TR 2022/3 - Income tax: personal services income and personal services businesses

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Taxation Ruling

Income tax: personal services income and personal services businesses

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If this Ruling applies to you, and you correctly rely on it, we will apply the law to you in the way set out in this Ruling. That is, you will not pay any more tax or penalties or interest in respect of the matters covered by this Ruling.

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What this Ruling is about

1. This Ruling is about the personal services income (PSI) rules contained in Part 2-42 of the *Income Tax Assessment Act 1997*. It considers:

- how to identify PSI
- how the PSI rules apply to an individual or entity, and
- the application of the personal services business (PSB) tests.

2. All legislative references in this Ruling are to the *Income Tax Assessment Act 1997*, unless otherwise indicated.

3. The following list contains non-exhaustive examples of income that will clearly be PSI:

- salary or wages[1]
- income of a professional person practising on their own account without professional assistance

[1] Refer to paragraph 9 of this Ruling.

- income payable under a contract which is wholly or principally for the labour or services of a person
- income derived by a professional sportsperson or entertainer from the exercise of their professional skills, and
- income derived by consultants; for example, computer consultants or engineers from the exercise of personal expertise.[2]

4. Income that is generated from a business structure[3] is not PSI and therefore the PSI rules and this Ruling have no application to that income.

5. The PSI rules are aimed at improving the integrity of, and equity in, the tax system by ensuring that individuals cannot reduce or defer their income tax by alienating or splitting their PSI through the use of interposed companies, partnerships or trusts; that is, the personal services entity (PSE).[4]

6. The PSI rules ensure that the net PSI received by a PSE is attributed to the individual who performed the personal services. They also limit the deductions available to PSEs and to individuals who provide personal services but not through a PSE (referred to as 'sole traders' in this Ruling). This Ruling does not consider attribution and deductions relating to PSI.[5]

7. The relationship between an employer and employee is a contractual one. It is often referred to as a contract 'of' service. Such a relationship is typically contrasted with the principal and independent contractor relationship that is referred to as a contract 'for' services. Income derived from such contracts is considered to be from the personal exertion or personal service of the individual.[6]

8. It is necessary to establish whether the test individual[7] is an employee or independent contractor of the service acquirer.[8] Guidance on whether or not an individual is an employee or independent contractor can be found in Taxation Ruling TR 2005/16 *Income tax: Pay As You Go – withholding from payments to employees*.[9]

9. The PSI rules do not apply if an individual provides their personal services to a service acquirer as an employee.[10] Any income derived in this capacity will be the ordinary assessable income of the individual.[11] If the individual is not an employee of the service acquirer, then the PSI rules may apply.

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[2] Paragraph 1.27 of the Explanatory Memorandum to the New Business Tax System (Alienation of Personal Services Income) Bill 2000 (the EM).
[3] Refer to paragraphs 42 to 45 of this Ruling.
[4] Paragraph 1.5 of the EM.
[5] See TR 2003/6 and TR 2003/10.
[6] Paragraph 17 of TR 2005/16.
[7] This term is used in this Ruling for ease of reference. This term is not used in the legislation nor is it a reference to the meaning of the term as referred to in Schedule 2F to the ITAA 1936. Refer to paragraph 29 of this Ruling.
[8] Merely interposing an entity without giving proper effect to the arrangement will not change the individual's status as an employee of a service acquirer; see *In the matter of an application by Donald Alexander Porter for an Inquiry into an election in the Transport Workers Union of Australia* [1989] FCA 342 and *ACE Insurance Limited v Trifunovski* [2013] FCAFC 3 at [135–155].
[9] A clause in a contract labelling that the individual is an independent contractor is not determinative as the courts look to the totality of the contractual arrangement between the parties; see *Construction, Forestry, Maritime, Mining and Energy Union v Personnel Contracting Pty Ltd* [2022] HCA 1 (*Personnel Contracting*) at [61], [64] and [66] per Kiefel CJ, Keane and Edelman JJ, at [127] per Gageler and Gleeson JJ and at [162–163] and [172] per Gordon J, with whom Steward J relevantly agreed at [203].
[10] The combined effect of sections 85-10 and 86-1. See also paragraph 1.37 of the EM.
[11] Subsection 6-5(1).

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10. Where a PSE is involved, the PSI rules do not apply if, as a matter of fact, the income is not derived by the PSE. For example, in situations where an independent contractor seeks to assign the future income from their contract for service to a PSE, the income from such contracts cannot be assigned to the PSE and the income will be considered to be derived by the individual.[12]

11. Where the PSE has entered into contracts with a service acquirer or purchases the business with assets and goodwill which will provide the service to the service acquirer, the PSE will be considered to have derived the income and the PSI rules may apply.[13]

12. The PSI rules do not apply if the PSE or sole trader conducts a PSB. A PSE or sole trader conducts a PSB if it meets at least one of 4 PSB tests or if they have received a Personal Services Business Determination (PSBD) from the Commissioner.[14]

13. The following 4 PSB tests[15] can be applied to the PSI of each test individual:

- results test
- unrelated clients test
- employment test, and
- business premises test.

14. A PSE or sole trader that conducts a PSB may still be subject to the anti-avoidance provisions contained in Part IVA of the *Income Tax Assessment Act 1936* (ITAA 1936).[16] Part IVA gives the Commissioner the power to cancel a 'tax benefit' that has, or would but for section 177F of the ITAA 1936, be obtained by a taxpayer in connection with a scheme to which Part IVA applies. This power is found in subsection 177F(1) of the ITAA 1936. Regard must be had to the individual circumstances of each case in making a determination under section 177F of the ITAA 1936 to cancel a tax benefit. Part IVA of the ITAA 1936 may apply to the sole trader or PSE that conducts a PSB involving an income-splitting arrangement where the dominant purpose is to obtain a tax benefit resulting from the alienation or the splitting of the PSI of the sole trader or the individual undertaking the work for, or on behalf of, the PSE.[17]

15. This Ruling explains:

- the meaning of PSI (paragraphs 34 to 36 of this Ruling)
- what is not PSI (paragraphs 38 to 41 of this Ruling)
- determining whose PSI it is (paragraphs 50 to 57of this Ruling)
- who is not subject to the PSI rules (paragraphs 58 to 59 of this Ruling)

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[12] See *Taxation, Commissioner of (Cth) v Everett* [1980] HCA 6 and *Spratt v Commissioner of Inland Revenue (NZ)* [1964] NZLR 272 as summarised in *Liedig, H.J. v Commissioner of Taxation* [1994] FCA 236; 94 ATC 4269 (*Liedig*) and *Case 4/2001* [2001] AATA 341.

[13] See *Tupicoff, Gary v The Commissioner of Taxation* [1984] FCA 382 *(Tupicoff) and Commissioner of Taxation (Cth) v Gulland* [1985] HCA 83 (*Gulland*). See also reference to these cases in *Liedig* at [4278–4279].

[14] Sections 87-1 and 85-30, and subsections 86-15(3) and 86-60(b).

[15] Subsection 87-15(2).

[16] Refer to the note in section 86-10.

