

TD 2014/D15 - Income tax: where a personal services entity receives a payment from a service acquirer in relation to a period, is that payment personal services income within the meaning of subsection 84-5(1) of the Income Tax Assessment Act 1997 notwithstanding during that period the service provider is not providing services to the service acquirer until further called upon?

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This document has been finalised by TD 2015/1.



Draft Taxation Determination

Income tax: where a personal services entity receives a payment from a service acquirer in relation to a period, is that payment personal services income within the meaning of subsection 84-5(1) of the *Income Tax Assessment Act 1997* notwithstanding during that period the service provider is not providing services to the service acquirer until further called upon?

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This publication is a draft for public comment. It represents the Commissioner's preliminary view about the way in which a relevant taxation provision applies, or would apply to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

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Ruling

1. Yes. A payment received by a personal services entity from a service acquirer during a period the service provider is not providing services to the service acquirer until further called upon, is personal services income within the meaning of subsection 84-5(1).¹

Example 1

2. *Jim is the sole shareholder/director of Services Coy. Services Coy has a contract with Client Coy to make Jim available to provide his skill and expertise to Client Coy from 1 July 2010 to 30 June 2015 as required by Client Coy. The contractual fee is a flat non-contingent \$40,000 per month.*
3. *Jim has a contract of employment with Services Coy to undertake the services for Client Coy on Service Coy's behalf.*

¹ Unless context otherwise dictates, all legislative references in this Draft Taxation Determination are to the *Income Tax Assessment Act 1997*.

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4. *On 29 November 2014 a dispute arises between Jim and the management of Client Coy which results in Jim being directed to stay away from the business premises of Client Coy until further advised. The contract between Client Coy and Services Coy expires on 30 June 2015 without Jim being called upon to resume providing services to Client Coy.*

5. *During the period from 30 November 2014 to 30 June 2015, Client Coy continues to pay the \$40,000 monthly fee to Services Coy. The payments made by Client Coy to Services Coy during this period are Jim's personal services income within the meaning of subsection 84-5(1) notwithstanding that Client Coy did not call upon Jim to undertake any further services.*

Definitions

Personal services entity

6. The references throughout this draft Determination to a 'personal services entity' are to an entity within the meaning of subsection 86-15(2) – namely, to a company, partnership or trust whose ordinary or statutory income includes the personal services income (within the meaning of subsection 84-5(1)), of one or more individuals.

Service acquirer

7. The references throughout this draft Determination to a 'service acquirer' are to an entity or entities that acquire the personal services of an individual directly from the individual or through a personal services entity.²

Service provider

8. The references throughout this draft Determination to a 'service provider' are to the relevant individual in respect of whom the definition of personal services income in subsection 84-5(1) is being applied.

Date of effect

9. When the final Determination is issued, it is proposed to apply both before and after its date of issue. However, the Determination will 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 Determination (see paragraphs 75 to 76 of Taxation Ruling TR 2006/10).

Commissioner of Taxation

17 September 2014

² Note that the term 'service acquirer' is used in the same sense in TR 2001/7 *Income tax: the meaning of personal services income*. Refer to paragraph 16 of that Ruling.

Appendix 1 – Explanation

❶ *This Appendix is provided as information to help you understand how the Commissioner's preliminary view has been reached. It does not form part of the proposed binding public ruling.*

Background

10. Part 2-42 contains provisions which are broadly directed at the alienation of personal service income. It commenced on 1 July 2000.

11. Paragraph 1.6 of the Explanatory Memorandum to the New Business Tax System (Alienation of Personal Services Income) Bill 2000 which inserted Part 2-42 relevantly explains 'alienation of personal services income' to occur:

1.6 ... when the services of an individual are provided through an interposed entity rather than directly by the individual who performs the services. When alienation occurs, income may be retained in the entity and either taxed at the lower rate available to the entity and/or diverted to associates, allowing a lower rate of tax to be paid on that income. The use of interposed entities is also seen by some taxpayers as creating an entitlement to a range of deductions which would not be available to an individual providing the same services as an employee.

Personal services income

12. What amounts to 'personal services income' for the purposes of Part 2-42 is central to the operation of that Part. It is defined in subsection 84-5(1) as follows:

Your *ordinary income or *statutory income, or the ordinary income or statutory income of any other entity, is your **personal services income** if the income is mainly a reward for your personal efforts or skills (or would mainly be such a reward if it was your income).

