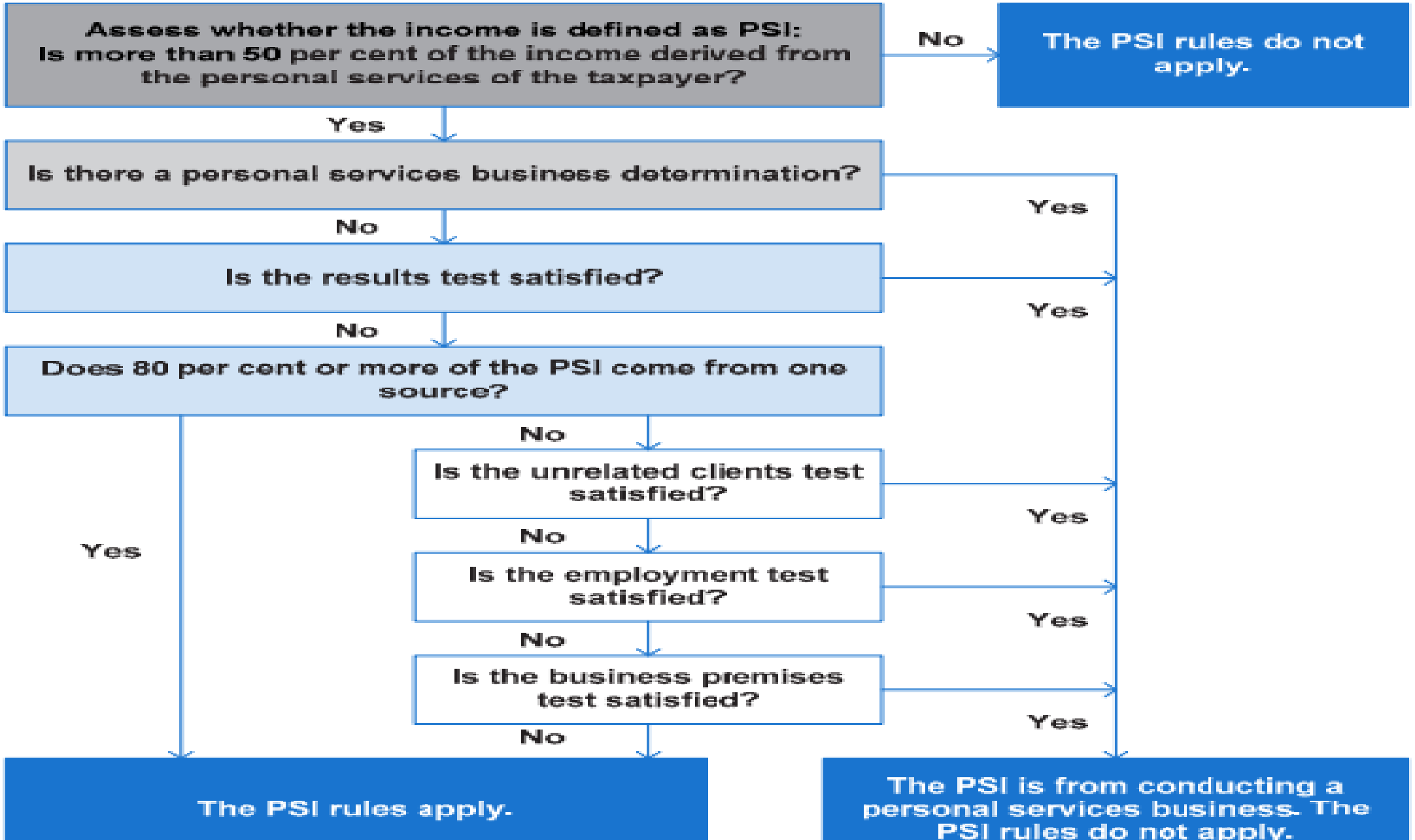


Personal Services income

Figure 1.1: Taxpayer self-assessment steps for the application of PSI rules



Overview

Personal Services Income (PSI) is income that is mainly a reward for an individual's personal efforts or skills.

Examples of PSI include:

- income of a professional practitioner in a sole practice.
- income payable under a contract which is wholly or principally for the labour or services of a person.
- income derived by a professional sportsperson or entertainer from the exercise of professional skills.
- income derived by consultants from the exercise of personal expertise.