[17] See *Tupicoff, Gulland, Bunting, R.J. v Federal Commissioner of Taxation* [1989] FCA 688, *Re Egan and Federal Commissioner of Taxation* [2001] AATA 449, *Case W58* 89 ATC 524, *Case Y13* 91 ATC 191, *Case 3/99* 99 ATC 134, *Liedig* at [4277–4278] and Taxation Rulings IT 2121 *Income tax: family companies and trusts in relation to income from personal exertion*, IT 2330 *Income Tax: Income Splitting,* IT 2503 *Income tax: Incorporation of medical and other professional practices* and IT 2639 *Income tax: personal services income.*

- the effect of the PSI rules (paragraphs 60 to 63 of this Ruling)
- PSB (paragraphs 66 to 73 of this Ruling)
- the PSB tests (paragraphs 74 to 148 of this Ruling)
- PSBD (paragraphs 152 to 159 of this Ruling), and
- the application of Part IVA of the ITAA 1936 (paragraphs 160 to 162 of this Ruling).

16. This Ruling provides examples to illustrate the application of some of these principles:

- what is (and is not) PSI (paragraphs 163 to 175 of this Ruling)
- determining who is earning PSI (paragraphs 176 to 194 of this Ruling)
- PSBs – results test (paragraphs 195 to 209 of this Ruling)
- PSBs – unrelated clients test (paragraphs 210 to 223 of this Ruling)
- PSBs – employment test (paragraphs 224 to 245 of this Ruling)
- PSBs – business premises test (paragraphs 246 to 256 of this Ruling)
- PSBD – unusual circumstances (paragraphs 257 to 265 of this Ruling)
- special rules for agents (paragraph 266 of this Ruling), and
- potential application of Part IVA of the ITAA 1936 (paragraphs 267 to 269 of this Ruling).

Frequently used terms

17. 'Associate' has the same meaning as in section 318 of the ITAA 1936:

- 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 or sufficient influence of the individual or associate.
- For a company, an associate includes
  - a partner of the company or a partnership in which the company is a partner
  - if a partner of the company or partnership is an individual, the spouse or child of that 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.

- For a trustee, an associate includes an entity or associate of the entity that benefits or is capable of benefiting under the trust.
- For a partnership, an associate includes each partner of the partnership or associate of the partner.

18. 'Attribution' is the method by which net PSI is included in the assessable income of the test individual, even though it is the ordinary or statutory income of a PSE.[18]

19. 'Entity' includes a company, partnership, trust or individual.[19]

20. 'Net personal services income' (net PSI) is the amount of PSI derived from a contract after being reduced by deductions that may be claimed against that PSI by the test individual who derived the PSI.[20]

21. A PSB is conducted in an income year if one of the personal services business tests is met or if there is a PSBD in force in relation to the PSI of the test individual.

22. A PSBD is a notice from the Commissioner stating that one of the PSB tests is met by the test individual in relation to the PSE.[21]

23. A PSE is a partnership, company or trust that receives the PSI of one or more test individuals and is interposed between the individual providing the work or services and the service acquirer.[22]

24. PSI is income generated from an individual's personal efforts or skills; for example, their labour where the payment made is mainly a reward for that labour.[23]

25. The PSI rules are the measures contained in Part 2-42 that determine how PSI is to be treated, deductions available against that income and any pay as you go obligations. The expression 'PSI rules do not apply' is used in this Ruling for ease of reference; however, we recognise that the PSI rules still apply to assessing whether an entity is conducting a PSB. Relevant reporting obligations still apply.

26. 'Principal work' is work carried out by an individual or PSE that is central to meeting obligations under an agreement with the service acquirer. Principal work does not include associated clerical or administrative work (such as bookkeeping and answering phones), unless the principal work is administrative in nature.

27. A 'service acquirer' contracts with an individual or PSE to obtain the services of one or more test individuals. This term is not used in taxation legislation but is used in this Ruling for ease of reference.

28. A 'sole trader' is an individual who earns PSI but does not work through a PSE. This term is not used in taxation legislation but is used in this Ruling for ease of reference.

29. A 'test individual' is the person who is contracted to perform the services or who is responsible for performing the services that generates their PSI when working as a sole trader or through a PSE. Where a PSE is being used, there can be more than one test individual. This term is not used in taxation legislation nor is it a reference to the meaning

[18] Section 86-15.
[19] Subsection 960-100(1).
[20] See paragraphs 28 to 29 of TR 2003/6.
[21] Sections 87-60 and 87-65.
[22] Subsection 86-15(2).
[23] Subsections 84-5(1) and (2).

of the term as referred to in Schedule 2F to the ITAA 1936. This term is used in this Ruling for ease of reference.

Previous rulings

30. This Ruling combines Taxation Rulings TR 2001/7 *Income tax: the meaning of personal services income* and TR 2001/8 *Income tax: what is a personal services business.* It maintains the principles set out in those rulings, while taking legislative changes and judicial decisions into account. The changes and decisions made to this Ruling have further clarified the law and supported the ATO view since the issue of those earlier rulings.

Related rulings

31. As appropriate, this Ruling should be read in conjunction with Taxation Rulings TR 2003/6 *Income tax: attribution of personal services income* and TR 2003/10 *Income tax: deductions that relate to personal services income*.

Ruling

Sources of income

32. Income may be derived from several sources, including:

- PSI
- the supply or sale of goods
- the supply or use of income-producing assets
- a business structure
- interest income, or
- rental income.

33. The PSI rules only apply to PSI.

See Example 3 of this Ruling.

Meaning of personal services income

34. PSI is defined as income that is mainly a reward for an individual's personal efforts or skills (or would mainly be such a reward if it was the income of the individual).[24]

35. Only individuals can have PSI. It can be earned directly by a sole trader or indirectly through an interposed entity (PSE).[25]

36. The reference to 'or would mainly be such a reward if it was the income of the individual'[26] applies to situations where the income is legally derived by a PSE and not the

[24] Subsection 84-5(1).
[25] Subsections 84-5(2) and (4).
[26] Subsection 84-5(1) uses the wording '(or would mainly be such a reward if it was your income)'.

individual. If a PSE fails to meet a PSB test in respect of a test individual, the net PSI is deemed to be the income of the test individual and is attributed to that individual.[27]

Meaning of 'mainly'

37. The use of the word 'mainly' means that the income referred to needs to be 'chiefly', 'principally' or 'primarily' a reward for the provision of the personal efforts or for the exercise of the skills of an individual. That is, more than half (50%) of the ordinary or statutory income received is required to be a reward for the personal efforts and skills of an individual rather than being generated by the use of assets, the sale of goods or by a business structure.[28]

See Examples 1, 2, 7, 8 and 14 of this Ruling.

What is not personal services income

Supply or sale of goods

38. Income that is mainly generated from the supply and sale of goods is not PSI.[29]

39. Although personal efforts and skills may be required to make or produce an item for sale, the contract for the sale of the item would be considered to be a contract for the sale or supply of goods. The contract payment is to acquire ownership of the item and therefore, the payment is not considered to be PSI.

