rulings TR 2001/*8 Income tax: what is a personal services business* (now withdrawn) and TR 2022/3 *Income tax: personal services income and personal services businesses* has made clear that Part IVA can apply to alienation arrangements including income splitting and profit retention.
3	**Future assets** How will companies save for future assets or bring in new employees if they are taxed in the hands of the individual? Start-up businesses cannot always pay an employee straight away and need time to save money in the company to build the business.	The final Guideline provides additional examples to further address these issues. Retention of profit arrangements are indicative of low risk if the intention is to temporarily retain some profit for a clear commercial purpose and that intention is carried out. This includes situations, for example, where an amount of net PSI is retained in a personal services business (PSB) with the intention to purchase equipment or cover expenses that the individual needs to perform their services. If the purchase of the assets is to enable the individual to charge

Issue number	Issue raised	ATO response
		more for services, take on more clients and increase future profits – this temporary retention of profits is for a clear commercial purpose. Importantly, the intention is carried out and the amount temporarily retained should only be enough to cover the anticipated expenses.
4	**Clarity of language** In paragraph 7 of the draft Guideline, it is unclear which provision 'it' is referring to in the sentence, '… because where it applies no tax benefit is obtained …'. '[I]t' refers to the preceding mention of either the PSI rules of Part IVA, but it becomes apparent only later that it's referring to the PSI rules, disrupting the flow of the sentence. We recommend changing the part of the sentence quoted above to: '… because, where the PSI rules apply, no tax benefit is obtained …'.	In the final Guideline, this sentence (now in paragraph 8) has been clarified to reflect the intended reference to when the PSI rules apply.
5	**Operating through an interposed entity** Some companies will only contract with another company (interposed entity) for commercial purposes, which makes attributing PSI more complex.	Operating through an interposed entity (a PSE) is not the issue. The final Guideline addresses situations where a PSE is utilised to alienate PSI through profit retention arrangements or income splitting with associates, resulting in a lower overall tax rate and providing a tax benefit to the individual whose PSI is involved.
6	**Record-keeping** Record keeping is a challenge for PSBs which are micro or family businesses, where a number of family members perform services, or where they perform a mix of work (supplying goods and providing personal services). A practical or informal family business approach should be taken to record keeping.	Record keeping is an important part of meeting your tax obligations and to the extent possible, entities, including micro and small family businesses, should be recording transactions as they occur, or as soon as practical after transactions have occurred. Such businesses should consider whether to seek record-keeping assistance from an appropriately qualified person.
7	**Low risk examples limited in scope** Further examples should be provided in the final Guideline that demonstrate a taxpayer's need to retain profits – for example, to meet ongoing costs. This is especially so in the case of entities that need to retain profits as part of cashflow management if they are	The final Guideline includes further low-risk arrangement examples that demonstrate retention of profit arrangements that have a clear commercial purpose and are carried out as intended.

Issue number	Issue raised	ATO response
	unable to generate income for certain periods of time and need to meet ongoing costs, to fund working capital, purchase trading stock, trade debtors and loans used in the business.	
8	**Superannuation contributions for administrative employees** Example 6 of the draft Guideline deals with a situation where a superannuation benefit is provided to the individual undertaking principal work. It would be helpful if the final Guideline could include one or more examples dealing with situations where superannuation contributions are made for the benefit of a related individual who only performs administrative work in the business.	When you are a PSB and you engage a related individual as an employee to undertake administrative tasks for a wage commensurate with the services performed, pay as you go withholding is required, and superannuation contributions must be made to avoid the imposition of the superannuation guarantee charge (as is required for any unrelated employee). Those expenses are allowable deductions when calculating net PSI – just as they are for superannuation paid on behalf of the individual engaged as an employee by the PSB to provide the principal personal services. Taxation Determination TD 2005/29 *Income tax: will Part IVA of the Income Tax Assessment Act 1936 always apply if a taxpayer who carries on a business (including a personal services business) pays superannuation contributions that do not exceed the age-based limits but are considerably in excess of the value of the services provided by the employee?* sets out our position on the application of Part IVA where a PSB employs a related individual and makes superannuation benefits for that individual that are in excess of the value of the services they have provided.
9	**Low-risk example – clarity on outcomes** Example 4 of the draft Guideline is unclear on certain matters, and anomalies arise irrespective of how those uncertain matters might be clarified. It is recommended that the example be amended to remove anomalies and achieve appropriate tax and commercial outcomes.	In the final Guideline, Example 4 now clarifies the tax and commercial outcomes.
10	**Timing of calculations** Example 4 of the draft Guideline indicates that, in the ATO's view, calculating profit and bonus figures prior to 30 June should be the norm and that undertaking the calculations after year-end is only acceptable in one-off	The purpose of Example 4 in the Guideline is to illustrate that a one-off deferral of distribution of net PSI derived in an income year can be considered low risk where the deferral is temporary and clearly driven by factors outside the control of the taxpayer.

