TR 2001/D3 - Income tax: what is a personal services business

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Draft Taxation Ruling
Income tax: what is a personal services business

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Preamble

Draft Taxation Rulings (DTRs) represent the preliminary, though considered, views of the Australian Taxation Office. DTRs may not be relied on by taxation officers, taxpayers and practitioners. It is only final Taxation Rulings that represent authoritative statements by the Australian Taxation Office of its stance on the particular matters covered in the Ruling.

What this Ruling is about

1. This Ruling is the second of four Taxation Rulings that will explain the alienation of personal services income measure (the measure) in Part 2-42 of the *Income Tax Assessment Act 1997* (ITAA 97).

2. The four Rulings will explain:

- the meaning of personal services income;
- the meaning of a personal service business;
- deductions that relate to personal services income; and
- the attribution rules contained in Subdivision 86-A and the practical consequences of the operation of those rules.

3. This Ruling deals with the second of these topics focussing on:

- what is a personal services business;
- the manner in which the three tests contained in Subdivision 87-A of the ITAA 97 are to be applied in determining whether or not a personal services business is conducted by an individual or a personal services entity;
- the meaning of key phrases and concepts that are contained in the three personal services business tests and the matters about which the Commissioner must be satisfied before making a personal services business determination; and

- the process for the making, by the Commissioner, of a determination under Subdivision 87-B of the ITAA 97 that an individual's personal services income is from that individual or a personal services entity conducting a personal services business.

4. Key terms used in this Ruling are defined at paragraphs 18 to 27.

Class of persons

5. This ruling applies to:

- those individuals whose ordinary income or statutory income includes income that is mainly a reward for their personal efforts or skills; and
- those companies, partnerships or trusts whose ordinary or statutory income includes income that is mainly a reward for the personal efforts or skills of an individual (an individual's personal services income).

Background

6. The *New Business Tax System (Alienation of Personal Services Income) Act 2000* (Alienation of Personal Services Income Act) amended the ITAA 97 by inserting new Part 2-42 into that Act and, amended the *Taxation Administration Act 1953* (TAA 1953) by inserting new Division 13 in Schedule 1 to that Act. Part 2-42 of ITAA 97 contains the measure that sets out the income tax treatment of the ordinary or statutory income of an individual or a personal services entity that is an individual's personal services income.

7. The measure contained in Part 2-42 applies from the 2000-2001 income year. However, it does not apply until the 2002-2003 income year for those individuals or personal services entities who:

- were in the former prescribed payments system and were entitled to and had made a payee declaration to a payer; and
- the payee declaration was in force as of 13 April 2000; and
- the Commissioner had received the payee declaration for the payee from the payer on or before 13 April 2000.

8. This is in accordance with the application provision accompanying the Alienation of Personal Services Income Act. The

Commissioner has made a declaration that they are to be treated as if they were conducting a personal services business until the end of the 2001-2002 income year. A copy of the Commissioner's declaration was published on 30 August 2000 in the Commonwealth of Australia Gazette No. GN 34.

9. The measure was introduced following recommendations made in the report of the Review *of Business Taxation: A Tax System Redesigned (*commonly called the Ralph Report*)*. The relevant recommendations that relate to this measure are recommendations 7.2, 7.3 and 7.4. Those recommendations were aimed at improving the integrity and equity in the tax system. The recommendations arose out of concerns that substantial erosion of the income tax base had occurred as a consequence of the alienation of personal services income through the use of interposed companies, partnerships and trusts; and that there was a perception that individuals, as contractors, and interposed entities were able to claim a greater range of deductions than those available to individuals who provided personal services as employees.

10. The application of Part 2-42 of the ITAA 97 is predicated on the view that, contractually, income from personal services can be the income of any entity. However, subsection 84-5(2) of the ITAA 97 ensures that for tax purposes, only an individual can have personal services income (as defined).

11. The application of Part 2-42 of the ITAA 97 does not result in a change in the nature of contractual relationships between parties to an arrangement that involves the rendering of personal services. Individuals do not become employees of service acquirers as a consequence of the application of Part 2-42. Nor does the operation of Part 2-42 affect an individual's or a personal services entity's entitlement to an Australian Business Number, or entitlement to be registered for the purposes of *A New Tax System (Goods and Services Tax) Act* 1999 (GST Act).

12. Division 84 of Part 2-42 sets out the meaning of 'personal services income'. This definition applies throughout the ITAA 1997 and Schedule 1 to the TAA 1953. A later Taxation Ruling will provide a full explanation of the meaning of personal services income in subsection 84-5(1).

13. Division 85 and Subdivision 86-B apply to limit the deductions that relate to an individual's personal services income that can be claimed by an individual or a personal services entity. A later Taxation Ruling will set out the Commissioner's views on the rules contained in Division 85 and Subdivision 86-B.

14. Under Subdivision 86-A, where an amount of the ordinary income or statutory income of a personal services entity is the personal services income of an individual, that income, after

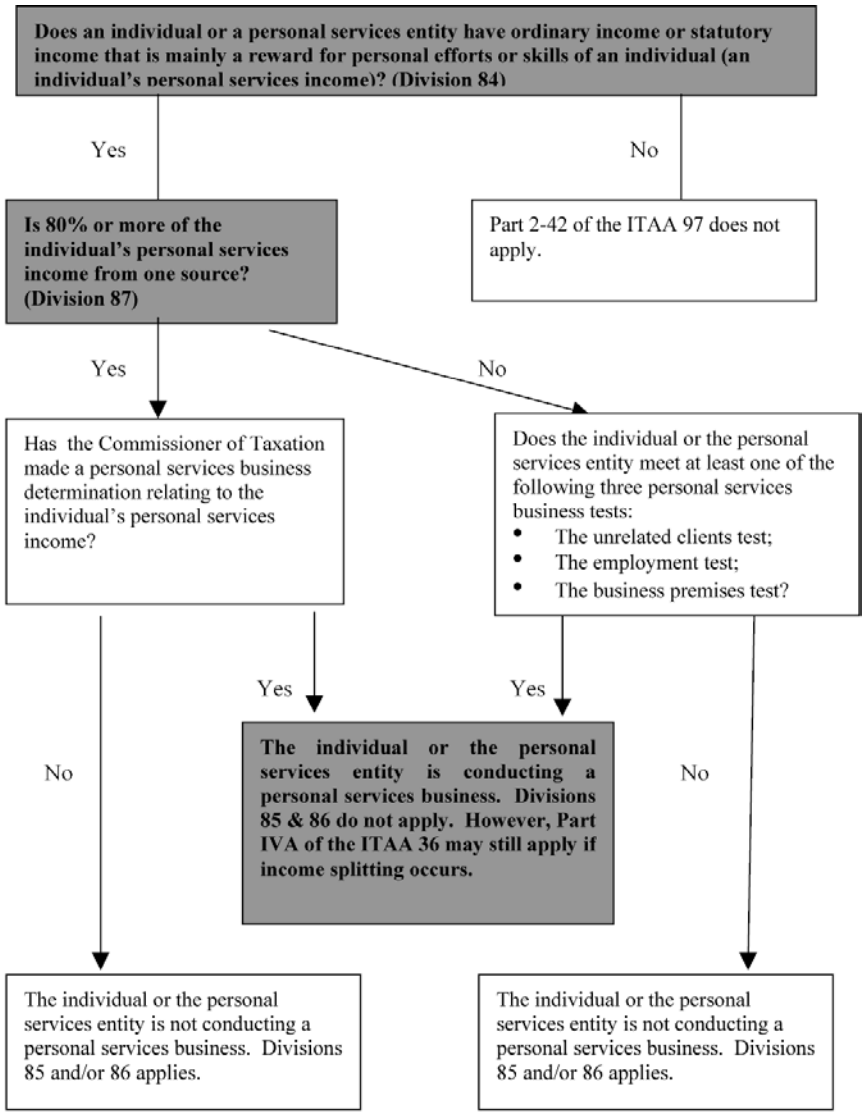
allowance of limited deductions set out in Subdivision 86-B, is attributed to the individual, and included in the assessable income of that individual. Where income is attributed to an individual as a result of the operation of Subdivision 86-A, the entity may have PAYG withholding obligations relating to that income under Division 13 of Schedule 1 to the TAA 1953. A later Taxation Ruling will set out the attribution rules contained in Subdivision 86-A and the practical consequences of the operation of those rules.

15. Division 85 and/or Division 86 do not apply where an individual's personal services income is from that individual or a personal services entity conducting a personal services business. The attribution rule contained in section 86-15 of Subdivision 86-A does not apply where a personal services entity pays an individual's personal services income to that individual as salary and wages within 14 days after the end of the PAYG payment period in which that income became the income of the entity.

16. Division 87 sets out the rules for determining when an individual's personal services income is from the individual or a personal services entity conducting a personal services business. The Division sets out the tests for what is a personal services business. Under Division 87, an individual or personal services entity conducts a personal services business if:

- where less than 80% of an individual's personal services income is from each source, the individual or the personal services entity is able to satisfy at least one of the **3 personal services business tests** in relation to that personal services income**;** or
- where 80% or more of an individual's personal services income is from one source, the individual or a personal services entity obtains a **personal services business determination** from the Commissioner.

17. The following flowchart explains how Part 2-42 applies.



Definitions

Personal services entity (entity)

18. A personal services entity is a company, partnership or trust whose ordinary income or statutory income includes the personal services income of one or more individuals (subsection 86-15(2)).

Service acquirer(s)

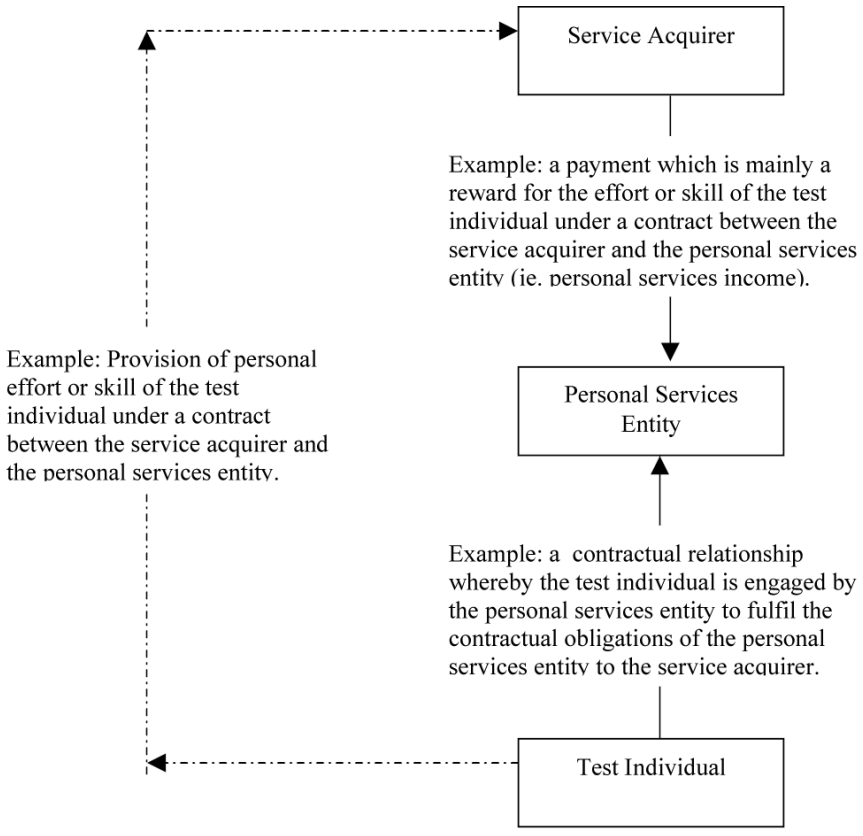
19. The service acquirer is / are the entity or entities that acquire the personal services of an individual directly from the individual or through a personal services entity. The service acquirer is the client of an individual or personal services entity and is the source (see

paragraph 31) of the ordinary or statutory income of the individual or the personal services entity that is an individual's personal services income.