See Example 5 of this Ruling.

Supply and use of income-producing assets

40. Income that is mainly generated from the supply and use of income-producing assets is not PSI.[30]

41. The following factors are relevant in determining whether an amount is mainly for the use or supply of assets or the provision of personal efforts or skills[31]:

- the market value of the supply and use of the asset, compared with the market value of the personal services
- the basis on which the contract price has been calculated and whether the contract price includes costs borne by the sole trader or PSE for the supply and use of the asset in the income-producing activity
- the significance or uniqueness of the assets
- the gross value of the asset compared to the income of the sole trader or PSE from the particular activity, and
- the role the asset plays in generating the income.

See Example 4 of this Ruling.

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[27] See TR 2003/6.
[28] See examples in subsection 84-5(1) and *Fawcett Properties Ltd v Buckingham County Council* [1961] AC 636 at page 669.
[29] Paragraph 1.23 of the EM.
[30] Example 2 of subsection 84-5(1).
[31] Paragraphs 1.23 and 1.34 of the EM.

Status: **legally binding**

Business structure

42. Income which is generated from the business structure of an entity is not PSI.[32]

43. Where income is derived by an entity which has substantial income-producing assets or a number of employees, or both, the income is more likely to be generated by the profit-yielding structure of the business rather than from the rendering of personal services.[33]

44. Entities may have regard to the following factors to determine whether their income is mainly a reward for the personal efforts or skills of individuals or is derived from a business structure[34]:

- the number of arm's length employees or others engaged by the entity to perform work and their relative contribution to the income earning activities
- the existence of goodwill
- the extent to which income-producing assets of the business are used to derive the income
- the nature of the activities carried out
- the size of the operation, and
- the extent to which the income is dependent upon a particular individual's own personal skills, efforts or expertise.

See Examples 6, 7 and 8 of this Ruling.

45. The fact that services are performed through an entity that is not an individual does not automatically mean that income received by the entity in respect of those services is generated from a business structure. The factors listed in paragraphs 43 to 44 of this Ruling must be applied to each test individual's particular circumstances to assess whether the income is generated from a business structure or whether it is generated from the test individual's own personal skills, efforts or expertise.

Considering the substance of contractual arrangements

46. Whether an amount received by a sole trader or PSE is mainly a reward for the personal efforts or skills of the test individual depends on the substance of the arrangement between the parties.

47. Where the substance of the arrangement is that there is one set of obligations (different components that are integral or common to each other), they are looked at together. For example, where a sole trader or PSE provides plumbing services to replace a faulty tap, all the activities associated with those services would be looked at as one source of income rather than separate sources of income for labour and replacement parts. The supply of the tap in this case is integral to the plumbing services. If the income from the supply of the tap is less than 50% of the income received for the service overall, the whole amount is PSI.[35]

[32] Example 3 of subsection 84-5(1).
[33] See Example 3 in section 84-5.
[34] See Example 3 in section 84-5.
[35] See paragraph 1.28 of the EM.

48. If, however, the income received by the plumber for supplying the replacement tap was more than 50% of the income received for the service overall, then the whole of the amount received is not PSI but is mainly for the sale or supply of goods.

49. Where the substance of the arrangement deals with obligations which are completely separate and distinct, each obligation is the source of separate amounts of income. For example, where a sole trader or PSE derives income from plumbing services and also from the sale of household cleaning products to the householder, the 2 activities are not related but give rise to separate amounts of income. Amounts derived from the sale of household cleaning products in this case would not be PSI.

Determining whose personal services income it is

50. In determining whose PSI it is, consideration is required of all the facts and circumstances of the contractual arrangements between all parties involved in providing the services to the service acquirer.

51. As a sole trader has a contractual obligation to provide their services, any PSI derived under the contract belongs to the sole trader even if another individual is engaged by the sole trader to assist in the principal work.

52. Where a test individual works through a PSE, the contract for services is with the PSE and payment is made to it. However, unless the PSB requirements are met, the net PSI generated under that contract is wholly attributable to the test individual who performs the service for the service acquirer as part of the arrangement with the PSE, even if the PSE engages another individual to assist them with principal work. An exception is where an individual who is not a test individual of the PSE mainly generates the income under the contract, the income will not be the PSI of the test individual.

53. Where multiple test individuals work together through a PSE, each discrete amount of income received by the PSE under each contract entered into with the service acquirer is examined to determine which test individual's personal effort and skills mainly generated that income. This can be done by an analysis of contracts and invoices.

54. Contracts may indicate:

- the parties to the contract
- the obligations to be fulfilled (the principal work), and
- named individuals required to provide the services.

55. Invoices may indicate:

- amounts of income received, and
- which individual actually provided the services.

56. Each discrete amount of income received by the PSE will be the PSI of the test individual whose personal effort and skills mainly generated that income (more than 50%), even if they have been assisted by other individuals in performing the principal work under the contract.[36]

[36] *The Engineering Company and Commissioner of Taxation* [2008] AATA 934 at [18–19].

57. If a test individual is contracted to perform the services as a sole trader or through a PSE, it will be their PSI unless contemporaneous evidence can be provided that supports that another entity did 50% or more of the principal work as an employee or independent contractor engaged by the sole trader or PSE.

See Examples 9, 10, 11, 12 and 13 of this Ruling.

Who is not subject to the personal services income rules

58. The PSI rules do not apply to income received as an employee, except where the test individual is an employee of the PSE providing the service to the service acquirer and none of the PSB tests are met in respect of that test individual's PSI.[37]

59. The PSI rules do not apply in an income year if the sole trader or PSE:

- is able to self-assess that they conduct a PSB in respect of the test individual, or
- holds a PSBD in respect of the test individuals.

Effect of the personal services income rules

Sole trader

60. In the case of a sole trader, the PSI rules restrict the types of deductions that the sole trader can claim.[38]

Personal services entity

61. In the case of a PSE, the PSI rules:

- restrict the types of deductions that can be claimed against the PSI of the test individual[39]
- attribute the net PSI received by the PSE to the test individual that mainly generated the PSI (after deductions that are incurred in deriving that PSI)[40], and
- will generally give rise to pay as you go withholding obligations whether or not a test individual is an employee of the PSE.[41]

62. Where a sole trader or PSE qualifies as a PSB in an income year in relation to a test individual, the PSI rules do not apply to that test individual's PSI in that income year.[42] As such, the ordinary tax rules apply for that income year and the income retains its character as PSI of the sole trader or PSE.[43]

63. Individuals do not become employees of service acquirers as a consequence of the PSI rules applying to them.[44]

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[37] See TR 2005/16 for information on the meaning of 'employee'.
[38] Division 85.
[39] Division 85 and Subdivision 86-B.
[40] Division 86.
[41] Divisions 12 and 13 of Schedule 1 to the *Taxation Administration Act 1953*.
[42] Section 86-15.
[43] Note: Part IVA of ITAA 1936 could be applicable to that PSI if it resulted in income splitting or retention of profits arrangements where the dominant purpose is to obtain a tax benefit.
[44] Section 84-10 and *Skiba and Commissioner of Taxation* [2007] AATA 1705 at [46] (*Skiba*).