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Overview

PSI does *not* include income that is mainly:

- for supplying or selling goods (e.g. from retailing, wholesaling or manufacturing).
- generated by an income-producing asset .
- for granting a right to use property (e.g. the copyright to a computer program).
- generated by a business structure (e.g. an accountant working for a large accounting firm).

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PSI and Companies, Partnerships and Trusts

To determine if a business is receiving PSI, it is necessary to look at the income (or reward) from each completed contract, and work out what percentage of the payment is for:

- the skills, knowledge, expertise or efforts of those who performed the services (i.e. the labour component), and,
- the materials supplied and/or tools and equipment used to complete the job.

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PSI and Companies, Partnerships and Trusts

If **more than 50%** of the income received is for the skills, knowledge, expertise or efforts of the individuals who performed the services, then the income for that contract is PSI.

If **50% or less** of the income received is for the skills, knowledge, expertise or efforts of the individuals who performed the services, then the income for that contract is not PSI.

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Overview

Only individual taxpayers can have PSI.

If PSI is channelled through a company, partnership or trust (i.e. a *personal services entity or PSE*), it is still the individual's personal services income for income tax purposes.

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Illustration: Determination of PSI

ITP Pty Ltd provides computer programming services but Wei does all the work involved in providing those services. Wei is the only employee of ITP Pty Ltd and carries out all of the contracted work. Wei uses the client's equipment and software and does not supply any of his own equipment.

Required:

Has the income been derived from personal services?

Solution:

ITP's income from providing the services is Wei's personal services income because it is a reward for his own personal efforts and skills.

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Illustration: Determination of PSI

Tim owns and drives a semi-trailer that he uses to transport goods.

Required:

Has the income been derived from personal services?

Solution:

The income is not Tim's personal services income because it is produced mainly by the use of the semi-trailer and not by his personal efforts or skills.

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If the PSI Rules Apply

The PSI, reduced by certain deductions to which the personal services entity is entitled, is treated as the income of the individual who does the personal services work and must be included in their income tax return - called *attribution.*

The personal services entity must either:

- pay the PSI promptly, as salary or wages, to the individual who does the personal services work,

  or

- attribute the net PSI to the individual who does the personal services work and withhold and remit tax on that income .

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Personal Services Business (PSB)

A taxpayer's business qualifies as a personal services business if:

- it meet the *results test*, or
- *less than 80% of the individual's PSI in an income year comes from any single source* and any of either the *unrelated clients test* or the *employment test* or the *business premises test* are met, or
- a *PSB determination* is obtained from the FCT confirming that the business is a personal services business.

Income derived by a Personal Service Business (PSB) is exempt from the personal services regime.

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The Results Test

Used to work out if the PSI rules apply.

The results test will be satisfied in an income year if, in respect of at least 75% of the PSI of the individual doing the personal services work, having regard to the custom or work practice when work of that kind is performed:

- The PSI is paid to achieve a specified result or outcome under a contract or arrangement, and,
- The individual provides the tools or equipment necessary (if any) to do the work, and,
- The individual is liable for the cost of rectifying defects in the work performed.

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The 80% Rule

If the results test is not satisfied, it is necessary to consider the 80% rule.

This rule looks at whether the taxpayer receives 80% or more of their PSI from one client (and their associates).

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Unrelated Clients Test

This test looks at whether income is received from two or more unrelated clients.

An individual or PSE will meet the unrelated clients test in the income year if:

- the service provider (individual or PSE) doing the personal services work generates PSI from two or more clients who are not associated with each other or with the service provider.

- the personal services must also be provided as a direct result of the service provider making offers to the public.

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Employment Test

Subject to certain exceptions noted below, an individual service provider will meet the employment test in the income year if they:

- have employees, engage sub-contractors or engage entities that perform at least 20% (by market value) of the principal work, or
- have apprentices for at least half the income year.

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Business Premises Test

An individual or PSE service provider will meet the business premises test if, at all times in the year of income, the service provider maintains and uses business premises that are:

- mainly used to conduct the work (more than 50% of the use) from which PSI is gained or produced.
- used exclusively by the service provider.
- physically separate from the private residence of:
  - the individual doing the personal services work
  - their associates
  - the service provider's associates
- physically separate from the business address of all clients or their associates.