Test Individual

20. A test individual is an individual whose personal services income is included in a personal services entity's ordinary or statutory income, and to whom that income will be attributed under Division 86 unless one of the exceptions in that Division applies. A personal services entity may have more than one test individual. Part 2-42 applies on an individual by individual basis.

21. A diagrammatical representation of the above definitions is as follows:



Associate

22. The word 'associate' has the same meaning as in section 318 of the *Income Tax Assessment Act 1936* (ITAA 36).

23. For an individual an associate includes:

- a relative of the individual;

- a partner of the individual or a partnership in which the individual is a partner;
- if a partner of the individual is an individual, the spouse or child of that partner;
- a trustee of a trust estate under which the individual or an associate benefits; or
- a company under the control of the individual or associate.

24. For a company an associate includes:

- a partner of the company or a partnership in which the company is a partner;
- a trustee of a trust estate under which the company or associate benefits;
- another individual or associate who controls the company; or
- another company which is under the control of the company or the company's associate.

25. For a trustee an associate includes an entity or associate of the entity that benefits or is capable of benefiting under the trust.

26. For a partnership an associate includes each partner of the partnership or associate of the partner.

27. Section 87-35 specifically excludes the following from being associates of each other for the purposes of subsection 87-15(3) (the 80% rule) and paragraph 87-20(1)(a) (the unrelated clients test):

(i) Australian government agencies which is defined to mean:

- the Commonwealth, a State or a Territory; or
- an authority of the Commonwealth, a State or a Territory;

(ii) Commonwealth government agencies within the meaning of the *Public Service Act 1999*;

(iii) Each part of an authority of a State or Territory that has; under a law of a State or Territory, a status corresponding to a Commonwealth government agency within the meaning of the *Public Service Act 1999*.

Ruling

28. For the purposes of Part 2-42 of the ITAA 97, conducting a personal services business is distinguished from conducting other types of businesses. The concept of a personal services business is only relevant where an individual or a personal services entity has income that is an individual's personal services income. Part 2-42 of the ITAA 97 does not affect other business activities that are conducted by an individual or entity, nor does it have any effect on income that is not personal services income within the meaning of subsection 84-5(1).

29. Section 87-15 describes what a personal services business is. The section reads as follows:

> '(1) An individual or a personal services entity conducts a **personal services business** during an income year if the individual or entity meets at least one of the 3 personal services business tests.
>
> (2) The 3 **personal services business** tests are:
>
> (a) the unrelated clients test under section 87-20;
>
> (b) the employment test under section 87-25;
>
> (c) the business premises test under section 87-30.
>
> (3) However, if 80% or more of an individual's personal services income during the income year is income from the same entity (or from the same entity and that entity's associates), the individual's personal services income is *not* taken to be from conducting a personal services business unless:
>
> (a) when the personal services income is gained or produced, a personal services business determination is in force relating to the individual's personal services income; and
>
> (b) if the determination was made on the application of a personal services entity – the individual's personal services income is income from the entity conducting the personal services business.'

The 80% or more from one source rule

30. To conclude whether an individual or a personal services entity is conducting a personal services business, it is first necessary to determine whether 80% or more of an individual's personal services

income is from one source. The answer to that question determines the process to be followed in deciding whether a personal services business is being conducted.

31. The term 'income from one source' refers to income from the same entity or from the same entity and that entity's associates.

32. Where 80% or more of an individual's personal services income is from one source, the individual or the personal services entity must obtain from the Commissioner a personal services business determination relating to that individual's personal services income for them to be taken to be conducting a personal services business.

33. Subsection 87-15(3) requires that the personal services business determination relating to an individual's personal services income be in force when that personal services income is gained or produced. It would be prudent for affected individuals and personal services entities to consider making an application for a personal services business determination at the commencement of the relevant income year on the basis of there being a 'reasonable expectation' that, during the income year, 80% or more of an individual's personal services income is from one source. To obtain a determination the requirements in subsections 87-60(3) for individuals, and 87-65(3) for personal services entities, must be met. In the case of a personal services entity, where a determination in relation to an individual's personal services income does not take effect or is not in force in a particular PAYG payment period in which the income was gained or produced, a PAYG withholding obligation may arise.

34. The 'reasonable expectation' mentioned in paragraph 87-60(3)(c) and 87-65(3)(c) may be arrived at having regard to factors such as:

- whether in previous years 80% or more of an individual's personal services income was from one source;
- whether, on the basis of the existing contractual arrangements, there is an expectation that that contract will span the whole of the income year;
- where a contract is for a period of less than 12 months, whether there is an expectation that the contract will be 'rolled over': and
- whether the individual or the entity will continue to provide services to the same service acquirer under a new contract.

35. Where 80% or more of an individual's personal services income is not from one source, that is less than 80% is from each

source (hereafter this is referred to as 'less than 80% from one source'), then the individual or personal services entity must self-assess as to whether they meet at least one of the 3 personal services business tests. An individual or personal services entity in these circumstances cannot apply for a personal services business determination, but can seek a private binding ruling in respect of the three tests.

Personal services business tests

36. Subsection 87-15(2) states that the three personal services business tests are:

(a) the unrelated clients test;

(b) the employment test;

(c) the business premises test.

Unrelated clients test

37. The unrelated clients test is set out in section 87-20. The section states:

'(1) An individual or a *personal services entity meets the unrelated clients test in an income year if:

(a) during the year, the individual or personal services entity gains or produces income from providing services to 2 or more entities that are not associates of each other, and are not *associates of the individual or of the personal services entity; and

(b) the services are provided as a direct result of the individual or the personal services entity making offers or invitations (for example, by advertising), to the public at large or to a section of the public, to provide the services.

(2) The individual or personal services entity is not treated, for the purposes of paragraph (1)(b), as having made offers or invitations to provide services merely by being available to provide the services through an entity that conducts a business of arranging for persons to provide services directly for clients of the entity.'

During the year

38. The reference in paragraph 87-20(1)(a) to 'during the year, the individual or personal services entity gains or produces income from providing services to 2 or more entities' does not require the services to be provided continuously and concurrently to two or more unrelated clients (as defined in the paragraph) for the whole of the income year. If at any time during the year, either concurrently or sequentially, the individual or the personal services entity gains or produces income from providing services to two or more unrelated clients, the requirement of paragraph 87-20(1)(a) would be satisfied.

What does 'gains or produces income from providing services' mean?

39. The individual or personal services entity must, during the income year, gain or produce income from providing services to two or more unrelated clients. As the application of the test is only relevant in those cases where income is an individual's personal services income, the reference in paragraph 87-20(1)(a) to "gains or produces income" can only be a reference to gaining or producing an individual's personal services income.

40. It is appropriate in the context of the particular provision to accept that "gains or produces income" is a reference to ordinary or statutory income of any entity that is an individual's personal services income.

What is meant by 'direct result'?

41. Paragraph 87-20(1)(b) requires the services to be provided as a direct result of making offers or invitations to the public or a section of the public. 'Direct result' in this context means an immediate, straightforward consequence or outcome.

42. For the unrelated clients test to be passed an apparent link or a causal connection must be established between the activities of making offers or invitations to the public and the provision of personal services to unrelated clients. 'Direct result' does not imply that there can be no step between the cause and the consequence.

What is meant by 'Making offers or invitations to the public at large or to a section of the public'?

43. Making offers or invitations to the public at large or to a section of the public (referred to as 'the public' hereon) indicates a willingness to enter into agreements to provide services to various service acquirers. The phrase 'making offers or invitations' is not

restricted to the contract law usage but is to be given a broad meaning to include any form of solicitation to the public or a section of the public.

44. The manner in which the offer or invitation to the public may be made is not limited to activities like advertising, and can extend to actions such as having an Internet web-site or accepting work from word of mouth referrals. The essential character of those activities that constitute making offers or invitations to the public is to convey a holding out and the preparedness of the individual or personal services entity to provide services to the public. There is no holding out in this sense where the individual or personal services entity makes offers or invitations to provide services to entities with which there is an antecedent relationship, such as a previous employer, unless other factors are present.

45. To determine if an offer or invitation is made 'to the public at large or to a section of the public' it is necessary to consider if there is an antecedent or subsisting relationship between the individual or the personal services entity and the entity to which the offer or invitation is made.

46. Where there is a subsisting or prior relationship the following factors need to be considered to establish if the offer or invitation is to the public at large or a section of the public:

- The number of persons or entities to which the offer or invitation is made;
- The nature and content of the offer or invitation; and
- The nature of the particular relationship between the parties to the offer or invitation.

What is 'a business of arranging for persons to provide services'?

47. In sub-section 87-20(2) 'a business of arranging for persons to provide services' includes employment agencies, labour hire firms, personnel agencies or any similar arrangement involving an entity entering into a contract with a service acquirer to supply the services of an individual or personal services entity to that service acquirer.

Employment test

48. The employment test for a personal services business is contained in section 87-25 of the ITAA 97. This provision provides:

> '(1) An individual meets the employment test in an income year if:

(a) the individual engages one or more entities (other than associates of the individual that are not individuals) to perform work; and

(b) that entity performs, or those entities together perform, at least 20% (by market value) of the individual's principal work for that year.

(2) A personal services entity meets the employment test in an income year if:

(a) the entity engages one or more other entities to perform work, other than:

(i) individuals whose personal services income is included in the entity's ordinary income or statutory income; or

(ii) associates of the entity that are not individuals; and

(b) that other entity performs, or those other entities together perform, at least 20% (by market value) of the entity's principal work for that year.

(3) An individual or a *personal services entity also meets the employment test in an income year if, for at least half the income year, the individual or entity has one or more apprentices.'

49. Thus, there are two ways of satisfying the employment test:

- by engaging certain entities to perform at least 20% (by market value) of the individual's or entity's principal work; or
- by having one or more apprentices for at least half the income year.

Engages

50. The reference to 'engages' in subsections 87-25(1) and (2) takes its ordinary meaning and is not limited to employment type relationships. 'Engages' includes making a contractual arrangement or agreement for the services of another entity.

51. Any company, partnership or trust that would be considered to be an associate of either the individual or the personal services entity, according to the meaning in section 318 of the ITAA 36, cannot be counted for the purposes of the test. This exclusion is contained in paragraph 87-25(1)(a) and subparagraph 87-25(2)(a)(ii), but does not apply to individuals who are associates of the test individual.