Issue number	Issue raised	ATO response
	special circumstances. This does not reflect commercial reality. It is suggested that the final Guideline include a low-risk example which has a PSB finalising their accounts within a reasonable time after year-end or that a sensible time lag be permitted.	The timing of the calculations is simply used to establish the taxpayer's normal pattern of behaviour and thereby identify abnormal behaviours of a kind that fall outside that pattern.
11	**Example 6 – unaddressed consequences** Example 6 of the draft Guideline does not address a number of outcomes and consequences that will arise. The applicable company tax rate is 25% and profit is equal to taxable income. There are double taxation issues and anomalies that arise and GST implications for funds retained for purchase.	In the final Guideline, Example 6 now includes the price of the equipment (excluding GST) and clarifies that the amount retained in the company for the purchase of the equipment is from post-tax profits. We have also changed the type of payment in this Example from a bonus to a franked dividend, to prevent double taxation of the $2,000.
12	**Example 9 – fact pattern** Example 9 of the draft Guideline suggests that investing retained profits in a passive investment such as a share portfolio will automatically trigger a higher risk rating. It would be interesting for the final Guideline to have an example where the passive investment was a modest and highly liquid investment such as a term deposit or cash holdings in high interest accounts, to determine whether it would be considered a low-risk arrangement by the ATO.	In our view, it would make no difference if the retained profits were invested in a modest and highly liquid investment rather than a share portfolio. The circumstances set out in this example (now Example 13 in the final Guideline) would remain as higher risk because there are profits retained in a lower-taxed entity.
13	**Additional examples required – range of professions** The final Guideline should provide clarity and examples of how the ATO would apply the PSI rules and Part IVA on a non-white collar professional business such as a tradesperson or a heavy machinery operator.	The final Guideline includes examples reflecting a broader range of professions.
14	**Additional example required – income generated from business structure** The final Guideline should clarify and include an example of how the ATO would apply the PSI rules and Part IVA	Consideration of the circumstances in which income is considered to be generated from a business structure is beyond the scope of this Guideline. Paragraph 16 of the final Guideline makes clear that the Guideline does not apply to alienation arrangements where the income generated is not PSI – such as income from a business structure. Paragraph 16, through footnote 11,

Issue number	Issue raised	ATO response
	where a husband and wife 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 thus would not be caught in the realm of the PSI and Part IVA rules?	outlines where to find further guidance on when income is being generated from a business structure.
15	**Additional example – silent investor** The final Guideline should provide an example of how the ATO would apply the PSI rules and Part IVA where one partner of the business, that is, a silent partner, such as a retired parent or relative, 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?	The final Guideline includes an example (Example 9) that has, as part of the arrangement, a relative who is a silent investor in a new business.
16	**Example 13 – alternative outcome** In the final Guideline, an alternative outcome should be added into Example 13, outlining the outcome if Tom conducted both his civil engineering consulting and the other business selling goods in his personal name. This will allow Tom to be entitled to all allowable deductions – the losses from other business operations would be deductible against the civil engineering consulting income. There is no Part IVA risk.	This Guideline is only relevant where PSI of an individual is derived through a personal services entity (PSE) (company or trust). TR 2022/3 provides guidance relevant to individuals who earn PSI but do not work through a PSE (that is, sole traders).
17	**Example 13 – fact pattern** Given that BLD is in losses from its other business operation, the payment of a bonus or salary by BLD to Tom, equal to the net PSI, could have serious risk and cause BLD difficulties in paying its creditors and run the risk of insolvent trading.	The intent of all examples in the Guideline is to indicate factors that might cause us to apply compliance resources to review whether Part IVA may apply, not to set out when Part IVA will apply. In this example (now Example 17 in the final Guideline), the fact that the PSI is retained to offset significant losses from another business activity, may not be for a relevant or appropriate commercial purpose and may require further review.