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Personal Services Business Determination

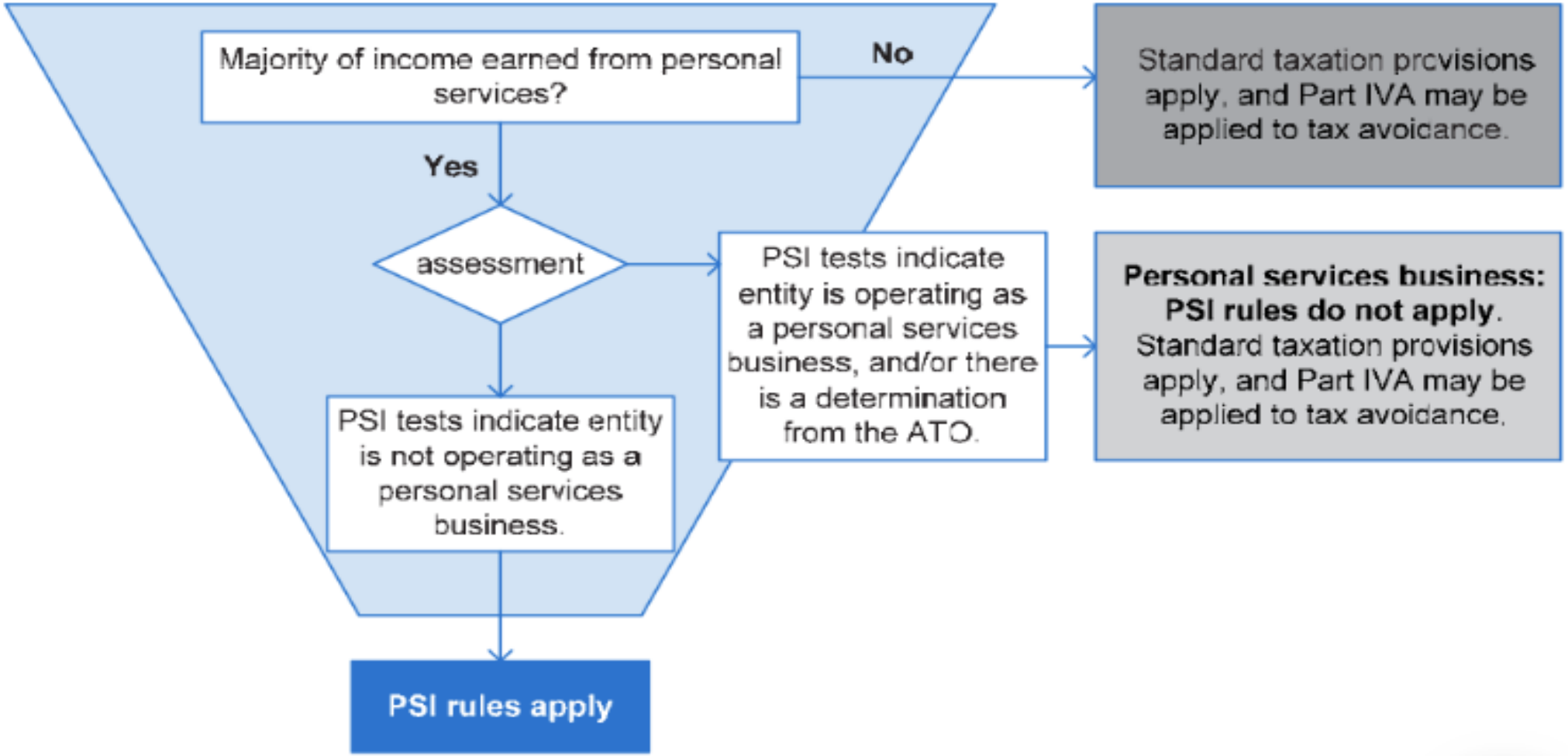
This is a notice from the ATO stating that the taxpayer is conducting a personal services business.

A taxpayer can apply for a determination if:

- they are not sure whether they meet one or more of the personal services business tests, or
- they don't meet the results test and 80 per cent or more of their personal services income comes from one client, or
- unusual circumstances prevent the taxpayer from meeting one or more of the tests.