Individuals whose personal services income is included in the entity's ordinary or statutory income

52. The reference in sub-paragraph 87-25(2)(a)(i) to 'individuals whose personal services income is included in the entity's ordinary or statutory income' means the test individual or individuals cannot be counted for the purpose of determining whether the personal services entity passes the test. This phrase does not include employees other than the test individual or individuals.

Partnerships

53. Individual partners of a partnership cannot be engaged by the partnership to perform principal work of the entity for the purposes of passing the employment test.

Principal work

54. The term 'principal work' in paragraphs 87-25(1)(b) and (2)(b) is not defined and therefore takes its meaning in ordinary concepts and usage. Whether an associate is performing work which forms part of the principal work is a question of fact and must be decided on a case by case basis. Principal work is work performed by an entity which contributes to a test individual fulfilling his/her personal contractual obligations, or the contractual obligations of a personal services entity to a service acquirer.

55. As a general guide, principal work can be described as that work which is central to meeting the obligations under the agreement with the service acquirer. It is work that is essential to the generation of income of the test individual or personal services entity under the contract.

56. The concept of principal work does not include work which is ancillary or incidental such as helping or aiding the work of the test individual, unless this directly contributes to meeting the end result of the agreement. Work that is associated with administration such as bookkeeping, answering telephones or other clerical work is ancillary and is not principal work (unless the main work to be performed for the service acquirer is such administrative work).

At least 20% (by market value)

57. The reference to 'by market value' in paragraphs 87-25(1)(b) and (2)(b) means what a service acquirer would pay to the individual or entity, on an arm's length basis, for the performance of the principal work. The income that is generated from the work performed would normally be the market value of that work. The

principal work of the individual or the entity may consist of components with different market values.

Apprentice

58. For the purposes of sub-section 87-25(3), an apprentice is a natural person who works for another for a fixed period of time with obligations to learn a trade, business or skill. At common law, a contract of apprenticeship is one where the primary object is the education of the apprentice. Apprenticeships, within the common law meaning of the word, are now largely regulated by State or Territory industrial and commercial legislation. These apprenticeships are referred to in this ruling as 'formal apprenticeships'. Contracts that are not in respect of formal apprenticeships are unlikely to have the necessary primary object.

59. Persons engaged in apprenticeships or traineeships regulated by State and Territory Vocational Education and Training legislation have a primary object of education and therefore satisfy the common law meaning of apprentice.

60. The employment test is satisfied where an individual or entity has, for at least half the income year, one or more apprentices. The test does not require that the same apprentice be engaged or that the qualifying period comprises consecutive days.

Business premises test

61. Section 87-30 of the ITAA 97 states the business premises test as follows:

> '(1) An individual or a personal services entity meets the business premises test in an income year if, at all times during the income year, the individual or entity maintains and uses business premises:
>
> (a) at which the individual or entity mainly conducts activities from which personal services income is gained or produced; and
>
> (b) of which the individual or entity has exclusive use; and
>
> (c) that are physically separate from any premises that the individual or entity, or any associates of the individual or entity, uses for private purposes; and
>
> (d) that are physically separate from the premises of the entity to which the individual or entity provides services and from the premises of any

associates of the entity to which the individual or entity provides services.

(2) The individual or entity need not maintain and use the same business premises throughout the income year.'

62. All the conditions set out in sub-section 87-30(1) must be met for the business premises test to be satisfied.

Maintain and use

63. For the purposes of subsection 87-30(1) the individual or personal services entity must at all times during the income year maintain and use business premises. It is not sufficient for business premises to be leased or owned; there is an additional requirement that the business premises are maintained and used.

Mainly

64. Paragraph 87-30(1)(a) requires the individual or entity to maintain and use business premises at which they *mainly* conduct activities from which personal services income is gained or produced. This means the business premises may be used for other activities and still satisfy the paragraph 87-30(1)(a) requirement so long as those other activities are incidental or secondary to the activities from which personal services income is gained or produced.

Premises

65. As 'premises' is not defined in paragraphs 87-30(1)(c) and (d), the ordinary or common law meaning is used for the purposes of this test. The word 'premises' means any piece of land or any kind of structure or building, or any part of land or any part of a structure or building. Multiple premises may therefore exist on a single title.

66. Caravans, mobile homes, motor vehicles, aircraft, ships, other floating vessels, trains and trucks are not of themselves premises. Such chattels are often positioned on land where the land qualifies as premises. Where this is the case, it is the land which amounts to premises, and not, for example, the caravan which might be stationed on the land.

67. Therefore, where a caravan is situated in public space under licence, these are premises in the relevant sense. However, in the case of a motor vehicle (for example of a travelling salesman), there isn't any licence pertaining to a fixed location and therefore there is nothing which amounts to premises in the relevant sense.

Business premises

68. The phrase 'business premises' in sub-section 87-30(1) means premises which are occupied for the purposes of carrying on a business. The meaning of 'carrying on a business' is explained in Taxation Ruling TR 97/11. Business premises may be occupied by way of ownership, lease, licence or mere possession. The usage of the phrase 'business premises' in subsection 87-30(1) highlights that only genuine business premises are contemplated for the purposes of passing the business premises test (see also section 87-10).

Exclusive use

69. Paragraph 87-30(1)(b) requires the individual or entity to have exclusive use of the business premises. Where an individual or entity leases premises together with another individual or entity on the basis that the total premises are shared, neither lessee has exclusive use of the premises.

70. Where, however, the leased premises comprise discrete areas and an agreement exists between the lessees that each may occupy a specific area, and those areas are capable of being physically secured, the joint lessees have exclusive use of their respective areas.

Physically separate

71. The reference in paragraphs 87-30(1)(c) and 87-30(1)(d) to 'physically separate' means the business premises test will not be satisfied where the business premises are:

- within the premises of the individual or entity (or associates of the individual or entity) that are used for private purposes; or
- within the premises of the service acquirer (or associates of the service acquirer).

72. In deciding whether business premises are within disqualified premises, the issue to be determined is whether the physical impression or character of the business premises causes those premises to be capable of notional division (as being physically distinct) from the remainder of the premises.

73. Where business premises are within a larger building, the implication is that the business premises are not physically separate. This will also be the case where the business premises are within the curtilage of private premises. However, in both cases, this implication is not necessarily determinative and if other factors sufficiently influence the overall impression, an alternative conclusion may be reached.

74. The factors listed below are to be considered in combination to reach a conclusion regarding the physical impression (or character) of the business premises in relation to the remainder of the premises:

- whether the physical appearance of the business premises makes them distinct from the remaining premises;
- whether the business premises are detached from other building structures on the land;
- whether there is a right to occupy or exclude others from the business premises;
- the extent to which facilities and staff are shared with occupants of adjoining or surrounding premises;
- whether the business premises have discrete access for the individual and clients;
- whether the business premises are on separate legal title;
- whether the business premises are leased;
- whether there is a permanent barrier preventing internal access between the business premises and the remaining premises;
- whether the business premises are incorporated functionally into surrounding premises;
- where signage exists, the impression it gives in relation to the use to which the business premises are put.

75. Only after consideration of all such factors in combination (where applicable), can a conclusion be reached as to whether the business premises are within disqualified premises or are physically separate from those premises.

Changing business premises

76. Subsection 87-30(2) does not require an individual or entity to maintain and use the same business premises throughout the whole year. This means that the individual or entity can change business premises during the year, however they need to have business premises at all times during the year.

The Determination Process

77. The rules relating to when the Commissioner can make a personal services business determination are contained in section

87-60 where an application is made by an individual, and section 87-65 where application is made by a personal services entity.

78. In both cases, the Commissioner must not make a determination unless satisfied the individual or entity could reasonably be expected to meet, or met:

(a) the **employment test** under section 87-25; or

(b) the **business premises test** under section 87-30, or both;

or

(c) but for **unusual circumstances** applying to the individual or entity in that year, the individual or entity **could reasonably have been expected** to meet, or would have met at least one of:

(i) the **unrelated clients test** under section 87-20;

(ii) the **employment test** under section 87-25; or

(iii) **business premises test** under section 87-30;

and

(d) the individual's personal services income could reasonably be expected to be, or was, from the activities of the individual or entity that enabled the passage of the applicable test;

and

(e) 80% or more of the individual's personal services income could reasonably be expected to be, or was, from the same entity, or from the same entity and that entity's associates.

79. If, having regard to these rules, the Commissioner is unable to make a determination, a determination may still be made if the Commissioner is satisfied that the applicant meets the further grounds in subsection 87-60(5) or 87-65(5).

Reasonable expectation

80. Whether an event could reasonably be expected to occur must be considered objectively and requires more than a possibility, risk or chance of the event occurring.

Unusual circumstances

81. The term 'unusual circumstances' used in subparagraph 87-60(3)(a)(ii) and 87-65(3)(a)(ii) refers to circumstances that are

completely out of the ordinary and which suspend the capacity of an individual or entity to meet a test. In addition, the circumstances must only be temporary and the usual circumstances are to resume in the short term. As a rule of thumb, where circumstances exist for a period of less than one year that are out of the ordinary or are not the normal circumstances, they may be accepted as being unusual.

82. Whether unusual circumstances exist will be considered on a case by case basis according to the applicable facts. It is therefore necessary for an individual or entity to present the Commissioner with all relevant particulars where unusual circumstances are sought to be relied on. Those particulars include:

(a) the normal circumstances of the individual or entity;

(b) when unusual circumstances first commenced;

(c) what those unusual circumstances are; and

(d) when it is expected that normal circumstances will be reverted to.

83. Unusual circumstances are only recognisable where the individual or entity is able to show what constitutes the usual circumstances in relation to the activities in question.

84. Circumstances which are unusual in one year may subsequently become usual if the prior circumstances are not restored.

85. Where, for example, an individual or entity has a single client or is without business premises for a period greater than 12 months, the conclusion may be reached that the prior circumstances will not be restored, and therefore unusual circumstances no longer exist. This is capable of rebuttal depending upon the applicable facts.

Further grounds for determination

86. The further grounds for a determination are specified in subsection 87-60(5) for an individual and in subsection 87-65(5) for a personal services entity. In determining whether an individual or entity meets the further grounds, the Commissioner may have regard to what is the custom or practice when work of that kind is performed by an entity other than an employee.

87. The further grounds comprise four conditions about which the Commissioner must be satisfied before making a determination.

Producing a result

88. The phrase in paragraphs 87-60(5)(a) and 87-65(5)(a) 'producing a result' contemplates contractual arrangements where the individual or entity is engaged to provide a particular result, is free to

employ people and plant for that purpose and is to be paid according to the result. The focus is on the output or result that the contract requires rather than how the contract is performed. In such contracts, payment is usually made for a negotiated contract price, as opposed to an hourly rate, and does not amount to a common law master/servant relationship.

89. In those circumstances where a contract is entered into on the basis of a retainer being paid to an individual or to a personal services entity for the services of an individual, with additional income being generated on the production of a result, an individual's personal services income would not be regarded as being for producing a result.