Payments that have the appearance of being in consideration for doing nothing

Leave

13. It might be thought that a payment made by a service acquirer to a personal services entity during a period in which the service provider is not called upon to do anything is not 'personal services income' as defined because the payment appears to be in consideration for doing nothing.

14. On this view, a payment made during a period of paid leave would not be personal services income.³ However, such a view is clearly not in accord with the intention of the legislature given the alienation measure is targeted at salary like payments.⁴

15. As a matter of contract, payments made during periods of leave are in fulfilment of the promise made by the service acquirer which in turn is in consideration for the promise made by the personal services entity to provide the efforts or skills of the service provider.

16. Such payments are therefore made in consideration of the efforts or skills of the service provider albeit the payment is made to the personal services entity.

³ Whether that be annual, sick or personal leave.

⁴ The Second Reading speech to the New Business Tax System (Alienation of Personal Services Income) Bill 2000, for example, states that the object of the measure is to 'treat earnings from work in the same way under the income tax law, regardless of the legal structure used by the income earner'.

17. A close reading of subsection 84-5(1) shows there is no temporal qualification in terms of when the payment must be made in relation to the time (if at all) the skills of the service provider are exercised. All subsection 84-5(1) requires is that the ordinary or statutory income be a reward for their personal efforts or skills.

18. For these reasons, payments made by a service acquirer to a personal services entity during a period of leave of the service provider are nevertheless personal services income of the service provider.

Payments under a contract of retainer

19. Payments under a contract of retainer are also intended to come within the meaning of personal services income in subsection 84-5(1). So much is clear from paragraph 7.15 of the Explanatory Memorandum to Taxation Laws Amendment Bill (No. 6) 2001, which inserted section 87-40 of Part 2-42, which relevantly states:

... At least 75% of the agent's personal services income from the principal must be income based on the agent's performance in providing services to the customers on the principal's behalf, such as a percentage of income generated or fees for service. The agent may have up to 25% fixed remuneration, **such as retainer** or salary like payment, and may still satisfy these conditions ...

[emphasis added]

20. That is, the Explanatory Memorandum proceeds on the basis that salary like payments (including a retainer) are personal services income within the meaning of Part 2-42.

21. In the relevant sense, the essence of a retainer is for a service provider to be on call to provide the specified services should the need arise.

22. For example, the *Collins English Dictionary* (online version) defines 'retainer' as:

A *retainer* is a fee that you pay to someone in order to make sure that they will be available to do work for you if you need them to.

23. Where no services are provided, the personal services entity may nevertheless remain entitled to the agreed payment for the relevant period.

24. As a matter of contract, the retainer payments are in fulfilment of the promise made by the service acquirer which in turn is in consideration for the promise made by the personal services entity to hold the service provider ready to provide their skills should they be called upon to do so.

25. Such payments are therefore made to secure the skills of the service provider and as such are properly characterised as being a reward for those skills.

26. Retainer payments are accordingly personal services income of the service provider as defined under subsection 84-5(1).

Gardening leave payments

27. Gardening leave is a term given to a situation whereby a service provider is required to serve out a period of notice at home (or 'in the garden'). Gardening leave is not novel, occurring in various industry sectors including professional services and the entertainment industry. Gardening leave is governed as a matter of contract and may or may not be expressly contemplated in the relevant written service agreement.⁵

28. During a period of gardening leave, the service provider (or their personal services entity) continues to receive all contractual payments and benefits the service acquirer agreed to provide in consideration for the service provider's original promise to provide personal effort or skills, but is prohibited from commencing service with third parties until the gardening leave period has expired. It is a practice which is often adopted with service providers who have a certain status whereby they have access to confidential information or customers and leave to join a competitor. During the period of gardening leave the service provider's access to such information or customers is typically either restricted or denied.⁶ Further, the service provider is typically contractually prevented from commencing with a rival or setting up a business in competition until the expiration of the notice period.

29. Even where the governing contract does not compel the service acquirer to occupy the service provider with tasks so as to make full use of their skills, gardening leave is not for present purposes materially distinct from a contract of retainer. That is, the service provider continues to be bound as a matter of contract (in this context, between the personal services entity and the service acquirer) to hold themselves ready to exercise their skills for the benefit of the service acquirer if called upon to do so.⁷

30. This point was made by Habersberger J in *BearingPoint Australia Pty Ltd v. Hillard* [2008] VSC 115 (18 April 2008).⁸ Where it was said at paragraph 103:

Of course, putting an employee on garden leave for the whole of the notice period costs the employer just as much in terms of remuneration, but by doing so the employer retains the right to make use of the employee's services during this period.