Status: **legally binding**

Chains of personal services entities

64. If there is more than one interposed entity involved in an arrangement, the transfer of income through those entities does not alter the character of the income being transferred; it remains PSI of the relevant test individual.

65. Each of the entities in the chain will be a PSE as the income it receives is the PSI of the test individual that can be attributed to the test individual and the deduction limitation rules may still apply.

See Examples 15 and 16 of this Ruling.

Personal services business

Self-assessment as a personal services business

Sole trader

66. A sole trader can self-assess that they conduct a PSB in an income year if:

- they meet the results test in relation to at least 75% of their PSI[45] (see paragraphs 77 to 96 of this Ruling), or
- less than 80% of their PSI is from the same entity and its associates (the 80% rule) and they satisfy one or more of the other PSB tests (see paragraphs 97 to 148 of this Ruling).[46]

Personal services entity

67. A PSE can self-assess that it conducts a PSB in relation to each test individual's PSI in an income year if:

- it meets the results test in relation to at least 75% of the PSI of that test individual's PSI[47] (see paragraphs 77 to 96 of this Ruling), or
- less than 80% of the test individual's PSI is from the same entity and its associates and the test individual's PSI satisfies one or more of the other PSB tests[48] (see paragraphs 97 to 148 of this Ruling).

68. In the case of a PSE, the 80% rule must be applied to the PSI of each test individual, not to the total income received by the PSE in respect of all test individuals.

Determining the source of the income for the 80% rule

69. The source of the PSI is determined by referring to the entity that has the contractual obligation to pay the service provider.

70. Where a contract to provide services is entered into with a labour hire firm or similar arrangement, the labour hire firm is the source of the income for the purposes of the 80% rule as it is the labour hire firm that has the contractual obligation to pay the individual sole trader or PSE.[49]

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[45] Subsection 87-18(1).
[46] Note 2 to subsection 87-15(1) and subsection 87-15(3).
[47] Subsection 87-18(3).
[48] Note 2 to subsection 87-15(1) and subsection 87-15(3).
[49] *BRMJCQ* at [87].

Status: **legally binding**

71. The views set out in paragraphs 69 and 70 of this Ruling are supported by the Administrative Appeals Tribunal (AAT) decisions of *BRMJCQ Pty Limited and Commissioner of Taxation* [2010] AATA 311 (*BRMJCQ)* at [87] and *Skiba* at [83]. We note that there is an alternative view, as applied by the AAT in *Confidential and Commissioner of Taxation* [2011] AATA 682 (*Confidential*) at [40], that you can look through the engagement of a labour-hire firm to identify the source of the PSI in circumstances where the origins of the contract with the labour-hire firm are found in commitments made directly between the individual of the PSE or the PSE and the end consumer of the services. While the AAT in *Confidential* considered the *BRMJCQ* and *Skiba* decisions, it took a far broader interpretation of subsection 87-15(3) than in the earlier cases. We will continue to adopt the view consistent with the decisions set out in *BRMJCQ* and *Skiba* until we receive further clarification on the issue through the AAT or Courts.

72. What is required is consideration of the immediate source of the PSI; that is, who has the contractual obligation to make the payments?[50]

See Example 25 of this Ruling.

73. If self-assessment is unavailable to a sole trader or PSE in relation to a test individual, the PSI rules will apply to the PSI of that test individual for the relevant income year, unless the Commissioner issues a PSBD.[51]

The personal services business tests

74. The PSB tests are the:

- results test
- unrelated clients test
- employment test, and
- business premises test.

75. If one of the tests is met in an income year, the PSI rules will not apply to the PSI of the test individual in that income year. However, Part IVA may still apply to income splitting or retention of profits arrangements where the dominant purpose is to obtain a tax benefit for the individual whose personal efforts or skills generated the income.

76. Where more than one test individual provides their services through a PSE, the tests must be applied to each test individual. Situations may arise where some test individuals meet a test and others do not. In these cases, the PSI of each test individual will be treated differently. That is, the PSI rules will not apply to the PSI of the test individuals who meet a PSB test but will apply to those test individuals who do not meet a test.

See Examples 9 and 10 of this Ruling.

The results test

77. The results test is satisfied if at least 75% of a test individual's PSI in an income year meets all the following 3 conditions:

- the income is for producing a result

[50] *Skiba* at [83].
[51] Refer to Note 2 to subsection 87-15(1) and section 87-1.

- the sole trader or PSE is required to supply the plant, equipment and tools of trade needed to do the work that produces the result, and
- the sole trader or PSE is, or would be, liable for the cost of rectifying defects.[52]

78. The results test is based on the common law indicia for distinguishing an independent contractor from an employee. However, it is a statutory provision to be interpreted on the words contained in the provision. As such, where other indicia of an independent contractor are present but the 3 results test conditions are absent, the sole trader or PSE will not satisfy the test.[53]

79. When applying the results test, it is necessary to consider the contractual arrangement entered into between the sole trader or PSE and the payer. All aspects of the contractual arrangement need to be carefully weighed up, especially when some contractual terms may support a conclusion that the sole trader or PSE is contracting to produce a result and other contractual terms support a conclusion that the sole trader of PSE is contracting to supply the services of a test individual. Contractual clauses that label the nature of the thing being supplied will not be determinative[54], particularly if they contradict the overall effect of the contractual arrangement. In certain circumstances, it may be necessary to look beyond the terms of a written contract to determine whether the relevant contractual liability actually exists or has been varied by the conduct of the parties, or is a sham.[55]

80. When working out if a sole trader or PSE (in relation to a particular test individual) meets the 3 conditions of the results test, the custom or practice in the particular industry is a relevant consideration.[56]

81. The reference to custom or practice in the PSI rules is to act as a safety net for a sole trader or PSE who works in an industry where participants would generally meet the results test but whose contract may not clearly indicate that a particular condition is met. In such a case, the sole trader or PSE can rely on custom and practice to support a conclusion that they meet the particular condition.[57]

82. However, custom or practice is not intended to override the 3 conditions required to meet the results test. For example, the fact that participants in a particular industry are generally paid for their time will not result in the first condition being met where their agreement clearly indicates that they are not being paid for producing a result.[58]

The income is for producing a result

83. To satisfy the first condition, the income must be for producing a result.[59]

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[52] Section 87-18.
[53] *IRG Technical Services Pty Ltd v Deputy Commissioner of Taxation* [2007] FCA 1867 (*IRG Technical*) at [37].
[54] See *Personnel Contracting* at [61], [64] and [66], per Kiefel CJ, Keane and Edelman JJ at [127], per Gageler and Gleeson JJ at [162–163] and [172] and per Gordon J, with whom Steward J relevantly agreed, at [203]. See also *R v Foster ; Ex parte Commonwealth Life (Amalgamated) Assurances Ltd* [1952] HCA 10; 85 CLR 138, per Dixon, Fullagar and Kitto JJ at [150–151] and [153–154] and referred to in *ACE Insurance Limited v Trifunovski* [2013] FCAFC 3, per Buchanan J at [67–70].
[55] *Personnel Contracting* at [136–143], [127], [177], [184] and [203]; *ZG Operations Australia Pty Ltd v Jamsek* [2022] HCA 2 (*Jamsek*) at [8–9] and *On Call Interpreters and Translators Agency Pty Ltd v Commissioner of Taxation (No 3)* [2011] FCA 366 at [290].
[56] Subsection 87-18(4).
[57] *Taneja and Commissioner of Taxation* [2009] AATA 87 (*Taneja*) at [22].
[58] *Taneja* at [23] and *Douglass v Commissioner of Taxation* [2019] FCA 1246 at [34] and [43–44].
[59] Paragraphs 87-18(1)(a) for individuals and 87-18(3)(a) for PSEs.