Required to supply the plant and equipment, or tools of trade, needed to perform the work

90. In paragraph 87-60(5)(b) and 87-65(5)(b), the reference to the individual or entity being 'required to supply the plant and equipment, or tools of trade, needed to perform the work' means the individual or entity must provide all the necessary plant, tools and other equipment to produce the result. If the service acquirer supplies any of the plant and equipment or tools needed by the individual or entity to perform the work, this condition will not be met. If no plant and equipment or tools of trade are needed to perform the work, this condition cannot be satisfied.

To be liable for the cost of rectifying any defect in the work performed

91. To satisfy the third condition, the individual or personal services entity must actually cover the cost of rectifying defects to the work performed and not merely have a term in a contract including such an obligation. This means it is not sufficient to have a term in a written contract where the contracting parties have no intention of adhering to that written term.

92. Where there is no written term, liability may still exist if it is imposed by regulation or statute. Exposure to fines or penalties under statute is not a liability for these purposes.

93. Where work is not capable of rectification, this condition cannot be passed. Whether this is the case needs to be considered on a case by case basis.

94. A liability for the cost of rectifying any defects in the work performed does not arise where a right to claim for damages exists in respect of faulty or negligent performance of contractual obligations.

95. The reference in subsections 87-60(5) and 87-65(5) to, "the cost of rectifying any defect in the work performed" means all the cost.

Eligible for a determination

96. The fourth condition contained in paragraphs 87-60(5)(d) and 87-65(5)(d) limits further grounds for making a determination to only those individuals or entities that are able to apply for a determination (that is where 80% or more of an individual's personal services income is from one source).

Custom and practice

97. The phrase 'custom and practice' in subsections 87-60(6) and 87-65(6) means the manner in which an activity is usually conducted. In order to establish the basis upon which an activity is usually conducted, it follows that the activity must have a history of existence. Therefore, the longer the history of existence of a course of conduct, the greater the likelihood it constitutes a custom or practice.

98. The custom or practice that the Commissioner can have regard to is the custom or practice in relation to the work of the kind that is performed by an entity, other than an employee, and not the custom or practice that may exist in relation to a particular industry, vocation or profession. While the latter may be a useful guide, it may not necessarily be conclusive as to the custom or practice in respect of the work that is actually performed and that produces the result.

99. Whether the Commissioner has regard to a custom or practice is discretionary.

Operation of Division 87

100. In those cases where 80% or more of an individual's personal services income is from one source, Division 87 operates both prospectively and retrospectively to ascertain whether personal services income is income from conducting a personal services business during an income year. The tests can be applied at any stage throughout the income year based on activities that have already occurred or on the reasonable expectation that certain activities will occur or continue to occur.

Date of effect

101. This Ruling first applies to the 2000-2001 income year. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

Explanations

102. Where an individual has received personal services income, as defined in section 84-5, then Division 85 affects the deductibility of amounts against the individual's non-employee personal services income, unless that income is from the individual conducting a personal services business. Where the personal services income of the individual is received by a personal services entity then Division 86 operates to attribute that income to the individual and limit the deductions available against that income unless the entity is conducting a personal services business. To ascertain if the personal services income is from the individual or a personal services entity conducting a personal services business, the tests contained in Division 87 are applied.

103. The object of Division 87 is to define personal services businesses in a way that ensures the measure in Part 2-42 does not apply to genuine businesses but applies to those situations that are merely arrangements for dealing with personal services income of individuals.

104. Where an individual's personal services income is the income of a personal services entity from the entity conducting a personal services business, the rules contained in Division 85 and/or 86 of the ITAA 97 will not apply. However, Part IVA of the ITAA 36 may still apply to those cases that fall outside Part 2-42 of the ITAA 97.

80% or more of personal services income from one source

105. The process by which it is determined that an individual's personal services income is from an individual or a personal services entity conducting a personal services business depends on whether 80% or more of that individual's personal services income is from one source. If it is, then the individual or personal services entity will need to obtain a personal services business determination from the Commissioner for them to be conducting a personal services business. If it is not, then the individual or the entity will need to self assess that

during an income year they meet at least one of the three personal services business tests.

Income from one source

106. The term 'income from one source' is used for brevity to encompass the concept of 'income from the same entity (or from the same entity and that entity's associates)' in subsection 87-15(3). The term 'income from one source' is used in the explanatory memorandum to the Alienation of Personal Services Income Act and in the Guide to Division 87.

In force

107. A personal services business determination only remains in force for the period specified in the Notice of Business Determination and for the period in which the conditions specified in the Notice remain satisfied. The Commissioner may revoke or vary a personal services business determination where material facts relevant to the issue of the personal services business determination are varied or altered (see sections 87-60 and 87-65).

Unrelated clients test

108. To pass the unrelated clients test both paragraph 87-20(1)(a) and (b) must be satisfied. Subsection 87-20(2) excludes certain types of activities from meeting the requirements in these paragraphs.

During the year

109. The term 'during the year' in paragraph 87-20(1)(a) refers to the period over which the test applies without imposing constraints on the timing of the contracts over the course of the year. 'During' takes the meaning 'in the course of' rather than requiring the provision of services throughout the year. Providing services 'during the year' means the services can be provided:

- continuously throughout the year,
- sequentially over the period of the year, or
- concurrently during the year.

Direct result

110. The term 'direct result' in paragraph 87-20(1)(b) is given its ordinary meaning. The *Macquarie Dictionary* defines 'direct' as

'without intervening agency; immediate; personal; going straight to the point; straightforward; downright'. 'Result' is defined as 'that which results; the outcome, consequence or effect'.

111. *F.C of T v Dixon* (1952) 86 CLR 540 at 553-554 provides guidance on the meaning of the word 'direct':

> 'A direct relation may be regarded as one where the employment is the proximate cause of the payment, an indirect relation as one where the employment is a cause less proximate, or indeed, only one contributory cause.'

112. The term 'direct result' was examined in Boiler Inspection and insurance Co of Canada v Sherwin-Williams of Canada [1951] AC 319 at page 333:

> 'Whatever meaning the word 'direct' may have in qualifying the word 'result', it does not imply that there can be no step between the cause and the consequence.'

What is meant by 'making offers or invitations'?

113. For the purposes of paragraph 87-20(1)(b), making an offer or invitation to the public in general or to a section of the public is an indication by the individual or entity of their willingness to perform services for anyone within a group or class of persons or to any member of the public. The intention of the individual or entity to attract or solicit the public to enter into agreements for their services by undertaking activities, such as advertising, points to the commerciality of the enterprise conducted by the individual or the personal services entity. Advertising and similar activities are factors that point to the existence of a genuine business, in contrast to arrangements contemplated to be within Part 2-42 of the ITAA 97 (see section 87-10).

114. As the meaning of the phrase 'making offers or invitations' is not given in the ITAA 97, for the purposes of the unrelated clients test the meaning is based on the ordinary usage of the terms.

115. The *Macquarie Dictionary* defines an offer as 'to present for acceptance or rejection; to put forward for consideration; to propose or volunteer; to make a proposal or suggestion; a bid; etc'.

116. An invitation is the mechanism by which an individual or personal services entity holds out to or informs the public or a section of the public of the services the individual or personal services entity is able to provide. The *Macquarie Dictionary* defines invitation as "to attract, allure or tempt." An invitation may be made in written or spoken form.

117. To pass the unrelated clients test, it is important that, as a matter of evidence, it is established that the service acquirer approached the individual or personal services entity due to awareness generated out of the activities of the individual or personal services entity that constitute making offers or invitations to the public or to a section of the public.

118. Advertising is an example of making an offer or invitation to the public given in the legislation. The ordinary meaning of the word 'advertise' is 'to make generally or publicly known, or to give public notice of' (*Deputy Commissioner of Taxation v Rotary Offset Press Pty Ltd* 71 ATC 4170; (1971) 45 ALJR 518). Advertising may be effected by providing information to the public, by the making of public announcements, by publications in periodicals or professional journals, by printed posters, by broadcasting over the radio, television, etc, or by placing an advertisement in a newspaper, magazine, or business directory.

119. Other types of activities or actions that are considered to be 'making offers or invitations' in this context include:

- public tenders;
- maintaining an Internet web site on which the availability of services are advertised; and
- word of mouth referrals.

What is meant by 'to the public or a section of the public'?

120. The question of whether an offer or invitation is made to the public at large or a section of the public is a matter of fact and will depend on the individual circumstances.

121. An offer or invitation is made to 'the public at large' where any interested member of the public is capable of accepting it (*Lee v Evans* (1964) 112 CLR 276 at page 287). It will also be relevant to examine whether the individual or the personal services entity was engaged in an independent business and that in the course of that business the individual or the personal services entity would render services to whoever will contract on like terms.

122. An offer or invitation to 'a section of the public' is made in situations where only a select group is chosen to whom the invitation is made. Making an offer or invitation to a 'section of the public' could include offering to provide services to one entity (*Nash v Lynde* (1929) AC 158; *Corporate Affairs Commission (South Australia) & Anor v Australian Central Credit Union* (1985) 3 ACLC 792.) However, an offer or invitation to one entity does not necessarily constitute an offer or invitation to a section of the public unless other factors are present.

123. In *Corporate Affairs Commission (South Australia) & Anor v Australian Central Credit Union,* the High Court provided some guidance on the factors for determining whether an offer or invitation is to a 'section of the public'. That case was concerned with the making of offers or invitations to the public to subscribe for securities. While the statutory context is different from the Alienation measure, the approach is useful for the purposes of section 87-20 in situations where it is not apparent that the offer or invitation is of a genuine commercial nature. In the context of the facts of that case, the High Court commented at page 795:

> 'If,… there is some subsisting special relationship between offeror and members of a group or rational connection between the common characteristic of members of the group and the offer made to them, the question whether the group constitutes a section of the public for the purposes of the offer will fall to be determined by reference to a variety of factors of which the most important will ordinarily be: the number of persons comprising the group, the subsisting relationship between the offeror and the members of the group, the nature and content of the offer, the significance of any particular characteristic which identifies the members of the group and any connection between that characteristic and the offer…'

124. For the purpose of the unrelated clients test, where there is a prior or subsisting relationship between the parties to an offer or invitation, the following factors can be considered when determining whether the offer or invitation is made to a section of the public:

- The number of persons or entities to which the offer or invitation is made. While not determinative, it is likely to be a public offer or invitation if more entities are involved. Where steps are taken to exclude the individual from providing services to the public generally, such as undertaking a long term contract with one service acquirer or offering services to one entity exclusively, the requirement to offer or invite the public to acquire their services is not satisfied, as the services are provided on a selective basis and intention to operate commercially in the community is not demonstrated.
- The nature and content of the offer or invitation. Where the offer or invitation is made as part of a competitive commercial process, such as a public tender, a prior relationship may not detract from the offer being made to the public.
- The nature of the particular relationship between the parties to the offer or invitation. Where the parties to

> the relationship can be viewed as genuinely independent of each other, the commercial character of the transaction is maintained. For example, where a subsequent offer is made to an entity with which there had been a previous commercial relationship, the offer would have the character of an offer to a section of the public.

