Personal Service Income

When individuals use their skills or efforts to earn income, such as through consulting or freelancing directly for clients, they must follow specific tax rules for reporting and taxation of their Personal Service Income (PSI).

We will understand this by following scenarios:

Scenario 1:

- Imagine you are a tax professional working in a famous accounting firm in Australia.
- Consider your annual salary income from the company is $220,000 and you have tax deductions of $20,000 for that year.
- So, as per the tax slabs, you have to pay up to 45% of your taxable income as tax to the government without Medicare levy, Medicare levy surcharge and other offsets and other tax add-ons.

Here are the Tax rates of Individuals in Australia:

Australian residents tax rates 2022–23

Taxable income	Tax on this income
$18,201 – $45,000	19c for each $1 over $18,200
$45,001 – $120,000	$5,092 plus 32.5c for each $1 over $45,000
$120,001 – $180,000	$29,467 plus 37c for each $1 over $120,000
$180,001 and over	$51,667 plus 45c for each $1 over $180,000

This is what your simple tax calculation looks like (without any tax offsets and levies)

Total Salary income	$ 2,20,000.00
Less: Tax deductions	$ -20,000.00
Taxable income	**$ 2,00,000.00**

Nil tax up to $18,200	$ -
19% tax ($18,201 - $45,000)	$ 5,092.00
32.5% tax ($45,001 - $120,000)	$ 24,375.00
37% tax ($120,001 - $180,000)	$ 22,200.00
45% tax ($180,001 - $200,000)	$ 9,000.00
Income tax to pay	**$ 60,667.00**

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According to the given scenario, your tax liability to the ATO amounts to $60,667. Please note that this amount does not include any tax offsets or levies.

It's quite a significant amount to pay as tax, isn't it? I'm sure no one would like to pay such a hefty sum to the government. Would you?

Here's a tax tip to help you reduce your tax liability:

Why not start a company like Carisma and work as a contractor for that accounting firm instead of being an employee?



So, instead of receiving salary, your newly started company will now provide you with a professional or contract income of $220,000.

You no longer need to pay tax for an income of $220,000, as companies are taxed at corporate tax rates due to being separate legal entities.

For those who don’t know the current small business tax rate is only 25%

The best part is that you can claim expenses such as appointing your wife as administrator and paying wages to her, rent expenses, rates, stationery etc….

When comparing the individual tax rate of 45% for a taxable income of $200,000, you will only have to pay 25% of the net profit of your newly started company as tax to the government.

"You can save a considerable amount of tax by utilizing the income flowing structure mentioned above."

Here is the calculation for the above:

Contract Income	$ 2,20,000.00
Less: Expenses	

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Salary to your wife	$ -20,000.00
Rent	$ -20,000.00
Rates	$ -5,000.00
Net profit	**$ 1,75,000.00**
25% tax on Net profit	**$ 43,750.00**

Hey, could you help me out by checking how much tax we've paid in scenario 1?

I think it is $60,667.00.

But now it is only $43,750.00

So, the possible tax saving here is $16,917.00.

"If we convert the amount as mentioned above, it would be approximately INR 9.5 lakhs."

Sounds crazy is that?

Well…... Unfortunately, you can't get this benefit just like doing that.



What Prevent that? Yes, Correct…. It is PSI Rules.

Because just like you do everyone can do this right?

Here, "How does the government ensure accurate tax collection? So, as per the ATO PSI rules, if you earn an income of $220,000, it is considered personal service income and not your business income. Therefore, you are required to pay taxes on this income based on your tax bracket."

Someone: Wait… so you are saying that you can't start a company for personal services.

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No, I am not saying that.

You can start a company to provide personal services. But you genuinely require such a company's business structure to perform as a contractor.

If you do this, you won't be taxed based on your slab rate. Instead, you can pay based on your company's tax rate.



Confusing!!!!

Fine… Let's break it down.

So…. It is a time for you to understand PSB.

PSB - Personal Service Business.

If you can prove that the income you received during the year is classified as Personal Services Business

Personal Service Income

(PSB), then the PSI rules will not be applicable.

(Hereafter wherever I mention PSI rules will not apply, which is good for you because you can claim all business-related deductions and pay tax at the corporate rate of 25%)

Okay… what the hell is PSB?

Well...It's a type of business where an individual provides services based on their skills directly to clients. PSB is distinct from PSI (Personal Services Income) because it operates more like a traditional business, not solely dependent on one person's efforts. PSB can have tax benefits and deductions different from those available to individuals earning PSI.