Status: **legally binding**

84. In contracts that are for producing a result, payment is usually made for a negotiated contract price to achieve a specified outcome. As opposed to an hourly or daily rate for doing work, payment is made when the contractually specified results have been fulfilled.[60] A contract price for achieving a specified result may be calculated by reference to an estimated number of hours applied to an hourly rate. If that estimate changes, a new contract or a variation to the original contract may be agreed between parties, allowing for a change to the negotiated contract for producing the result. What needs to be considered is whether the contract price is for achieving a specified result and not merely payment for the hours worked.

85. The essence of the contract must be to achieve a result and not to do work. The fact that a sole trader or PSE is required to complete identifiable tasks is not the same as achieving a contractually specified result if those tasks merely form part of the work being paid for on an ongoing basis.[61]

86. The condition will not be satisfied merely because the contract states that the contract is for producing a result. Consideration should be given to the substance of the arrangement between the sole trader or PSE and the service acquirer and what the sole trader or the PSE is actually being paid for.[62]

Supply of plant, equipment and tools of trade needed to perform the work

87. To satisfy the second condition, the sole trader or PSE must supply any plant and equipment or tools of trade needed to do the work that produces the result[63] and which a service acquirer would expect the sole trader or PSE to provide[64] or which the sole trader or PSE is contractually required to provide.

88. There are situations where, having regard to the nature of the work, no plant or equipment or tools of trade are needed to perform the work. Where this is the case, this condition will be met.[65]

89. Minimal usage of the tools or equipment of others will not of itself disqualify the taxpayer from meeting this condition.

Liability for the cost of rectifying defects

90. To satisfy the third condition, the sole trader or PSE is, or would be, liable for the cost of rectifying any defects in the work.[66] There is no requirement that they actually perform the work which rectifies the defect, so long as they are liable for the cost of rectifying any defect in the work performed.

91. The main consideration is whether they are exposed to commercial risk.[67]

92. Where physical rectification is not possible, the purpose of the provision would be satisfied where a right to claim for damages exists in respect of faulty or negligent performance of contractual obligations and the sole trader or PSE is, or would be, liable for the relevant component of damages awarded for the faulty or defective work.

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[60] *Skiba* at [62–64].
[61] *IRG Technical* at [110]; *Skiba* at [65-66].
[62] *IRG Technical* at [50].
[63] Paragraphs 87-18(1)(b) for individuals and 87-18(3)(b) for PSEs.
[64] *IRG Technical* at [113–114].
[65] *IRG Technical* at [113–114].
[66] Paragraphs 87-18(1)(c) for individuals and 87-18(3)(c) for PSEs.
[67] *Skiba* at [71].

93. A requirement to have professional indemnity insurance is an indicator that the sole trader or PSE is liable for rectification where the indemnity insurance is part of the contractual arrangements between the parties. However, the fact that a person may be subject to disciplinary action by a professional body for misconduct is not sufficient to satisfy the rectification element of the test.

94. This condition will not be satisfied where rectification occurs in circumstances where the sole trader or PSE has not been liable for the cost of rectification.[68]

95. A contractual term stating the sole trader or PSE has the liability for the cost of rectification of defects would support the conclusion that this condition could be satisfied if the term creates an actual liability.

96. Having a client refuse to pay for work done if they are unhappy with the service provided is considered a different risk to having the liability to pay for the rectification of defects and will not satisfy this condition.

See Examples 17 to 21 of this Ruling.

The other personal services business tests

The unrelated clients test

97. To meet the unrelated clients test in an income year:

- a sole trader or PSE is required to gain or produce the PSI from providing services to 2 or more entities; those entities cannot be associates of each other or associated with the sole trader or PSE[69], and
- the services must be provided as a direct result of making offers or invitations (for example, by advertising) and those offers must be made to the public at large or a section of the public.[70]

98. If the services are provided by registering through a labour-hire firm or similar arrangement, the test will not be met as the required offer or invitation has not been made to the public at large or to a section of the public.[71]

Direct result of making offers or invitations

99. To meet this condition, the offer or invitation must be the reason that the sole trader or PSE obtained the work from the client and there must be a direct causal effect between the offer or invitation and obtaining the work.[72]

100. A wide variety of activities can constitute making offers or invitations (such as print advertising, printing posters, radio and television broadcasting, public tender, having a website and posting internet advertisements), but all require the involvement of making public announcements.

101. To meet the test, the offer or invitation must operate directly on the client, not the intermediary. Offers or invitations accepted by labour-hire firms or similar intermediaries,

[68] *IRG Technical* at [105].
[69] Paragraph 87-20(1)(a).
[70] Paragraph 87-20(1)(b).
[71] Subsection 87-20(2).
[72] *Commissioner of Taxation v Fortunatow* [2020] FCAFC 139 (*Fortunatow*) at [17].

registering with labour-hire firms or similar intermediaries, or responding to advertisements on web-based recruitment sites will not meet this condition.[73]

102. Where it can be demonstrated that a sole trader or PSE has made an offer to the public at large or a section of the public and (as a direct result of that offer) the service acquirer decides to engage the services of the sole trader or PSE but, as a requirement of that engagement directs the sole trader or PSE to a labour-hire firm or similar intermediary as part of the service acquirer's requirements, the service acquirer will count as part of the unrelated clients test.[74] However, they will not be counted as the source of PSI for purposes of the 80% rule because it is the labour-hire firm or similar intermediary that has the contractual obligation to pay the service provider.[75]

The public or a section of the public

103. An offer or invitation is made to 'the public at large' where any interested member of the public is capable of accepting it.[76] 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 in certain circumstances[77]; for example, in relation to competitive tenders.