[Emphasis added]

31. Payments made during the period of such gardening leave are therefore not materially different to those paid under a retainer. They enable the service acquirer to continue to call upon the skills of the service provider and as such constitute personal services income within the meaning of subsection 84-5(1).⁹

32. Where the governing contract does compel the service acquirer to occupy the service provider with tasks so as to make full use of their skills, a failure on the part of the service acquirer to do so, may be sufficient a breach to enable the service provider to be discharged from the contract. Such was the case in *William Hill Organisation Ltd v. Tucker* [1998] EWCA Civ 615 where Lord Justice Morritt (with whom Lord Justices Smith and Walker agreed) refused to grant injunctive relief to prevent the service provider in that case from commencing employment with a competitor during the notice period.

⁵ *William Hill Organisation Ltd v. Tucker* [1998] EWCA Civ 615 (2 April 1998).

⁶ See for example *Tullett Prebon (Australia) Pty Ltd v. Simon Purcell* [2008] NSWSC 852 at paragraph 8.

⁷ Noting that a breach by the service provider of their obligation to do so might only be capable of being remedied by damages, rather than specific enforcement. See *Tullett Prebon (Australia) Pty Ltd v. Simon Purcell* [2008] NSWSC 852 at paragraph 30, and the authorities cited therein.

⁸ In the analogous employment law sense.

⁹ Unless the contract expressly terminates the right to continue to call upon the service provider's skills (which may, in turn, bring the employment contract to an end).

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33. However, even where there has been a relevant breach of the contract in respect of the provision of personal services or skills, until such time as that contract is actually terminated, relevant gardening leave payments remain pursuant to that continuing contract.¹⁰

34. It might again be argued that payments made during 'gardening leave' are to do nothing. This may particularly be the case where the service acquirer is not compelled to, does not intend to and does not in fact keep the service provider engaged with tasks during the period of the 'gardening leave'. The Commissioner disagrees with this view unless the contract expressly terminates the service acquirer's rights to continue to call upon the service provider's skills.

35. In cases where the service acquirer is not compelled to, does not intend to and does not in fact keep the service provider engaged during the period of leave, but nevertheless retains the right to call upon the service provider's skills as required, the payment that is made is still in consideration of the promise made by the personal services entity to provide those skills. That is, contractually it still secures the service provider's skills and is therefore personal services income as defined.

¹⁰ In such cases the continuation of the contract has been affirmed by the conduct of the personal services entity (see *Carr v. J A Berriman Pty Ltd* (1953) 89 CLR 327; [1953] HCA 31 for general principle).

Appendix 2 – Your comments

36. You are invited to comment on this draft Determination including the proposed date of effect. Please forward your comments to the contact officer by the due date.

37. A compendium of comments is prepared for the consideration of the relevant Rulings Panel or relevant tax officers. An edited version (names and identifying information removed) of the compendium of comments will also be prepared to:

- provide responses to persons providing comments
- be published on the ATO website at www.ato.gov.au.

Please advise if you do not want your comments included in the edited version of the compendium.

Due date:	24 October 2014
Contact officer:	David Newland
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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2001/7; TR 2006/10

Subject references:

- personal services income
- ordinary income
- statutory income

Legislative references:

- ITAA 1997 84-5(1)
- ITAA 1997 86-15(2)
- ITAA 1997 87-40
- ITAA 1997 Pt 2-42

Case references:

- BearingPoint Australia Pty Ltd v Hillard [2008] VSC 115

- William Hill Organisation Ltd v Tucker [1998] EWCA Civ 615
- Tullett Prebon (Australia) Pty Ltd v Simon Purcell [2008] NSWSC 852
- Carr v J A Berriman Pty Ltd (1953) 89 CLR 327; [1953] HCA 31

Other references:

- Collins English Dictionary (online version)
- Explanatory Memorandum to the New Business Tax System (Alienation of Personal Services Income) Bill 2000
- Explanatory Memorandum to Taxation Laws Amendment Bill (No. 6) 2001
- Second Reading speech to the New Business Tax System (Alienation of Personal Services Income) Bill 2000

ATO references

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