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Figure S.1: Interaction between the PSI rules and standard taxation provisions



When do the PSI Rules Apply?

The PSI rules apply when a taxpayer receives PSI and they:

- have not passed any of the tests, and
- do not have a PSB determination.

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PSI and Sole Traders

If a sole trader has worked through the tests and doesn't pass any of them, then the PSI rules apply.

This means that they will not be able to claim certain deductions against the PSI including rent, mortgage interest, rates, land tax, certain payments to associates, and there are some restrictions on superannuation for associates.

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PERSONAL SERVICES INCOME (PSI)

General

- Income earned from employment would be prefilled in item 1
- If it is not prefilled, then it might be filled in item 14

Deduction not Allowed

- Rent, mortgage interest, rates or land tax for your home
- Payments to your spouse, or other associate, for support work such as secretarial duties
- Expenses that you would generally not be able to deduct as an employee

Illustration: Restriction on deductions

Sue recently operates a business called Sue's Accounting Services. She provides financial advice and completes tax-related forms (e.g. tax returns and business activity statements) and operates this business from a room in her home.

All of the income generated is PSI as most of the income relates to Sue's skills, knowledge and expertise. Sue has determined that the PSI rules apply.

Therefore, she cannot claim rent, mortgage interest, rates or land tax relating to her residence against the PSI generated.

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PSI and Sole Traders

Payments to Associates for Support Work

Payments made to an associate (e.g. spouse, child or other relative) by a sole trader for performing non-principal work cannot be deducted.

Principal work is the work that must be done under the contract and generates PSI. It does not include support work.

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Illustration: Payments to associates for support work

Pedro provides marketing consultancy services which generates PSI. He employs his wife Julie to undertake some of the work. Julie's work falls into two categories:

- **inputting daily sales data into spreadsheets Pedro uses to prepare recommendations and reports, and,**
- **issuing invoices, banking receipts and administering the home office.**

As the data entry work is the first stage in the work required to fulfill the obligations under the contract, it forms part of the principal work and is therefore principal work.

However, issuing invoices, banking and administering the home office, is not principal work. Pedro cannot deduct the wages he paid to Julie for issuing invoices, banking and administering the home office.

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Illustration: Superannuation contributions for associates performing support work

Cathy is an editor who does editing and proofing work. She decides to get her brother, Jock, to do the bookwork and issue invoices for work she completes.

Jock's salary is $20,000 a year and Cathy contributes $1,800 to Jock's superannuation fund.

As Jock is an associate (he is Cathy's brother) and he performs non-principal work (bookwork and issuing invoices are not the main work clients pay for), Cathy cannot claim a deduction for the $1,800 superannuation contribution.

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Illustration: Effect of non-deductible salary

Dewi is a sole trader who pays a salary to Ted, an associate, to do the bookwork and run the home office (i.e. non-principal work). She is not entitled to claim a deduction for the salary she paid to Ted because he was not performing principal work and he is an associate.

As Dewi cannot claim a deduction for the salary she paid to Ted, the salary Ted received is not included in his income tax return as assessable income. Any PAYG withholding tax Dewi paid on behalf of Ted is credited to Dewi when she completes her individual income tax return.