104. A word-of-mouth referral is not generally considered to satisfy the requirements of the unrelated clients test.[78] A word-of-mouth referral is when a sole trader or PSE is offered work because of a recommendation from a previous client or industry contact. However, offers made by word of mouth in a very specialised or niche industry where there are only a very small number of potential service acquirers may, in limited circumstances, meet this condition.[79]

105. Where there is a prior or subsisting relationship between the parties to an offer or invitation, the following factors[80] are relevant when determining whether the offer or invitation made by the sole trader or PSE is made to a section of the public:

- The number of people 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.
- 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 deal with each other on an

[73] *Fortunatow* at [19–20].
[74] *Fortunatow* at [17].
[75] Refer to paragraphs 69 to 73 of this Ruling.
[76] *Lee v Evans* [1964] HCA 65.
[77] *Corporate Affairs Commission (SA) v Australian Central Credit Union* [1985] HCA 64 (*Corporate Affairs Commission*).
[78] *Metaskills Pty Limited and Commissioner of Taxation* [2005] AATA 647 at [55]; *Cameron and Commissioner of Taxation* [2011] AATA 386 at [30]; *Cameron v Commissioner of Taxation* [2012] FCAFC 76 at [61].
[79] *Yalos Engineering Pty Ltd and Commissioner of Taxation* [2010] AATA 408; *Commissioner of Taxation v Yalos Engineering Pty Ltd* [2009] FCA 1569 at [24]. In this case, the PSE operated in a very specialised industry with a limited number of participants and advertising in a general sense was inappropriate (at [19]). This case was distinguished by the Full Federal Court in *Cameron v Commissioner of Taxation* [2012] FCAFC 76 as turning on its own particular set of facts (at [65]).
[80] *Corporate Affairs Commission* at [795].

arm's length basis, the commercial character of the transaction is maintained. Accordingly, the fact that a sole trader or PSE may have worked for or provided services to an entity sometime in the past does not necessarily operate to exclude the sole trader or PSE from satisfying this test.

Who must make the 'offer'

106. The offer must be made by the sole trader or PSE.

107. Where an offer is made by an individual and it is clear that the offer is made by the individual as a representative of the PSE, then the offer is considered to have been made by the PSE and this element of the test will be met.[81]

108. Where an offer is made to a sole trader or PSE by the service acquirer, this element is not satisfied because it is the potential client (service acquirer) making the offer rather than the sole trader or PSE.

See Examples 22 to 26 of this Ruling.

The employment test

Sole trader

109. A sole trader meets the employment test in an income year if they engage one or more entities that perform at least 20% (by market value) of the sole trader's principal work.[82]

110. Any individual engaged by the sole trader to perform principal work counts towards the employment test even if they are an associate of the sole trader. Other types of entities engaged by the sole trader to perform principal work only count towards the employment test if they are not an associate of the sole trader.[83]

Personal services entity

111. A PSE meets the employment test in an income year if it engages one or more entities that perform at least 20% (by market value) of the entity's principal work. However, test individuals of the PSE do not count towards the employment test.[84]

112. The first requirement in order to meet the employment test is that there is the actual engagement of another entity by the sole trader or PSE. 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.

113. Any other individual who is not a test individual and who is engaged by the PSE to perform principal work counts towards the employment test even if the individual is an associate of the PSE. Entities, other than individuals, engaged to perform principal work only count towards the employment test if they are not associates of the PSE.[85]

[81] *Yalos Engineering Pty Ltd and Commissioner of Taxation* [2010] AATA 408 at [21].
[82] Subsection 87-25(1).
[83] Paragraph 87-25(1)(a).
[84] Section 87-25(2).
[85] Section 87-25(2).

114. If the PSE is a partnership, a partner performing principal work for another partner can be counted for the employment test if they are not also test individuals of the partnership.

115. In most cases, all partners within a partnership would be test individuals (that is, earning PSI through the partnership) so no such partner could count towards the employment test even if they performed principal work for another partner.

116. However, a partner who does not earn PSI through the partnership (for example, a 'husband and wife' partnership where typically only one partner earns PSI) may count towards the employment test if they are paid to perform principal work for one of the other partners.[86]

117. A sole trader or PSE will also meet the test if for at least half the income year it has one or more apprentices.[87]

See Examples 27 and 28 of this Ruling.

20% (by market value) – single contract in the income year

118. The Commissioner will accept the following formula for determining whether at least 20% (by market value) of the principal work is performed by another entity (or entities):

% = (market value amount ÷ contract price) × 100

119. The market value amount is what the sole trader or PSE charged the service acquirer on an arm's length basis for the principal work performed by the entity (or entities) engaged by the sole trader or PSE (the charge-out rate).

120. The contract price is the total amount paid under the agreement between the sole trader or PSE and the service acquirer.

121. The market value amount would normally exceed the amount that the sole trader or PSE pays to the entity they have engaged.[88]

122. Where the parties performing the work are not dealing with each other at arm's length, the market value amount is the market rate that the sole trader or PSE would ordinarily charge a service acquirer on an arm's length basis for the services of the entity.

See Examples 29 and 30 of this Ruling.

20% (by market value) – multiple contracts in the income year

123. Where the sole trader or PSE provides services under multiple contracts over the course of an income year, the contract price is the sum of all of the contract prices for the year relating to the test individual's PSI regardless of whether an entity was engaged to assist the sole trader or PSE's principal work.

124. The market value amount is, in the case of:

- arm's length parties – the sum of all of the amounts charged to the service acquirer for the services supplied by the engaged entity or entities, and

[86] Subsection 87-25(2A).
[87] Subsection 87-25(3).
[88] This is because the market value amount would include mark-up for on-costs and profit margin for the sole trader or PSE.

- non-arm's length parties – the sum of all the amounts that represent the market rate that the sole trader or PSE would ordinarily charge a service provider on an arm's length basis for the services supplied by the engaged entity or entities.

Contracts that straddle income years

125. The employment test is applied in an income year. If a contract goes across more than one income year, the contract price and market value only include the amounts derived in the relevant income year.

Apprentice

126. An apprentice is a natural person who works for another person for a fixed time under an apprenticeship or trainee arrangement. This is a formal arrangement involving an obligation to learn a trade, business or skill.

127. The apprentice need not be directly apprenticed to the sole trader or PSE. An apprentice that is supplied by a Group Training scheme or similar type of arrangement to work for the sole trader or PSE as part of their trade training would meet the requirement.

128. The employment test does not require that the same apprentice is engaged or that the qualifying period comprises consecutive days.

See Example 31 of this Ruling.

The business premises test

129. The business premises test requires that at all times during the income year, the sole trader or PSE maintains and uses business premises[89]:

- where the main activities conducted there gain or produce PSI[90]
- of which they have exclusive use[91]
- that are physically separate from any premises that they (or any associate) uses for private purposes[92], and
- that are physically separate from the premises of the service acquirer (or any associate of the service acquirer).[93]

Business premises

130. 'Business premises' are premises that have the usual physical attributes and fixtures associated with commercial or business usage and, from a business and commercial perspective, are apt for the purpose of carrying on a business.

[89] Subsection 87-30(1).
[90] Paragraph 87-30(1)(a).
[91] Paragraph 87-30(1)(b).
[92] Paragraph 87-30(1)(c).
[93] Paragraph 87-30(1)(d).

Status: **legally binding**

Maintains and uses

131. It is a requirement that the sole trader or PSE maintains and uses the business premises at all times in the income year. This means that the sole trader or PSE must do more than merely have leased premises in its name to pass the test. The premises should actually be used to produce the PSI.[94]

132. Business premises are maintained when they are kept in existence or retained. Business premises may be maintained by ownership or by way of occupancy under a lease, sublease, licence or possession. However, not all of these occupancy arrangements satisfy the 'exclusive use' requirement of the test.[95]

133. There is no requirement for running costs associated with the premises, such as cleaning or utility costs, to be borne by the sole trader or PSE.