125. The tender process is an example of where the above analysis can be applied. Offering to contract to provide personal services by responding to invitations to tender is an acceptable activity for meeting the requirements of paragraph 87-20(1)(b) where it is a public tender. The essential element of a public tender is that anyone is invited to tender, as opposed to a private tender where the invitation is made exclusively to certain parties. Being invited to participate in a private tender may point to a prior relationship and therefore more will be required to establish the offer as being one that is made to the public or a section of the public. For example, an individual may be asked to tender for a contract which is essentially a replacement for an existing employment contract. The employment relationship would constitute an antecedent relationship and this would detract from the commercial nature of the offer. It would be necessary to consider other factors such as the nature of the offer and who else was invited to tender to determine if the offer was made to a section of the public.

126. The question of whether providing services, as a result of a tender, is rendering services to the public was considered in *Behmer & Wright Pty Ltd v Commissioner of State Revenue (Vic)* 94 ATC 2067; (1994) 28 ATR 1082. Section 3C(1)(e)(v) of the *Pay-roll Tax Act 1971* exempts payments made under a contract for services where those services are rendered by a person who 'ordinarily renders services of that kind to the public generally'. The contractor in this case undertook a small number of relatively large contracts and was one of a few contractors selected to tender to carry out carpentry work for the applicant. While the contractor had had previous contracts with the applicant, he was considered to be genuinely independent of the applicant because the tendering process was competitive, other parties were invited to tender for the contracts and the applicant was not the only significant client of the contractor. It was concluded that the contractor in question ordinarily rendered his services to the public generally.

What is 'a business of arranging for persons to provide services'?

127. The operation of paragraph 87-20(1)(b) is limited by the operation of subsection 87-20(2). The paragraph states that an offer or invitation is not made by the individual or personal services entity if they are merely available to provide services through an entity that

conducts a business of arranging for persons to provide services to its clients. As a consequence of this provision, individuals or personal services entities who are registered with employment agencies, labour hire firms, personnel agencies or any arrangement involving an entity hiring the services of a individual or personal services entity in a manner similar to that of a labour hire firm, are taken not to have made an offer or invitation to provide services to the public at large or to a section of the public.

Employment test

128. An individual meets the employment test for the income year if he or she engages one or more entities, other than associates that are not individuals, to perform work and those entities together perform at least 20%, by market value, of the individual's principal work. The employment test will also be met if the individual has one or more apprentices for at least half the income year.

129. Similarly, a personal services entity meets the employment test for an income year if it engages one or more entities (other than the test individual or associates that are not individuals) to perform work. Those entities together must perform at least 20%, by market value, of the entity's principal work. The employment test will also be met if the entity has one or more apprentices for at least half the income year.

Engages

130. The first requirement in order to meet the employment test is that there is the actual engagement of another entity by the individual or personal services entity. In paragraphs 87-25(1)(a) and (2)(a) the word 'engages' takes the ordinary meaning. The *Macquarie Dictionary* defines 'engage' variously. The meanings most appropriate in the context of section 87-25 are:

- 'to secure for aid, employment, use, etc; hire: to engage a workman, to engage a room.'
- 'to bind as by pledge, promise, contract or oath: make liable: be engaged verbally or in writing to do it.'

131. The different meanings of the word 'engages' is discussed in *Benninga (Mitcham) Limited v Bijstra* [1946] KB 58 at page 62:

> 'An employer "engages" a servant when he makes an agreement with him for his services. A workman is "engaged" on work when he is actually carrying it out.'

132. 'Engages' in the employment test context specifies the action to be taken by the individual or personal services entity to contract with another entity to perform work.

133. For the employment test the term 'engages' is not limited to employment type relationships but may also include contractual arrangements or agreements for the services of another entity. In this regard 'engages' does not bring a requirement for payment to the entity that performs the principal work. The critical element in satisfying the employment test is the market value of principal work performed by an entity or entities engaged by the individual or personal services entity, not whether remuneration is made for the performance of the work.

The employment test: who can be 'engaged'?

134. The employment test will not be met if certain entities are engaged. Paragraph 87-25(1)(a) and sub-paragraph 87-25(2)(a)(ii) states that individuals and entities cannot engage associated entities, other than individuals, as a means of passing the employment test. This excludes any company, partnership or trust that would be considered an associate under section 318 of the ITAA 36.

Individuals whose personal services income is included in the entity's ordinary or statutory income

135. Sub-paragraph 87-25(2)(a)(i) states that a personal services entity cannot engage 'individuals whose personal services income is included in the entity's ordinary or statutory income' to pass the test. The phrase 'individuals whose personal services income is included in the entity's ordinary or statutory income' refers to the test individual or individuals. An individual's personal services income is only included in the ordinary or statutory income of a personal services entity where the income of the entity is mainly a reward for that individual's efforts or skills.

136. This phrase is not intended to include employees (other than the test individual or individuals). Other employees who assist the test individual in the performance of the contractual obligations for which the entity is paid are not individuals whose personal services income is included in the entity's ordinary or statutory income.

Partnerships

137. Individual partners of a partnership cannot be engaged by the partnership to perform principal work of the entity for the purposes of passing the employment test. A contractual arrangement or

relationship may exist between partners for the contribution of the services of the partner to the partnership and it could be said a partner is engaged in the principal work of the partnership. However, being engaged in the principal work of the partnership does not meet the requirements of the employment test; for the reason in paragraph 138 it is necessary for the personal services entity to engage one or more other entities to perform work.

138. The partnership as a personal services entity does not have the capacity to engage a partner to perform principal work. As the partnership has no separate legal status from the partners that comprise it, engaging one partner to perform principal work of another partner would be like the partnership engaging or contracting with itself. This reflects the findings in *Ellis v. Joseph Ellis & Co.* [1905] 1 KB 324 where it was concluded that a partnership cannot legally employ a partner and that a partner cannot be an employee of the other partners, since the individual cannot be both master and servant.

Principal work

139. Principal work can be described as that work that is central to meeting the individual's obligations under agreements between himself or herself, or a personal services entity, and the acquirer of the services. It is work that is essential to the generation of personal services income of the relevant individual or entity.

140. Principal work, therefore, is or are the activities directed at fulfilling the obligations of an individual or a personal services entity to a service acquirer under an agreement. The term refers to the work that an individual or a personal services entity is contractually required to perform for a service acquirer and for which the individual or personal services entity is paid. It is the work that directly gains or produces personal services income.

141. Principal work does not include work that is performed but which an individual or a personal services entity is not contractually required to perform; that is, work that does not directly gain or produce personal services income.

142. Whether work is 'principal work' depends on the circumstances of each case. In order to establish whether or not work forms part of the principal work of an individual or a personal services entity, it is necessary to determine which obligations under an agreement will produce the personal services income, ie what is the work that is required to be performed (the essential work) to produce that income. It is necessary to look at the particular activity or activities that are required to be done for income to be gained or produced.

143. The nature of the activity being undertaken may be such that the principal work to be carried out may not be the sole activity required in order to fulfil the obligations under an agreement. Activities that are incidental or subsidiary may be required to be performed in order to facilitate the performance of the principal work. The aim of introducing the term "principal" into the legislation is to exclude incidental or subsidiary work from consideration in determining the meaning of "principal work" for the purposes of Part 2-42 of the ITAA 97.

144. Activities such as clerical or administrative work that are incidental or subsidiary to those activities that generate the personal services income may aid the provision of services that are the object of the agreement, but they do not form part of the principal work from which personal services income is derived.

Entity's principal work

145. The entity's principal work for the purpose of this test is the work required to satisfy the entity's agreements or contracts, with a service acquirer, for the personal services of a test individual. Work performed by another entity that is necessary to fulfilling the personal services entity's contracts for the test individual's personal services will be the principal work of the entity.

20% (by market value)

146. The market value of the principal work will depend on the nature and components of the principal work. Whilst the payment by a service acquirer may reflect the total value of the work performed, different components of the principal work may have different market values.

147. In some cases, the market value of all the principal work may be the total of the payments made by a service acquirer, that is, the total income generated may be the market value. Where this is the case the reference to other entities performing at least 20% by market value of the principal work refers to their generating at least 20% of the income of an individual or a personal services entity. That work must be work the individual or personal services entity is contractually required to perform for the service acquirer.

148. The market value of the principal work that is performed by the entity or entities engaged is measured against the amount gained by the individual or personal services entity for the provision of the principal work. Waddell J in *Brisbane Water County Council v Cmr of Stamp Duties* [1979] 1 NSWR 320 at 324 stated:

> "Market value is the best price which may reasonably be obtained for the property to be valued if sold in the general market. The cases cited indicate that where the value of an item of property is to be ascertained, this means its value in the general market with three qualifications. Firstly, if there is no general market, as in the case of shares in a private company, such a market is to be assumed. Secondly, all possible purchasers are to be taken into account, even a purchaser prepared for his own reasons to pay a fancy price. Thirdly, the value to be ascertained is the value to the seller: *Abrahams v FC of T*, above, at 29."

149. The market value of the work performed by the entity or entities engaged by an individual or personal services entity is a question of fact and each case must be judged on its own merits. The work involved in fulfilling a contract or agreement may comprise of different types of tasks. The market value of these tasks may vary depending on the level or types of skills required. The hourly rate paid to an individual may represent an average market value covering both work of lesser or higher market value. For example, a bricklayer may have a contract to provide the brickwork on a federation style house. The contract comprises of tasks requiring different skill levels, including specialist work such as tuck pointing and unskilled work such as cleaning the site. The majority of the work to be performed is standard bricklaying. If the bricklayer engaged a worker to do the tuck pointing, the market value of this work would be higher than the hourly rate paid to the bricklayer. If the bricklayer engaged a worker to mix the cement, move the bricks and clean the site, this work may have a lesser market value than the hourly rate of the bricklayer.

150. The market value of the principal work is judged from the perspective of what the individual or personal services entity is paid or would be paid under the contract or agreement for services. This value includes the charge out costs of the individual or personal services entity. The crucial concept is that the worker is contributing to the performance of the principal work required by the contract and the value of that contribution can only be ascertained from the viewpoint of the value to the individual or personal services entity.

151. The amount paid to the entity engaged may be indicative of the market value of the principal work, but it is not determinative. For example, the bricklayer may engage a fellow bricklayer to perform standard bricklaying tasks, but pay the worker a lower hourly rate than that paid to the individual or personal services entity for doing the same work. The market value in that instance would be the amount payable or paid under the contract for the services.

152. To consider whether the amount paid is a valid measure of market value regard may be had to what a person at arms length,

working under the same conditions, would have been paid. Excessive remuneration paid to an associate of the individual or personal services entity for the performance of principal work, for example, would not represent the market value of the principal work performed.

