

March 2021

## ATO ISSUES NEW DRAFT TAX RULING 2021/D2 ON PSI AND PERSONAL SERVICES BUSINESSES

### **Mr Tupicoff self-incorporated in the same month as “Grease” hit the screens in 1978!**

On 1 June 1978, Mr Gary Tupicoff reorganized his insurance practice under a company and trust structure. In late 1984, the Full Federal Court held that, while the company and trust were not shams, the anti-avoidance provisions in s. 260 of the ITAA 1936 applied to annihilate the arrangements, leaving the trust’s net profit to be assessed entirely in Mr Tupicoff’s hands.

Although the ATO has allowed taxpayers to “self-incorporate” to get superannuation benefits, attempts to split income have been stamped out by the general anti-avoidance rules in Pt IVA of the ITAA 1936 and the “personal services income” (PSI) rules in Divs. 84 through 87 of the ITAA 1997.

Nevertheless, almost 43 years after Mr Tupicoff rearranged his business affairs, taxpayers and their advisors remain just as keen to structure in the most tax-efficient, and asset protective, way possible.

### **Draft Taxation Ruling TR 2021/D2**

The professional community therefore will welcome the release by the ATO on 11 March 2021 of draft *Taxation Ruling* TR 2021/D2 (professional services income and professional services businesses)—“hot on the heels” of the issue on 1 March 2021 of *Practical Compliance Guideline* PCG 2021/D2 (allocation of professional firm profits - ATO compliance approach): [see our previous Client Alert](#).

TR 2021/D2 provides general guidance on the operation of the PSI rules and combines TR 2001/7 (meaning of PSI) and TR 2001/8 (meaning of personal services business (PSB)). The new draft also takes into account Court and AAT decisions handed down since the old rulings were published 20 years ago.

Although TR 2021/D2 does not appear to signal any immediate dramatic change in the ATO’s administration of the PSI rules, it provides a useful compendium of the ATO’s views in this important area of family and professional tax planning.

When finalized, TR 2021/D2 will provide binding guidance on the manner in which the ATO will apply the PSI and PSB rules to taxpayers.

### **What do the PSI rules seek to achieve?**

The PSI rules ensure that PSI received by a “personal services entity” (PSE, for example, a company, partnership or trust) is attributed to the individual who performed the personal services. For example, the rules may apply if Karen contracts with an IT company to provide her personal services as a consultant via KarenCo Pty Ltd (as trustee for her Family Trust). The rules also limit the deductions available to PSEs and to individuals who provide personal services but not through a PSE (sole traders).

Importantly, the PSI rules do not apply if the PSE conducts a “personal services business” that meets at least one of four PSB tests or if they get a PSB Determination.

The PSI rules also do not apply if an individual provides personal services as an employee. Any income derived in that capacity will be the individual’s ordinary assessable income. However, if the individual is *not* an employee, then the PSI rules may apply.

## Overview of Draft Ruling

To assist taxpayers determine whether they fall within the PSI rules and meet the PSB tests, TR 2021/D2 sets out the Commissioner’s position on:

- the meaning of PSI
- what is, and is not, PSI
- determining the “owner” of PSI
- the effect of the PSI rules
- the four PSB tests: namely, the results, unrelated clients, employment and business premises tests
- applying for a PSB determination, and
- in these difficult times, the potential application of the anti-avoidance rules in Pt IVA where the PSI rules do *not* apply and a PSB is being conducted (i.e. where a taxpayer has satisfied the PSI rules but may be obtaining inappropriate tax outcomes).

## 40 worked examples & flowchart

The ATO clearly recognizes the utility of examples and TR 2021/D2 therefore includes 40 helpful and detailed case studies, and a flowchart, to demonstrate the operation of the rules.

In particular, there is a worked example involving a computer systems analyst, who provides his personal services through a family trust, which distributes income to the taxpayer’s wife and three children, who are in the lowest marginal tax bracket. The ATO conclude that “a likely conclusion would be that the dominant purpose of the arrangement is income splitting to which Pt IVA applies”.

Taxpayers and professional advisors—you have now been warned!

## Next steps and call to action

The recent release of the draft Ruling and PCG confirm that the ATO continues to have a significant interest in the tax consequences of income splitting, income alienation, and business and practice restructuring.

If we can assist you to avoid the unfortunate fate of Mr Tupicoff—and many who followed him—please contact:



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