At all times in the income year

134. The sole trader or PSE must have business premises for the whole period during which activities are conducted for the purpose of generating PSI.

135. Where a sole trader or PSE commences or ceases activities during the income year, it is sufficient that the business premises are maintained and used for that part of the income year in which the activities are conducted.

Changing business premises

136. A sole trader or PSE is not required to maintain and use the same business premises throughout the whole year; however, they need to have business premises at all relevant times during the year.[96]

Main activities generate personal services income

137. The generation of PSI must be the primary usage to which the business premises are put. Where more than one activity is conducted at the premises it is necessary to determine which activities generate PSI and which activities generate non-PSI.[97] This requirement will be met where more than 50% of the activities conducted at the premises are directed at producing PSI.

138. This requirement can still be satisfied even if the sole trader or PSE conducts activities from other premises.

See Examples 32 and 33 of this Ruling.

Exclusive use

139. A sole trader or PSE is required to have exclusive use of the business premises.

140. This will be satisfied where premises are occupied under ownership or lease as the legal nature of the proprietary interest allows the holder to determine who may or may not enter the premises and, therefore, they have exclusive use for the purposes of the test.

[94] Paragraphs 1.97 to 1.98 and Example 1.13 of the EM.
[95] Paragraph 1.99 of the EM.
[96] Subsection 87-30(2).
[97] *Cameron v Commissioner of Taxation* [2012] FCAFC 76 at [114].

Status: **legally binding**

141. A sole trader or PSE cannot have exclusive use of the premises if they do not have exclusive possession. If the owner grants permission for the occupation of premises amounting to a licence and not a lease, the individual sole trader or PSE does not have exclusive use of the premises.[98]

142. A sole trader or PSE cannot lease premises together with another individual or entity on the basis that they share the premises to meet this requirement. As joint lessees, neither lessee has exclusive use of the premises.[99]

See Examples 34 and 35 of this Ruling.

Shared areas

143. Shared areas, such as reception and waiting rooms, are considered ancillary to the business premises and are not included for the purposes of the business premises test.

Physically separate

144. Business premises must be physically separate from premises that the sole trader or PSE (or their associates) use for private purposes.

145. For example, a PSE may lease a shed in an associate's backyard as its business premises. As the shed is part of the premises consisting as the entirety of the dwelling and surrounds (curtilage) used by the associate for private purposes[100], the shed will not be considered to be physically separate.

146. On the other hand, if the PSE leased a shed in an associate's backyard that had its own entry from the road and was blocked off from the associate's private residence by a fence with no access to the private residence, the shed would, in this scenario, be considered to be physically separate to the associate's private premises.

147. The business premises must also be physically separate from the premises of the service acquirer or an associate of the service acquirer. For example, where a sole trader or PSE leases a room within the premises of the service acquirer for its business premises, the room is not considered to be physically separate from the premises of the service acquirer and would not meet what is required for the business premises test.

148. On the other hand, where a sole trader or PSE leases a discrete floor or part of a floor from the service acquirer for its business premises, such premises may be physically separate from the premises of the service acquirer depending on such factors as:

- the extent to which the floors or parts of floors are functionally and physically integrated with each other
- entry and exit facilities
- signage
- security arrangements, and
- occupancy rights.

See Examples 36 and 37 of this Ruling.

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[98] *Radaich v Smith* [1959] HCA 45; 33 ALJR 2014 at [218]; *Commissioner of Taxation v Dixon Consulting Pty Limited* [2006] FCA 1748 (*Dixon*) at [37].
[99] Paragraph 1.99 of the EM.
[100] *Dixon* at [48]. See also Example 1.14 of the EM.

Special rules for agents

149. The PSI rules are modified for sole traders or PSEs acting or representing others as agents who bear an entrepreneurial risk in the way they provide services.[101]

150. An agent may treat the clients of their principal as the source of their PSI for the purposes of the 80% rule if the agent:

- is not an employee of the principal
- receives income from the principal that is for services that the agent provides to other entities (customers) on the principal's behalf
- receives at least 75% of that income as commission or results-based payments (as opposed to retainer or salary-like payments)
- actively seeks customers for their principal, and
- does not provide services from premises owned or leased by their principal (or the principal's associates) unless the agent uses the premises under an arm's length arrangement.

151. If less than 80% of the agent's PSI is from one source, the agent may meet the unrelated clients test, treating customers of the principal as their clients.

See Example 40 of this Ruling.

Personal services business determination

152. A sole trader or PSE can apply for a PSBD from the Commissioner, in respect of each test individual, under any of the following circumstances:

- they could be reasonably expected to meet the results, employment or business premises tests[102]
- unusual circumstances prevented the results, employment or business premises test from being met[103]
- the unrelated clients test was met, or could reasonably be expected to be met, but unusual circumstances prevented the 80% rule from being satisfied[104], or
- unusual circumstances prevented the unrelated clients test and 80% rule from being met.[105]

Unusual circumstances

153. To issue a PSBD, the Commissioner must be satisfied that, if not for the unusual circumstances, the sole trader or PSE would have met, or could reasonably be expected to meet, the test or tests applied for in relation to the PSI of the test individual.

[101] Section 87-40.
[102] Subsections 87-60(3A) and 87-65(3A).
[103] Subsections 87-60(3B) and 87-65(3B).
[104] Subsections 87-60(5) and 87-65(5).
[105] Subsections 87-60(6) and 87-65(6).

154. A reasonable expectation of an event requires more than a possibility, risk or chance of the event occurring.[106]

155. Unusual circumstances are those circumstances that are not usual, not common and are out of the ordinary.[107] For example, if a sole trader or test individual performing services on behalf of the PSE meets a PSB test in preceding years and expects to meet the test again in subsequent years but a one-off event has affected its ability to meet the test in the current income year, the one-off event may constitute unusual circumstances.

156. The unusual circumstances must apply to the sole trader or test individual performing services on behalf of the PSE that requests the PSBD. Industry-wide circumstances, such as economic downturn affecting a particular industry, cannot be relied on as an unusual circumstance.[108]

157. Situations may arise where circumstances that might be considered unusual become usual or 'the norm'. For example, where a sole trader or PSE usually enters into monthly contracts with a client, then enters into a 12-month contract with the possibility of further rollovers. It is considered that, while the first 12-month contract may be unusual, the subsequent rollover may result in the circumstances ceasing to be unusual.

158. The unusual circumstances relevant to an income year must be temporary, rather than a new mode of operation. The more temporary the circumstances are and the greater the likelihood that normal conditions will resume, the easier it will be to satisfy the unusual circumstances requirement.

159. 'Unusual circumstances' in relation to the unrelated clients test include providing services to an insufficient number of entities if the sole trader or PSE:

- starts a business during the income year and can reasonably expect to meet the test in subsequent income years, or
- provides services to only one entity during the income year, but met the test in one or more preceding income years and can reasonably be expected to meet the test in subsequent income years.[109]

See Examples 38 and 39 of this Ruling.