Apprentice

153. The term 'apprentice' is not defined and therefore takes its meaning from ordinary concepts and usage. The meaning of apprenticeship in an ordinary meaning and legislative context is discussed in *Halsbury's Laws of Australia*.. A relevant extract is as follows:

> 'An apprenticeship is an agreement by which an employee is bound to serve an employer in an acknowledged trade, business or skill for a fixed period of time in return for which the employer undertakes to instruct the apprentice in the trade and pay his or her wages. The special contractual form of apprenticeship is traditionally known as an indenture; an indentured apprentice is simply an employee serving a period of training under an indenture in order to become qualified in a particular industry. The indenture must conform to the requirements laid down in either the relevant industrial award, the provisions of the State and Territory apprenticeship legislation, or both. In some jurisdictions and awards a distinction is made between an apprenticeship and a traineeship, generally depending on whether the vocation in which the employee is engaged is a trade or a calling.'

154. The common law meaning of the word 'apprentice' is discussed in *Halsbury's Laws of England* (4th edn). A relevant extract is as follows:

> 'At common law a contract of apprenticeship is something more than a contract of service. By a contract of apprenticeship a person is bound by another for the purpose of learning a trade or calling, the apprentice undertaking to serve the master for the purpose of being taught, and the master undertaking to teach the apprentice. Where teaching on the part of the master or learning on the part of the other person is not the primary but only an incidental object, the contract is one of employment rather than of apprenticeship.'

155. Whether persons engaged in non-regulated contracts satisfy the common law meaning of apprentice needs to be considered on a case by case basis.

Business premises test

Maintain and use

156. For the business premises test to be passed a requirement of section 87-30 is that the individual or a personal services entity maintains and uses business premises. This means that the individual or entity must do more than merely have leased premises in its name to pass the test. The premises should actually be used to produce the personal services income.

Business premises used by the individual or entity to mainly conduct activities producing personal services income

157. The use of the word 'mainly' means the generation of personal services income must be the primary usage to which the business premises are put. The explanatory memorandum provides the following:

> 'The business premises must be used mainly by the individual or entity to conduct activities producing personal services income.' (paragraph 1.98)

Example 1:

158. Byte Pty Ltd, contracts with Net Pty Ltd to provide information technology services to Net Pty Ltd. Byte Pty Ltd leases premises at the local shopping mall but 90% of the time uses the premises for retail trade of computing hardware and software. Byte Pty Ltd does not "mainly" conduct, at those premises, activities that gain or produce personal services income. The premises are mainly used for the purposes of retail trade activities.

Example 2:

159. Colin, a professional geologist, contracts through his personal services entity Col Pty Ltd to provide services to Big Mining Co Ltd. Colin spends 70% of his time in the field retrieving ore samples but performs the analysis in premises leased by Col Pty Ltd from the local Council. Col Pty Ltd has exclusive use of the premises and uses them only to undertake the technical analysis of the ore samples. Col Pty Ltd uses the business premises to mainly conduct activities that gain or produce personal services income and would pass the business premises test.

Premises

160. The word 'premises' is not defined and therefore takes its meaning in ordinary concepts and usage. The *Macquarie Dictionary* defines premises as follows:

> 'a. the property forming the subject of a conveyance. b. a tract of land. c. a house or building with the grounds, etc., belonging to it.'

161. In *Frost v Caslon, Frost v Wilkins* [1929] 2 KB 138, Scrutton L.J said:

> "I can see no reason why a room separately occupied should cease to be premises because it is contained within the structure of a larger building which is also premises. My view is that expressed in Fraser's Representation of the People Acts, 2nd Ed., where it is said (p.50) that the words 'any land or premises' are very wide, and will include any piece of land or any kind of structure or building of whatsoever kind, or any part thereof, provided it is capable of being occupied."

162. The meaning of the word in the context of leasehold estates was considered in *Bracey v Read* [1962] 2 All E.R. 472 where Cross J held:

> 'The word premises is not defined in the Act [*Landlord and Tenant Act* 1954]. Its strict legal meaning is the subject matter of the habendum in a lease, and it would cover any sort of property of which a lease is granted; but no doubt the word is used sometimes in a popular sense which is considerably more restricted, in the sense of buildings, or buildings with land immediately adjoining them....'.

163. Under the general law, any estate or interest in real property could be conveyed. Therefore, premises could comprise the fee simple estate of a building, part of a building, land, or land with buildings. Similarly, premises could also comprise a leasehold estate in respect of any building, part of a building, land or land with buildings.

164. The general law meaning of the word 'premises' accords with the meaning of that term in present times. The popular meaning is illustrated by the case of a doctor with a surgery in his/her private residence. The surgery would be popularly described as the business premises of the doctor. If the surgery were under lease from a third party, there would be in general law terms a leasehold estate or, in contemporary terms, a proprietary interest in the land.

165. The meaning of the word premises therefore provides that premises may exist within larger premises, however, whether such

premises are physically separate is another matter (see explanation of physically separate below).

Business Premises

166. The phrase 'business premises' is not defined. The ordinary meaning of the word 'premises' is discussed above. 'Business premises' are literally premises at which a business is carried on. The meaning of 'carrying on a business' is discussed in Taxation Ruling TR 97/11. Where a business is being carried on at premises within the meaning discussed above, those premises constitute 'business premises' in the relevant sense. Whether or not premises are 'business premises' needs to be considered on a case by case basis.

167. The authorities have established some general principles in relation to business premises and these are set out below.

No fixed limit on area of business premises

168. In *Burt v Commissioner of Taxation* (1912) 15 CLR 469, Griffith CJ said at page 475:

> "A good definition of 'business premises' may be taken from the New Zealand case which has been cited to us, where one learned Judge said it meant land or buildings or land and buildings used for the actual purposes of business. There is therefore no fixed limit of area to begin with. To give some illustration: In the case of a laundry, the drying ground is clearly part of the business premises…"

Business premises may merely comprise land, merely buildings or both

169. In *Re Alloway* [1916] NZLR 433, Edwards J said:

> "The words 'the premises' of a man engaged in business signify the place in which he carries on his business. Such premises may be wholly buildings, as in the case of many shopkeepers; or wholly land, as in the case of a timber yard; or partly buildings and partly land, as in the case of a timber yard used in conjunction with a large joinery business; or, more aptly as applied to the present case, large stables erected upon land part of which is used as a paddock."

Business premises need not be owned

170. The business premises test does not require that the business premises be owned by the individual or the personal services entity.

What is required is that the business premises must be maintained and used by the individual or the personal services entity. Business premises may be maintained where there is any right to occupy the premises that enables the individual or entity to carry on a business. Accordingly, business premises may be maintained by way of occupancy under a lease, sublease, licence or mere possession.

Exclusive use of premises

171. As the phrase 'exclusive use' is not defined it takes its meaning in ordinary concepts and usage. The *Macquarie Dictionary* defines 'exclusive' as:

> 'not admitting of something else; incompatible, limited to the object or objects designated, shutting out all other activities, single or sole….'

172. The requirement that the individual or the personal services entity has exclusive use of the business premises refers to exclusive use at the time that the individual or the entity conducts, at those business premises, activities that gain or produce personal services income.

Physically separate

173. The phrase 'physically separate' is not defined in the ITAA 1997. The phrase therefore takes its meaning in ordinary concepts and usage. The *Macquarie Dictionary* defines 'separate', in the relevant sense, as 'being or standing apart; cut off from access: separate houses'. *The New Shorter Oxford English Dictionary* also gives a meaning of 'separate' which assists in providing clarity. That meaning is as follows:

> 'Detached, set apart, (from something), not incorporated or joined. Existing or regarded as a unit by itself.'

174. Neither the *Macquarie* or *Oxford Dictionaries* give a definition of the word 'physically' which may be applied in the relevant sense. The phrase 'physically separate', however, does appear in the authorities and its usage aids in identifying the meaning to be given to the phrase. In *AAT Case (Veterans Appeals Division) Truscott v Repatriation Commission W96/51 1997* 2 duplex halves were described as physically separate. The 2 duplex halves were on separate title and Barnett J noted:

> 'There are no adjoining doors connecting the two duplex halves and on the applicant's own evidence, access from one of the halves into the other is achieved by walking out of the

laundry door, across a patio (which is not enclosed) and into the other'.

175. The decision of Justice Bignold of the Land and Environment Court of New South Wales in *Environment Protection Authority v Cleary Bros (Bombo) Pty Ltd* (unreported) (Cleary Bros) also provides some guidance on the circumstances in which premises can be regarded as being 'physically separate'. In that case, Cleary Bros held about 10 hectares of land on which it carried out a number of activities including:

(a) a quarry

(b) quarry stockpiles and a crushing plant

(c) a concrete batching plant

(d) a transport workshop

(e) a construction depot

(f) a parking lot.

176. It was held that the quarrying activities were carried out on premises that were physically separate from the premises on which the crushing and concrete batching operations were conducted. In coming to a conclusion as to the meaning of 'scheduled premises' within the meaning of the *Clean Air Act* 1961 Bignold J. took the view that:

> '… "the premises" are relevantly those parts only of the landholding which are used for the prescribed facilities and works which include not only the parts physically so used, but also parts necessary for, or ancillary to, those uses, e.g., the access way from the highway, the transport workshops, construction depots and parking areas. ... the "premises" do not relevantly include that part of the Defendant's landholding that constitutes the quarry.'

177. Although the case was decided in a different context, the approach taken by his Honour (notional division on the basis of use to which the respective parts were put) assists in deciding the question of whether premises, or parts of premises, are 'physically separate' from each other within the meaning of paragraphs 87-30(1)(c) and (d). While notional division on the basis of the use to which parts of land are put is not of itself determinative, it is a factor in deciding whether premises, or parts of premises, are physically separate in the context of the business premises test.

178. In those cases where a clear distinction can be made between premises, or parts of a premises, and each part is not ancillary or necessary to, or connected with, the use of the other parts, then each of those parts may be physically separate for the purposes of the business premises test in section 87-30. For example, if a doctor's surgery is

located in one part of a corner block and that part has its own entry and egress from the road and the surgery is blocked off from a separate private dwelling of the doctor on the same block of land by a fence with no entry or egress between the two, then the surgery would be regarded as being physically separate from premises that are used for private purposes. In this instance, the physical impression enables the land to be notionally divided into 2 parts, the first being the dwelling with curtilage employed for private purposes and the second being the building structure with curtilage employed for business purposes. In these circumstances the physical impression is that the business premises are not within the private premises of the individual or an associate, and are therefore physically separate.

179. Where business premises are incorporated into a dwelling employed for private purposes by the individual or an associate, the physical impression of the dwelling and curtilage does not allow for any notional division of the property into 2 parts. This accords with the *Oxford Dictionary* meaning above which specifies that where one thing is incorporated into another, the two things are not separate. Clearly, where two things are not separate, they cannot be construed as physically separate.

180. This approach is consistent with the position adopted in example 1.14 of the Explanatory Memorandum. Even though the garden shed is detached from the building structure which comprises the brother's residence, it is not physically separate because the physical impression of the property is that the shed forms part of the dwelling and curtilage which comprises the brother's private residence. The entire property has the visual impression of being a private residence.

181. A distinction may be made in the case of conjoint buildings such as in *Truscott's* case. In this instance, it is not necessary to consider any notional division of the building structure as there is legal and physical division of the structure into two parts. Conjoint buildings are usually on separate title and have a dividing wall which is a permanent physical barrier preventing internal access between premises. Such buildings also have discrete access and often have further physical divisions such as fencing. In these cases it is valid to conclude that one conjoined half is not incorporated into the other and therefore that each is physically separate from the other.