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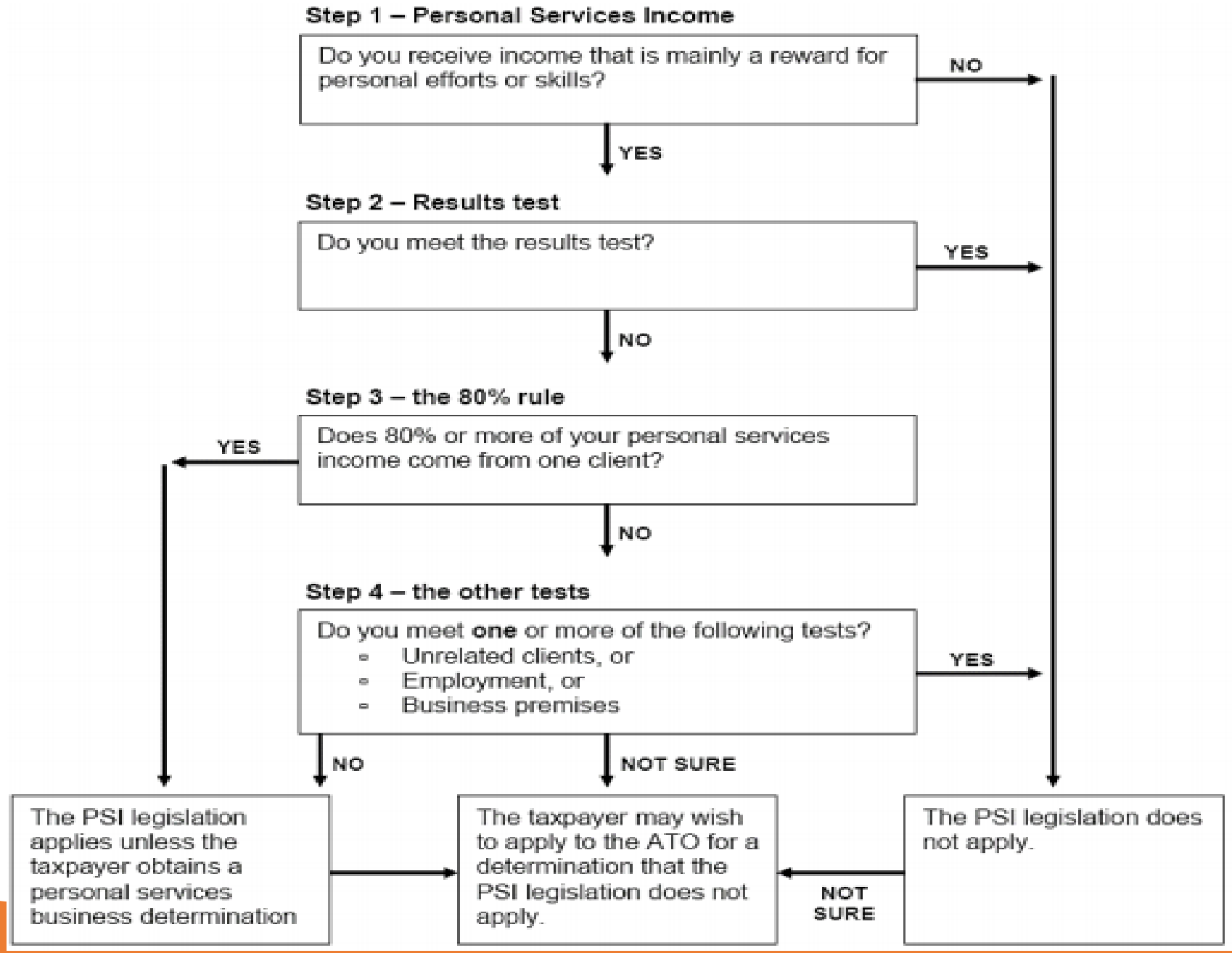
HAVE YOU SATISFIED THE PSI RULES?

A: A cleaner works for a firm with majority income from that firm and he is provided with all the equipment.

B: A cleaner who posts advertisements online seeking for different clients, and he purchased his own equipment and car for providing the service.