Issue number	Issue raised	ATO response
18	**Examples 1 and 2 – market value salary** The final Guideline should confirm that paying an employee higher than award wages will not, in itself, trigger a higher risk rating. We also note that awards do not apply in many industries. Accordingly, we suggest that in the final Guideline the wording be amended to simply reflect that the employees are being paid commercial, market value wages and salary.	The final Guideline reflects that employees are being paid an amount of wages or a salary that is commensurate with the work they have performed.
19	**Include guidance and judicial decisions** It would be helpful if footnote 7 in paragraph 6 of the draft Guideline explicitly referenced the details of existing guidance and judicial decisions that have 'made clear that Part IVA can apply to alienation arrangements involving income splitting and retention of profits where the dominant purpose of a participant in the scheme was to obtain a tax benefit'. It is acknowledged that there are references to ATO guidance and judicial decisions in the footnotes, with the exception of TR 2022/3, these references appear to refer to guidance and judicial decisions that were published prior to the introduction of PSI regime and therefore prior to the introduction of the concept of PSB.	The Guideline references several guidance products[1] which set out the ATO's long-standing views regarding the potential application of Part IVA to alienation arrangements. The views in these guidance products are supported by relevant judicial authority. which are also cited in the Guideline – see, for example, footnote 4. The final Guideline includes a reference (at footnote 3) to TR 2001/8 (now withdrawn) which was released shortly after the PSI rules were introduced. TR 2001/8 remained in force until replaced by TR 2022/3. The introduction of the PSI rules had the practical effect of narrowing the scope for Part IVA to apply to alienation arrangements (because where the PSI rules apply, no tax benefit is obtained), but it did not otherwise affect the continued operation of Part IVA.
20	**Modern conditions affecting personal service businesses** The case law provided in the draft Guideline relates to business and work conditions in the early 1980s. The facts and outcome of *Commissioner of Taxation v Mochkin* [2003] FCAFC 15 (*Mochkin*) were not highly dependent on	Although *Mochkin* concerned facts occurring in the 1980s and 1990s, the fundamental principles of income splitting and retention have not changed over time. These principles remain applicable to modern business practices.

[1] Including Taxation Ruling IT 2121 *Income tax: family companies and trusts in relation to income from personal exertion,* Taxation Ruling IT 2330 *Income tax: Income Splitting,* Taxation Ruling IT 2503 *Income tax: Incorporation of medical and other professional practices,* Taxation Ruling IT 2639 *Income tax: personal services income* and TR 2022/3.

Issue number	Issue raised	ATO response
	the time period involved and unlikely to change the need to consider modern business conditions in assessing the appropriate flexible approach to income splitting or retention by the many PSBs which are modern businesses.	Judicial precedent is adaptable to new facts and circumstances. Courts revisit older case law and interpret it in light of changes in business practices and technology.
21	**Wider and narrower schemes** In reference to *Mochkin* at [39], paragraph 27 of the draft Guideline states '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.' Respectfully, *Mochkin* at [39] does not support the draft Guideline'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. The final Guideline should more accurately reflect *Mochkin* at [39].	We accept the *obiter* comments by Sackville J (at [39] and [80] of *Mochkin*) only indicate the Commissioner could have argued an alternative narrower scheme, rather than suggesting that he would have been successful had he argued the narrower scheme. *Mochkin* does, however, emphasise the point made, in paragraph 32 of the final Guideline, that the facts and circumstances of particular arrangements can result in 2 different schemes. We have included this case as a reference in that paragraph.
22	**The use of an entity imposed by the client** Small businesses are met with demands to operate through a corporate entity as imposed by their clients. It is arguable that this crucial precondition for getting work means there was no sole purpose of obtaining a tax benefit from any subsequent income splitting by the test individual. The draft Guideline addresses this issue at paragraph 26 by suggesting that the Commissioner might choose to identify the relevant scheme narrowly rather than widely. The effectiveness of such an approach is open to question in light of the decision of the Full Federal Court in *Minerva Financial Group Pty Ltd v Commissioner of Taxation* [2024] FCAFC 28.	The fact that an individual is operating through an interposed entity (a PSE) is not the issue. It is the use of that PSE to divert PSI away from the individual whose PSI it is, in order to pay less tax, which is the focus of this Guideline. Even if a small business owner is required to operate through a company, Part IVA may still apply where that company has been used to facilitate an income splitting arrangement or a retention of profits arrangement, or both.