182. The position where premises are within a high rise building follows along similar lines. For example, where an individual or entity operates from a room within the premises of the service acquirer, there can be no notional division of the premises into discrete parts. The premises of the individual or entity are incorporated both physically and functionally into the premises of the service acquirer and therefore the entire floor space has the physical

impression of being that of the service acquirer's premises. The room of the individual or entity is therefore not physically separate from the premises of the service acquirer.

183. A factual variation is the situation where commission agents are co-located, with discrete offices, on the same floor and with a shared reception/waiting area. The premises in such circumstances are also usually owned by the service acquirer and are amidst a series of floors occupied by employed staff of the service acquirer. In these instances, the signage of the building both externally, and on each floor, is that of the service acquirer. The physical impression of the floor on which the commission agents operate is therefore indistinguishable from the overall impression of the series of floors of the service acquirer. In such instances, the premises of the commission agents are not physically separate in the relevant sense. This view accords with drafting intention.

184. In the case where an individual or entity leases a discrete floor in a high rise building from a third party and another floor is occupied by the service acquirer, it would be concluded in the usual run of cases that the premises are physically separate from those of the service acquirer. In such cases, the respective floors have a permanent physical barrier preventing internal access, they are subject to a separate lease, are not incorporated functionally into each other, do not share signage and have discrete access. The premises, therefore, have multiple indicia which support a conclusion they are physically separate from each other. As with conjoint buildings, the issue of notional division does not arise because of the physical division.

Changing business premises

185. The individual or personal services entity does not have to maintain and use the same business premises throughout the whole year. This means that the individual or entity can change business premises during the year as long as at all times during the income year, the individual or entity has business premises which satisfy the requirements in subsection 87-30(1).

Personal Services Business Determination

186. Subsection 87-15(3) provides if 80% or more of the personal services income of an individual during the income year is from one source, the individual's personal services income is not from conducting a personal services business unless, when the income is gained or produced, a personal services business determination is in force relating to the individual's personal services income.

187. The Commissioner can make a personal services business determination relating to an individual's personal services income if he is satisfied about a number of matters set out in section 87-60 (for individuals) or 87-65 (for personal services entities). If the Commissioner is satisfied that an individual or a personal services entity met or could reasonably be expected to meet either the employment test or the business premises test or both, a determination may be made. Thus in the normal or ordinary circumstances of an applicant for a determination, the Commissioner cannot have regard to the unrelated clients test.

188. The Commissioner may also make a determination in those cases in which he is satisfied that, but for unusual circumstances applying to the individual or to the personal services entity, the individual or the entity would have met or could reasonably have been expected to meet at least one of the three personal services business tests. Thus where unusual circumstances apply the Commissioner can have regard to all three tests.

Reasonable expectation

189. The phrase 'reasonable expectation' has been considered in a number of cases. In *News Corporation Ltd v National Companies and Securities Commission* (1984) 57 ALR 550; (1984) 5 FCR 88 at ALR 561; FCR 101, Woodward J said:

> 'A reasonable expectation of an event requires more than a possibility, risk or chance of the event occurring.'

See also *FC of T v. Peabody* (1994) 181 CLR 359; (1994) 28 ATR 344; 94 ATC 4663.

190. The test is an objective test; see *FC of T v Arklay* (1989) 85 ALR 368; (1989) 20 ATR 276; 89 ATC 4563; *Eastern Nitrogen Ltd v FC of T* (1999) FCA 1536; (1999) 43 ATR 112; 99 ATC 5163.

Unusual circumstances

191. The word 'unusual' is not defined and therefore takes its meaning in ordinary concepts and usage. The Macquarie Dictionary defines 'unusual' as 'not usual, common, or ordinary; uncommon in amount or degree; of an exceptional kind.'

192. The phrase 'unusual circumstances' and phrases of similar meaning have received some consideration by the Courts in other contexts. In *Re Z.* (1970) 15 FLR 420, Joske J commented that 'exceptional and unusual have much the same meaning'(p.421). He then held following Martin v Martin (1941) N.I. 1, at p.14, that 'exceptional' meant simply 'out of the ordinary' and thus concluded

that "the legislation enables the judge to exercise his discretion in a case which appears to him to be 'out of the ordinary'".

193. In addition, in *Re S.G.* (1968) 11 FLR 326, Blackburn J. held that:

> 'exceptional and unusual circumstances must relate to the particular parties concerned and not merely to the class or kind of persons to which they belong.'

194. In *Re Beadle v Director-General of Social Security* (1984) 6 ALD 1 the Tribunal said (at page 3),

> "An expression such as 'special circumstance' is by its very nature incapable of precise or exhaustive definition. The qualifying adjective looks to circumstances that are unusual, uncommon or exceptional. Whether circumstances answer any of these descriptions must depend upon the context in which they occur. For it's in this context which allows one to say that the circumstances in one case are markedly different from the usual run of cases. This is not to say that the circumstances must be unique but they must have a particular quality of unusualness that permits them to be described as special."

195. It is self evident that for unusual circumstances to be recognised, the usual circumstances must be first established.

196. Subsections 87-60(4) and 87-65(4) of the ITAA 97 provide two examples of 'unusual circumstances' in the context of the unrelated clients test. The subsections provide for the following:

> unusual circumstances include providing services to an insufficient number of entities to meet the unrelated clients test under section 87-20 if:
>
> (a) the individual or entity starts a business during the income year, and can reasonably be expected to meet the test in subsequent income years; or
>
> (b) the individual or entity provides services to only one entity during the income year, but met the test in one or more preceding income years and can be reasonably expected to meet the test in subsequent income years.

When unusual circumstances become usual circumstances

197. Subparagraph 87-60(3)(a)(ii) and Subparagraph 87-65(3)(a)(ii) refer to unusual circumstances applying to the individual or to the entity in the income year during which the determination first has effect. Situations may arise where circumstances that might be

considered to be unusual in an income year become the normal or usual. An example may be where an individual, who normally enters into monthly contracts with clients, enters into a 12 month contract with one client. At the conclusion of that contract the contract is rolled over for a further period of 12 month with the possibility of further rollovers. It is considered that, whilst the first 12 months contract may give rise to unusual circumstances in the relevant income year, the subsequent rollover of that contract may result in the circumstances ceasing to be unusual.

198. Whether a change in circumstances is temporary and unusual, or a new mode of operation, needs to be considered on a case by case basis. The onus will be on the applicant for a personal services business determination, in each case, to show why circumstances should be treated as unusual where a long-term contract exceeding 12 months has been entered into.

Further grounds for determination

199. The further grounds comprise four conditions, all of which must be satisfied for the individual or entity to be entitled to a Personal Services Business Determination on the basis of the further grounds. The further grounds are set out under subsection 87-60(5) where application is made by an individual and under subsection 87-65(5) where application is made by a personal services entity.

200. The four conditions are:

(1) the individual's or entity's personal services income is for producing a result;

(2) the individual or entity is required to supply the plant and equipment, or tools of trade, needed to perform the work from which the individual or entity produces the result;

(3) the individual or entity is, or would be, liable for the cost of rectifying any defect in the work performed; and

(4) 80% or more of the individual's or entity's personal services income could reasonably be expected to be, or was, income from the same entity, or from the same entity and that entity's associates.

201. The first three conditions are discussed below in order of occurrence. The fourth condition has been discussed earlier in this ruling.

Producing a result

202. The phrase 'producing a result' in subsections 87-60(5) (individuals) and 87-65(5) (personal services entities) has the same meaning as that contemplated by Sheller JJA in *World Book (Australia) Pty Ltd v FC of T* 92 ATC 4327; 23 ATR 412 in his consideration of the phrase 'produce a given a result'. In that case, at ATC 4334; ATR 420, Sheller JJA said as follows:

> 'In the present case it could be said that Mr Maiden contracted by use of his own resources and the resources of others and worked to achieve a given result, namely the sale of the appellants books. He was by the terms of the agreement, amongst other things, authorised to act by himself or through his approved employees as a selling agent for the appellant's products, he was entirely free to choose the areas in which and the times at which he solicited purchases for the product, he was free to employ whatever legal style or method of selling he deemed suitable and the appellant agreed that it should not have any right to direct or control him in any respect whatsoever.'

203. Therefore, the meaning of the phrase 'producing a result' means the performance of a service by one party for another where the first mentioned party is free to employ his/her own means (i.e., third party labour, plant and equipment etc) to achieve the contractually specified outcome. The consideration in turn must be a fixed sum on completion of the particular job as opposed to an amount paid by reference to hours worked.

204. An individual or entity will not satisfy the condition in paragraph 87-60(5)(a) or 87-65(5)(a) respectively, merely because the contract states that the personal services income is for producing a result. The individual or entity must actually be paid on the basis of achieving a result, rather than, for example, for hours worked.

Required to supply the plant and equipment, or tools of trade, needed to perform the work

205. The second condition for the further grounds is that the individual or the personal services entity is required to supply the plant and equipment or tools of trade needed to perform the work that produces the result. The reference to 'the' in 'the plant and equipment' means that the individual or the personal services entity is required to supply all the plant and equipment or tools of trade (see Explanatory Memorandum at paragraph 1.115). Thus, where the service acquirer provides some tools or some plant and equipment that are necessary for or needed by an individual or personal services

entity to complete their contractual obligations to produce a result, the second condition will not be satisfied.

206. This is to be distinguished from those circumstances where a service acquirer provides plant and equipment that are not needed by the individual or the personal services entity to perform the work. For example, the construction, by a builder, of scaffolding at a large, commercial building site does not result in carpenters, who use that scaffolding in getting to that part of the site where they do their work, failing the second condition. Whilst the scaffolding permits them to have access to the particular part of the site where they do their work, it would not constitute plant and equipment needed by them to do their work.

207. The reference to "the work" in the second condition, therefore, refers to the actual work that the individual or the personal services entity is contractually required to perform in order to produce the result.

Example 3:

208. Robert is a motivational speaker, whose personal services entity, Bob Pty Ltd, is contracted at all times during the year to a service acquirer, XYZ Pty Ltd. Robert utilises furnishings, projection equipment and other plant of XYZ Pty Ltd in fulfilling the contractual obligations of Bob Pty Ltd to XYZ Pty Ltd. Bob Pty Ltd is not required to supply all the plant, tools and other equipment needed to perform the work from which it produces the result and is therefore not entitled to a personal service business determination on the basis of the further grounds.

To be liable for the cost of rectifying any defect in the work performed

209. The third condition requires that the individual or the personal services entity is or would be liable for the cost of rectifying any defect in the work performed. The individual or entity must actually cover the cost of rectifying defects in the work performed. Whilst the existence of a term in an agreement that the individual or the personal services entity is liable for the cost of rectifying any defect in the work performed would be strong evidence of an obligation to make good any faulty workmanship, it may not be conclusive in every case. Regard must be had to all the circumstances in reaching a conclusion as to the existence of the liability.

210. The means by which the liability to rectify the defect is discharged is not determinative. The liability could be discharged out of the individual's or entity's own funds, or recovered under the terms

of an insurance policy held for the purposes of indemnifying against defective work.