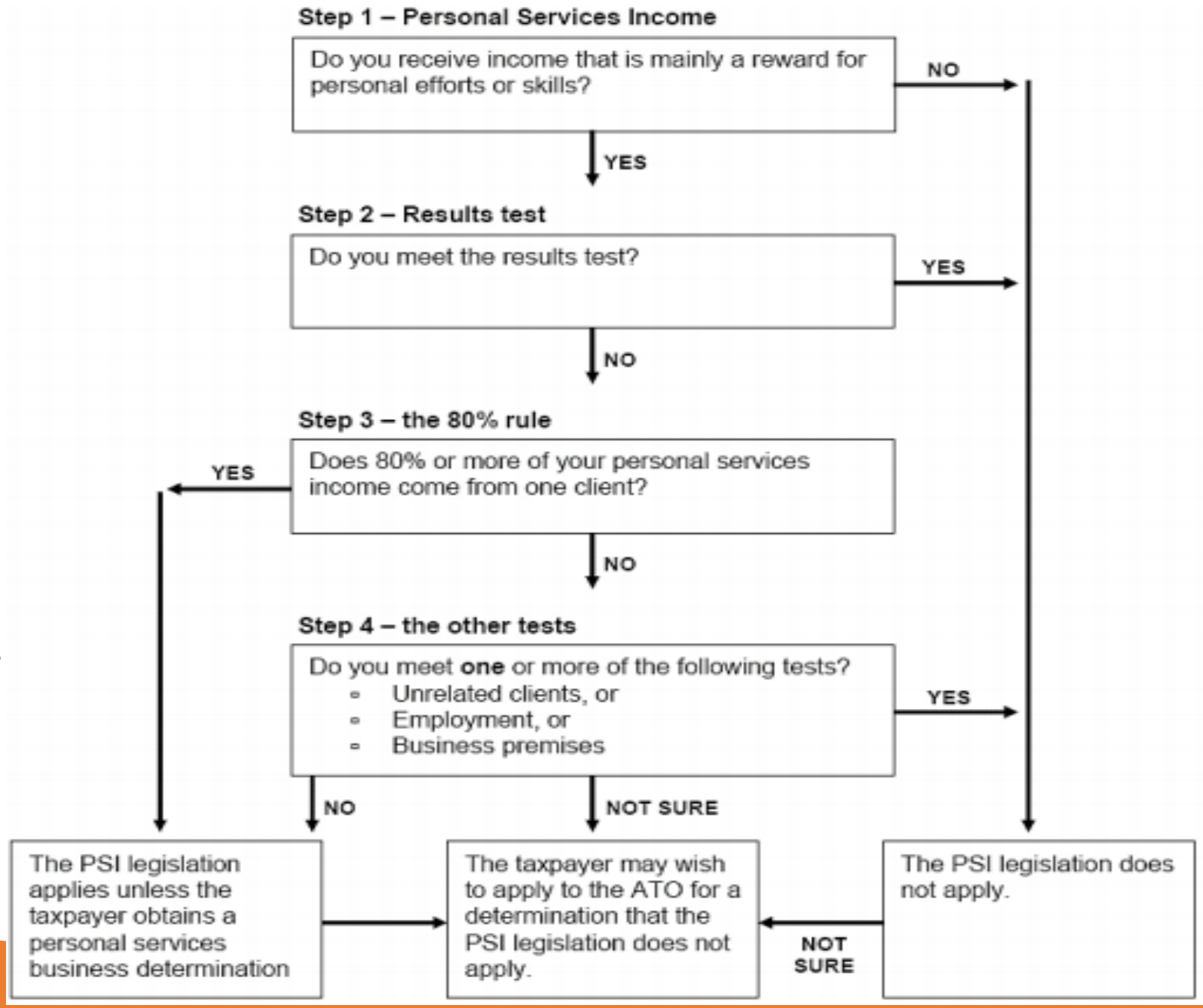
SCENARIO A

- Step 1: Yes
- Step 2: NO
  - paid to produce a specific result ✅
  - required to provide the equipment or tools ❌
  - required to have mistakes fixed at your own expense ❌
- Step 3: Yes
- The PSI applies, have limitation on deductions.



SCENARIO B

- Step 1: Yes
- Step 2: Yes
  - paid to produce a specific result ✅
  - required to provide the equipment or tools ✅
  - required to have mistakes fixed at your own expense ✅
- The PSI rules do not apply. The expenses of equipment and car can be deductible.



PERSONAL SERVICES BUSINESS (PSB)

Qualification to be considered as a PSB are:

- You are getting paid for the result not per hour
- Have public liability insurance
- More than one client
- Turnover more than $2500 annually

Do you have a turnover of more than $75000?

•Yes? You would need to register and report for BAS and GST.