Note the word above "It operates like a business, **not solely dependent on one person's efforts".**

This means, "You can offer personalized services to your clients by starting a company. However, it is important to note that your business operation should not solely depend on your efforts. You need to have a proper business structure in place, including equipment, staff, and other resources to effectively provide personal services to your clients."

If you can prove that your personal service income for the year is considered PSB and PSI rules won't apply.

However, In ATO's eye, you are still receiving personal service income, but you are working through a personal service business, so they won't apply PSI rules to your personal service income.

Sounds great right?

Now the question is how can we prove our personal service income as PSB?

Here is where the PSI tests are coming to check whether you received Personal service income as PSB or not.

If the PSB test is satisfied, PSI rules do not apply. If not, PSI rules apply, and you must pay taxes according to your slab rates, and the limitations on deductions will apply.

Now we see about the PSI tests…

Okay…. There are 4 steps in the test.

Personal Service Income



Business and professional items section

P1 Personal services income (PSI)

Print **X** in the appropriate box.

Did you receive any personal services income?

■ **YES** ☐ Read on. **NO** ☐ Go to item **P2**.

Part A

Did you satisfy the results test?

P **NO** ☐ Read on. **YES** ☐ Go to item **P2**.

Have you received a personal services business determination(s) that was in force for the whole of the period you earned PSI?

C **NO** ☐ Read on. **YES** ☐ Go to item **P2**.

Did you receive 80% or more of your PSI from one source?

Q **NO** ☐ Read on. **YES** ☐ Go to part B.

If you received less than 80% of your PSI from each source for the whole of the period you earned PSI and you satisfied any of the following personal services business tests, indicate which business test(s) you satisfied. Print **X** in the appropriate box(es). Refer to the publication *Business and professional items 2023* before you complete this item.

Unrelated clients test **D1** ☐ Employment test **E1** ☐ Business premises test **F1** ☐ If you printed **X** at **D1**, **E1** or **F1**, go to item **P2** below; otherwise go to part B.

Part B

Do not show amounts at part B that were subject to foreign resident withholding. Show these at item **P8**.

PSI – voluntary agreement	**M**	·00
PSI – where Australian business number not quoted	**N**	·00
PSI – labour hire or other specified payments	**O**	·00
PSI – other	**J**	·00
Deductions for payments to associates for principal work	**K**	·00
Total amount of other deductions against PSI	**L**	·00

Net PSI (**M** + **N** + **O** + **J**) less (**K** + **L**) **A** ·00 ☐

Step 1 - Have you received PSI?

If more than 50% of the income received is for your labour, skills, or expertise, then you have earned Personal Service Income.

More on this. https://www.ato.gov.au/businesses-and-organisations/income-deductions-and-concessions/personal-services-income/income-that-is-psi

If yes to this question, you must go to step 2.

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If no PSI rules don't apply so there are no changes to your taxes and you can enjoy the lower tax rate, that's a good thing!

Alright, Step 2 - The Results Test

To pass the results test, you need to meet all 3 of the following conditions for at least 75% of the PSI you earned:

- You must be paid to produce a specific result.
- You are required to provide equipment or tools (if required).
- You are required to fix mistakes at your own cost.

If it's a yes for all 3 conditions for 75% of the income that you earned, then you pass the results test and PSI rules don't apply. That's a good thing!

If no or you only meet one or none of those conditions, move on to step 3.

More on this. https://www.ato.gov.au/businesses-and-organisations/income-deductions-and-concessions/personal-services-income/working-out-if-the-psi-rules-apply/results-test

Let's jump onto step 3.

Step 3 is known as the 80/20 rule, if you get to this step, you then must pass step 3 and 4 in order for PSI rules to not apply.

So here is the test: Less than 80% of your income must come from 1 Client only.

If you meet this, then go to Step 4.

If 80% or more comes from 1 client, then PSI rules do apply, and you can't claim certain deductions and you must show the income that you earned personally. Not a good thing at all.

Step 4 - The remaining test.

There are 3 remaining tests, and you just need to pass any one of these tests for the PSI rules not to apply.

So, the 3 remaining tests are:

1. Unrelated Clients Test - you have 2 or more unrelated clients, and you offer the services to the public
2. Employment Test - you employ or contract others to provide services to your clients.
3. Business premises Test - you have a physical business premises separate from your client and separate from your home.

For more details. Unrelated clients test, the Employment test, and the Business premises test. Check the ATO Portal.

And that's it! If you pass Step 3 and Step 4 then you are a Personal Service Business and PSI rules

won’t apply.



Should you have any queries regarding the tests and wants to know what this tests really trying to proves then don’t hesitate to contact me😃.