Example 4:

211. Gavin is a joiner whose personal services entity Gav Pty Ltd (Gav) is contracted at all times during the income year to Wood Pty Ltd. Wood Pty Ltd and Gav have an express term in their written contract that Gav is liable for the cost of rectifying any defect in the work performed. Wood Pty Ltd and Gav, however, have an oral understanding that this express term will never be enforced. Gav is not entitled to a Personal Services Business Determination on the basis of the further grounds as the third condition is not satisfied.

212. The term 'rectifying any defect' is not defined in the ITAA 97 and therefore takes its meaning in ordinary concepts and usage. The *Macquarie Dictionary* defines 'rectify' as follows:

> 'to make, put, or set right, remedy, correct, to put right by adjustment or calculation.'

The word 'defect', in turn is defined in the relevant sense as follows:

> 'A falling short; a fault or imperfection.'

213. The phrase 'rectifying any defect' therefore literally means to put right any fault or imperfection. Clearly, not all work of an individual or entity is capable of rectification. Where this is the case, the third condition cannot be passed.

214. Where work is capable of rectification, the third condition requires that the individual or entity be liable for making good any defect in the work performed. A liability to pay court awarded damages to the service acquirer is not regarded as giving rise to a liability for the cost of rectifying any defect in the work performed. Nor does the exposure to statutory penalty for non-compliance with the law satisfy the requirement that the individual or the entity be liable for the cost of rectifying defects in the work performed.

Having regard to the custom or practice when work of that kind is performed

215. Paragraphs 87-60(6) and 87-65(6) give the Commissioner a discretion to consider the custom or practice relating to the work of the kind that is performed by the individual or the entity and that produces the result when making a personal services business determination on the basis of the further grounds. The relevant custom or practice is that which relates to the work of the kind performed by an entity other than an employee.

216. The phrase 'custom or practice' is not defined and therefore takes its meaning in ordinary concepts and usage. The *Macquarie Dictionary* definition of the constituent words, in the relevant sense, are as follows:

> 'custom, 1. a habitual practice; the usual way of acting in given circumstances. 2. habits or usages collectively; convention. 3.a. a rule peculiar to a particular locality, trade or profession which may be recognised as having legal force provided that it does not contradict a general rule of common or statutory law. b. such rules collectively…6. a group pattern of habitual activity, transmitted from one generation to another.'

and

> 'practice, 1. habitual or customary performance: normal business practice. 2. a habit or custom.'

217. The *Macquarie Dictionary* definitions of the words 'practice' and 'custom' therefore support a view that for an activity to be a 'custom or practice' it must have some history of existence before the present. Further, the longer the history of existence, the greater the likelihood the activity is a 'custom or practice' in the relevant sense.

218. In this context, it is clear that activities that change on a regular basis cannot by definition be considered a 'custom or practice'. Further, where an activity occurs in a particular way over many years so as to constitute a custom or practice, and the activity is altered so as to constitute a new activity, it is clear that until the new activity has its own history of existence it cannot be considered a custom or practice.

Applying the tests in Division 87

219. In those cases where 80% or more of an individual's personal services income is from one source, Division 87 operates both prospectively and retrospectively to ascertain whether, during the income year, that individual's personal services income is income from conducting a personal services business. The tests can be applied at any stage throughout the income year based on activities that have already occurred or on the reasonable expectation that certain activities will occur or continue to occur. In these circumstances, where the relevant tests are satisfied, the individual or the entity can be considered to be conducting a personal services business for the whole of the income year. The Commissioner may make a determination in these circumstances that takes effect as from 1 July in the relevant income year.

220. A personal services business determination only remains in force for the period specified in the Notice of Personal Services Business Determination and while the conditions to which the Determination is subject are met. The period specified in the Notice can specify a date of effect prior to the date the application was made.

221. Where less than 80% of an individual's personal services income is from one source, the individual or the entity may reach the requisite conclusion if "during an income year" that individual or that entity meets at least one of the 3 personal services business tests. In some circumstances the requisite conclusion can be reached during the year. In other cases, the individual or the entity may only be able to reach the conclusion at the end of the financial year.

Example 5:

222. Jack operates through a personal services entity called JJ Pty Ltd. Less than 80% of Jack's personal services income is from one source. JJ Pty Ltd employs an apprentice on 1 July 2000 for a period of 9 months. On 1 January 2001, JJ Pty Ltd meets the employment test and will be taken to be conducting a personal services business for the whole of the income year, 1 July 2000 to 30 June 2001.

Examples

Example 1: Unrelated Clients Test

223. Kevin is an engineer. He was an employee of Mud Mining Pty Ltd until last year when his employment contract was terminated and at the instigation of Mud Mining he entered into a contract for the provision of his engineering services. Kevin also produces income from providing services to his brother's company, Lost Exploration Pty Ltd (an associate of Mud Mining Pty Ltd). Kevin regularly places an advertisement in a mining industry periodical. As a result of his advertising activities Kevin provides services to Pebbles Pty Ltd who is not an associate of either Mud Mining or Lost Exploration Pty Ltd. Less than 80% of Kevin's income is from each source.

224. Kevin does not meet the requirements of the unrelated clients test even though he has three clients during the income year because:

(a) Kevin's contract with Mud Mining was not as a direct result of making an offer or invitation to the public, but rather a result of Mud Mining changing the working arrangements (paragraph 87-20(1)(b) is not satisfied); and

(b) Gaining income from providing services to Lost Exploration Pty Ltd does not satisfy paragraph 87-20(1)(a) because Lost Exploration would be considered an associate of Kevin's.

Example 2: Labour Hire Arrangements

225. Ian is a geologist who derives 70% of his personal services income from Rock Pty Ltd. Ian entered into a contract with Rock Pty Ltd as the result of a tendering process. The remaining income is gained as a result of Ian being registered with a labour hire firm. During the course of the income year Ian has performed services for five service acquirers as a result of his registration with the labour hire firm.

226. The services provided to Rock Pty Ltd meet the requirements of paragraph 87-20(1)(b) as they are provided as a direct result of Ian making an offer, in the form of a tender, to Rock Pty Ltd. However, due to the operation of subsection 87-20(2), Ian's registration with the labour hire firm is not treated as making an offer or invitation to provide services and therefore paragraph 87-20(1)(b) is not satisfied. Ian does not meet the requirements of the unrelated clients test.

Example 3: principal work

227. Kate and Lawrence have established a company. The company has entered into a contract with Palatial Pty Ltd to provide drafting services. Kate drafts plans for residential dwellings as stipulated in the agreement. Lawrence performs clerical duties such as banking and bookkeeping. In addition to clerical duties, Lawrence prepares all variations that are required and checks all of Kate's work against the clients specifications. Lawrence makes any corrections that are required using a drafting software package. Lawrence's work in preparing variations, checking Kate's work and making corrections using a drafting software package forms part of the principal work. Lawrence is qualified to do this type of work. The drafting work he undertakes is the principal work that will produce the personal services income under this agreement. Lawrence's banking and bookkeeping work does not form part of the principal work.

Example 4: market value

228. Jack is a contract engineer who contracts with Big Mining Co. to provide his services. He is paid a daily rate of $480.00 for his services. He occasionally hires Tom, who is not his associate, to assist him in his engineering work and pays Tom a daily rate of $160.00. This is the going rate for a labourer in the mining industry.

Tom works a total of 100 days for Jack during the year of income. Jack's contract lasts for the whole year. He worked for 250 days during the year. The market value of Jack's work for Big Mining Co. for the whole year is $120,000 (250 days x $480) of which $16,000 (100 days x $160.00) is gained or produced from the work that Tom does.

229. The market value of Tom's work for Jack is $16,000 (100 days x $160). This represents 13.33% of the total value of the principal work required to fulfil Jack's contract. As this is less than 20% (by market value) of the principal work, Jack would not meet the employment test.

Example 5: market value

230. Jodie is a draftsperson who contracts with Big House Pty Ltd for the provision of drafting services. Jodie engages her spouse Ian, who is also a draftsperson, to correct errors and make any variations to plans that are required by the clients. Ian performs principal work that is to be performed under the contract for a total of 5 hours per week. Ian performs a total 240 hours work for Jodie. Jodie derives $70,000 from the performance of principal work that is the object of the contract. Jodie's hourly rate is approximately $40 per hour. Jodie pays Ian $32,000 per year. The market value of the work performed by Ian is $9,600 calculated as follows: 240 hours x $40.

231. The portion of Jodie's principal work performed by Ian is:

$$\frac{\$9,600}{\$70,000} \times 100 = 13.71\%$$

232. Jodie does not meet the requirements of the employment test as Ian only performs 13.71%, by market value, of Jodie's principal work.

Example 6: liable for the cost of rectifying any defect in the work performed

233. Michael has a personal services entity Mick Pty Ltd (Mick) which is contracted for the whole income year to MM Pty Ltd (MM). The services performed by Michael in fulfilling the contract between Mick and MM are the provision of advice in relation to the operation of the income tax law. Some of the advice Michael provides is incorrect and MM suffers loss due to arrangements put in place in reliance on Michael's advice. The nature of the work undertaken by Michael is not capable of rectification because it, and the arrangements put in place by MM, are not capable of reversal. MM may claim for damages from Mick Pty Ltd or Michael for negligent advice (if established). This does not amount to Mick Pty Ltd or

Michael being liable for the cost of rectifying defects in the work performed for the purposes of the third condition in subsection 87-65(5).

Example 7: liable for the cost of rectifying any defect in the work performed

234. Dimitrious has a personal services entity Plastered Pty Ltd which is contracted for the whole income year to JJ Pty Ltd (JJ). The contract between Plastered and JJ is for the provision of plastering work and includes a term that Plastered is liable for the cost of rectifying the defect in any work performed. Dimitrious fulfils the contractual obligations of Plastered to JJ and, after completing a particular job, Plastered is advised by JJ that some hairline cracks have appeared in the plaster and a piece of cornice was not properly joined. The hairline cracks and the cornice joint are defects in the work performed which are capable of rectification. Plastered always adheres to the contractual term with JJ, and Dimitrious repairs the hairline cracks and cornice joint. Plastered, therefore, is liable for the cost of rectifying any defect in the work performed for JJ and satisfies the third condition in subsection 87-65(5).

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Your comments

236. We invite you to comment on this Draft Taxation ruling. We are allowing 6 weeks for comment before we finalise the Ruling. If you want your comments to be considered, please provide them to us within this period.

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Commissioner of Taxation
4 April 2001

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Related Rulings/Determinations:
TR 97/11; TR 92/20

Subject references:
- alienation of personal services income
- apprentice
- associate
- business of arranging for persons to provide services
- business premises
- business premises test
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- personal services business
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- PSBD 80% test
- PSBD criteria
- PSBD further grounds test
- PSBD normal circumstances business premises test
- PSBD normal circumstances employment test
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- PSBD unusual circumstances business premises test
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- PSBD unusual circumstances unrelated clients test

- public or a section of the public
- reasonable expectation
- service acquirer
- test individual
- tools of trade
- unrelated clients test
- unusual circumstances

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