Issue number	Issue raised	ATO response
23	**Red flag or risk indicators** If taxpayers and advisers need to reconsider any higher risk arrangements where there is an element of income splitting or profit retention, what are the indicators of red flags to identify a higher risk? Will there be a dollar value or a percentage? Or a moderate level of income splitting where net PSI allocated to lower associates remains below a threshold for a year of income?	The final Guideline does not establish an acceptable level of PSI alienation, 'threshold level' or a 'dollar value or percentage'. In the final Guideline, Table 2 provides an overview of the higher risk indicators where PSI is alienated through a PSE conducting a PSB.
24	**Alternative risk assessment factors** An alternative approach is to apply risk assessment factors (1) and (2) in Table 1 of Practical Compliance Guideline PCG 2021/4 *Allocation of professional firm profits - ATO compliance approach* to the net PSI of the PSB.	The low and higher risk indicators inform how we will assess alienation arrangements as having either a low or higher likelihood of compliance activity being applied to review the arrangement. The risk assessment framework in PCG 2021/4 was designed to encourage individual profession practitioners to self-assess.
25	**Value of personal services** In Example 7 of the draft Guideline, the entity passes the PSB tests and has a commercial purpose, however Part IVA is still applied because the distribution is done '*without regard to the value of her personal services which generated income*'. The term 'value of her personal services' is not clearly defined. It is unclear whether 100% of net profit after expenses must be distributed to the individual who generated the PSI or whether there are other parameters that determine the correct 'value' of the personal services.	The term 'value of personal services' (now in Example 10 in the final Guideline) indicates the amount that an arm's length buyer is prepared to pay the PSE for the particular individual's skills, knowledge and expertise. It follows that the net PSI derived from such a contract equals the value of that individual's personal services. The examples indicate the types of arrangements in which any deviation away from distributing 100% of the net profits to the individual may attract the application of compliance resources.
26	**Application of Part IVA** Taxpayers and their advisers are not in a position where they can apply Part IVA on behalf of the Commissioner.	The final Guideline does not advise taxpayers and their advisers to assess and apply Part IVA on behalf of the Commissioner. The Guideline explains when we will be more likely to have cause to apply compliance resources to consider the potential application of Part IVA to an alienation arrangement where PSI of an individual is derived through a PSE that is conducting a PSB.

Issue number	Issue raised	ATO response
		The administration and application of Part IVA is available in Law Administration Practice Statement PS LA 2005/24 *Application of General Anti-Avoidance Rules*.
27	**Net PSI includes a number of components** The ATO views expressed in the Guideline fail to take into account the commercial reality that net PSI derived by a PSE is the culmination of a number of inputs of which only one is the individual's personal efforts or skills. The PSE should be entitled to attribute part of the net PSI to the other components that generate the PSI and thereby be permitted to direct the value of those components away from the individual to which that income would, according to ATO views, otherwise be attributed.	PSI is income that is *mainly* a reward for an individual's personal efforts or skills. 'Mainly' means more than half (see paragraph 37 of TR 2022/3). Income that is mainly derived from the provision or use of assets, the sale of goods or the business structure of the entity is not PSI. When a contract involves a number of components, the entity needs to determine if the income derived from that contract is mainly a reward for the personal efforts or skills of the individual. If it is not, then the whole amount received under the contract is not PSI and the Guideline is not relevant to that income. See paragraphs 46 to 49 of TR 2022/3 for further guidance.
28	**Fees reflect other business costs** Fees charged represent substantially more than payment for the work done. The fees necessarily include components attributable to covering other business costs that are otherwise unrewarded including marketing, tendering, canvassing, engagement letters, billing and collection debt. These tasks distinguish a PSE business from an employee who simply turns up for work, does the work and goes home again without concern for these additional requirements of carrying on business.	It is important to recap that PSI is income that is mainly a reward for the personal efforts or skills of an individual. See our response to Issue 27 of this Compendium. A PSE will need to consider what the client is actually paying for and whether it is mainly for the reward for the individual's personal efforts or skills. If it is, the entire amount received under the contract is PSI and the character of the income is not changed by a notional allocation to other components for accounting purposes, such as business costs which determines the rate charged to clients. For example, if a plumber has a charge-out rate of $100 per hour and it is generated from them expending their personal effort as a plumber, that is $100 of PSI, despite it being notionally allocated to labour, business costs or profit for accounting purposes.
29	**Types of income** It does not make sense that different deliverables are taxed differently. For example, if a lawyer provides verbal or written legal advice, it is labelled as personal exertion income. However, if a lawyer comes out with an app or writes a book, it is	There is a distinction between personal services income and income for the supply or sale of goods. Refer to paragraphs 38 to 39 of TR 2022/3 for detailed guidance.

Issue number	Issue raised	ATO response
	labelled as sale of goods and not personal exertion income subject to the Guideline.	
30	**Tolerance to income splitting** The unique nature of many businesses is problematic if seeking to apply a 'one size fits all' approach for income splitting purposes. It is suggested the strict 'one size fits all' low or zero tolerance to income splitting for every PSB which passes the PSI rules should be reconsidered.	The examples in the Guideline of arrangements in the low and higher risk categories are not intended to be an exhaustive list of all possible low and higher risk arrangements. The type of scheme to which Part IVA may apply will depend on the particular facts and circumstances of the arrangement.

© AUSTRALIAN TAXATION OFFICE FOR THE COMMONWEALTH OF AUSTRALIA

You are free to copy, adapt, modify, transmit and distribute this material as you wish (but not in any way that suggests the ATO or the Commonwealth endorses you or any of your services or products).