Eligible for Business Expense Deduction

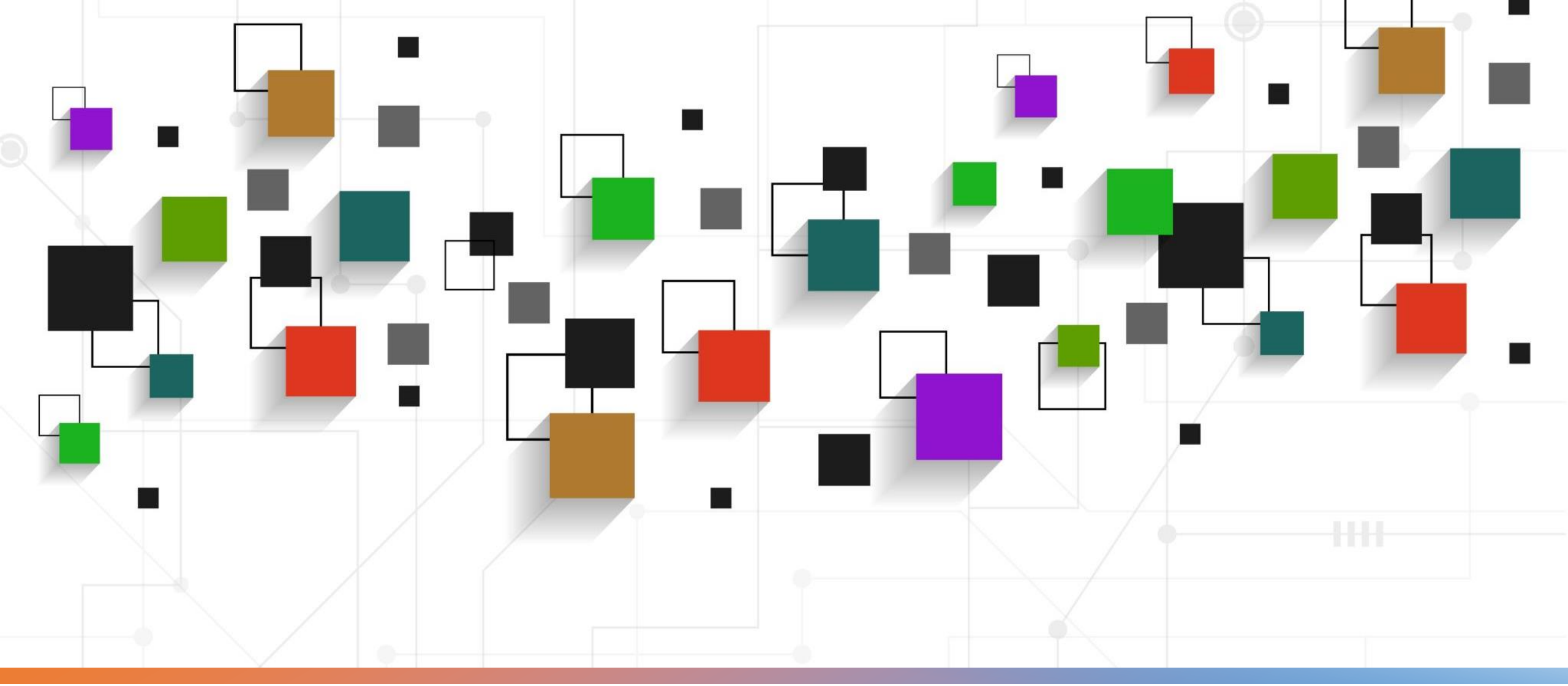
•Public liability insurance, licence renewals, travel, purchasing and laundering of uniforms, stationery….

•All of them require evidence just in case ATO requests for them.

Anti-avoidance rules may still apply

The ruling states that the general anti-avoidance provisions in Part IVA of the ITAA 1936 may still apply to cases where a PSE is considered to be conducting a PSB and the PSI rules do not apply. Particularly where there are factors indicating that the dominant purpose of the arrangement is to obtain a tax benefit by diverting, alienating, or splitting an individual's PSI or retaining profits in the lower taxed PSB.

For example, Jason is an independent contractor conducting a PSB through an interposed company that is a PSB because it passes the results test in relation to Jason's PSI. Jason is the only employee of the company, and he is paid salary from the company that is substantially less than the contracted price for his work. The profit made as a result of paying Jason's salary less than the contracted price is either distributed to Jason's spouse who is on a lower marginal tax rate, or the income is accumulated in the interposed company and taxed at the lower company tax rate (i.e. 25%). Were the ATO determines the dominate purpose of this arrangement is to obtain a tax benefit, Part IVA may apply to reverse the tax benefit.



Thank You