Application of Part IVA of the ITAA 1936

160. The general anti-avoidance provisions of Part IVA of the ITAA 1936 may still apply to cases where the PSE is considered to be conducting a PSB and the PSI rules do not apply. The ATO may seek to apply Part IVA where there are factors indicating that the dominant purpose of the arrangement is to obtain a tax benefit by diverting, alienating or splitting an individual's PSI or retaining profits in the lower taxed PSB.[110]

[106] *News Corp Ltd & ors v National Companies and Securities Commission* [1984] FCA 446; 57 ALR 550 at [561]; 5 FCR 88 at [101].
[107] *Re Z (*1970) 15 FLR 420; *Re Rosemary Beadle and Director-General of Social Security* [1984] AATA 176; *Groth Brian Lewis v Secretary Department of Social Security* [1995] FCA 989.
[108] *Scimitar Systems Pty Ltd and Deputy Commissioner of Taxation* [2004] AATA 720 at [29].
[109] Subsections 87-60(4) and 87-65(4).
[110] See section 86-10 and paragraph 1.17 of the EM. Further guidance is also provided in IT 2121, IT 2330 and IT 2639.

Status: **legally binding**

161. In deciding whether the PSB and test individual has engaged in income splitting in order to gain a tax benefit, the following considerations may be relevant:

- whether the salary or wages paid to the test individual is commensurate with the skills exercised or services provided, and with the income received by the PSB for those services
- whether the PSB distributes income to associates and does not distribute income to the test individual who provided the actual services, and
- whether the salary or wages paid to associates by the sole trader or PSB is not commensurate with the skills exercised and services provided, and the income received by the sole trader or PSB is for services performed by the test individual.

162. An example of a situation where there may be income splitting to which Part IVA could apply would be where an independent contractor (conducting a PSB through an interposed entity) is paid less than the contracted price for their work and the profit made as a result of paying less than the contracted price is distributed to the contractor's relatives who are on a lower marginal tax rate or accumulated in the interposed entity and taxed at a lower marginal rate of tax.[111]

See Example 41 of this Ruling.

Examples

Note: The following examples do not consider the application of the *A New Tax System (Goods and Services Tax) Act 1999*.

What is personal services income?

Example 1 – personal services income – sole trader

163. *Andre is a plumber who operates as a sole trader. He receives a contract to fix a blocked toilet and repair 3 leaking taps. He charges $25 for materials and $225 for his labour. The total of the invoice is $250. This income is Andre's PSI as it is mainly a reward for his personal efforts and skills.*

Example 2 – personal services income – personal services entity

164. *Judy is an information technology (IT) consultant who provides systems analysis services through her company, J.I.T. Pty Ltd, which enters into a contract with Rich Computer Co to provide Judy's consultancy services. The income J.I.T. Pty Ltd receives from Rich Computer Co is PSI as it is income generated from Judy's labour where more than 50% of the payment is a reward for her labour.*

[111] Part IVA and its predecessor, section 260 of the ITAA 1936, have successfully been applied in numerous cases involving scenarios where individuals whose income is a result of their personal efforts and skills have tried to lower the tax on that income through the use of an entity to split the individual's personal exertion or PSI with others or retaining profits in the lower-taxed interposed entity.

Example 3 – personal services income and non-personal services income – income from several sources

165. *Reindeer Pty Ltd has 3 sources of income, as indicated in its financial statements:*

- *income from consultancy work performed by its sole director, Ms Rudolph*
- *rent received on real property, and*
- *interest.*

166. *The income from consultancy work is PSI as the income is mainly a reward for the personal efforts and skills of Ms Rudolph. The rental and interest income is received as a result of holding assets (property and cash) and therefore is not PSI.*

Example 4 – not personal services income – income from the supply and use of income-producing assets

167. *Jack is an experienced backhoe operator. His family company, Jack & Jill Pty Ltd, owns a 10-tonne truck and a backhoe. Jack & Jill Pty Ltd enters into a contract with the Main Roads Department to dig trenches for laying sewerage pipes. The contract specifies that Jack & Jill Pty Ltd supplies a tractor with a backhoe and other special attachments, together with a licensed backhoe operator to work at specific locations.*

168. *Jack transports the backhoe on the truck to various construction sites at the request of the Main Roads Department. He then uses the backhoe to dig the trenches. The contract requires Jack & Jill Pty Ltd to provide specific plant and equipment to do the work. Without the backhoe and the truck, Jack & Jill Pty Ltd would not be able to gain or produce income.*

169. *Taking into account the significant size, value and uniqueness of the asset required to be supplied and the relative contribution of the asset compared to the personal service in generating the relevant income, the amount that is invoiced to the Main Roads Department is mainly for the cost of supplying the truck and the backhoe, and is not mainly for the efforts and skills of Jack. The income is therefore considered to be for the supply and use of income-producing assets and is not PSI.*

Example 5 – not personal services income – income from the sale of goods

170. *Grace is a carpenter who operates a partnership with her spouse, Chris. Grace designs and constructs bespoke furniture and sells it through the partnership via the internet and at trade fairs. The payments made to the partnership are for the sale of the furniture rather than Grace's personal efforts or skills. The income derived by the partnership is not PSI.*

Example 6 – not personal services income – income from a business structure

171. *Jim is an electrician who operates a partnership with his wife, Jane. Jane does not perform any of the electrical work but performs some of the administrative work. Jim undertakes the work required by clients and engages 3 full-time employees who undertake electrical work for him. The partnership owns 2 vans equipped with the necessary tools and equipment that are used by Jim and his employees. The partnership has generated goodwill, having a trade name and approximately 150 regular clients. The income is derived from the business structure of the partnership and is not PSI.*

Example 7 – personal services income – income not from a business structure

172. *Clare is an IT consultant who operates through a partnership with her spouse, Ralph, to provide IT services. Ralph does not engage in any of the principal work of the partnership (that is, IT activities), although he provides minor administrative assistance. The partnership has no significant assets, no employees or other workers and has not generated any significant goodwill. The income is not derived from the business structure of the partnership. As Clare is performing all the principal work of the partnership, the income derived by the partnership is Clare's PSI as it is mainly a reward for her personal efforts and skills.*

Example 8 – personal services income – not business structure

173. *Chris, Adrian and Simon are accountants who provide their services as principals through CAS Accounting Firm; not as individuals, but rather in their capacity as trustees for their respective family trusts. A service entity, CAS Services, provides office accommodation, all staff requirements, IT equipment and other services as required for CAS Accounting Firm to operate. In the past 3 years, CAS Accounting Firm has established a wide customer base. Chris, Adrian and Simon each receive income from CAS Accounting Firm only in their capacity as trustees of their family trusts.*

174. *Applying the general guidelines for determining whether income from a practice company or trust is from a business structure, Chris, Adrian and Simon (as trustees) are principal practitioners. As CAS Accounting Firm has 3 principal practitioners (Chris, Adrian and Simon) and no other practitioners (principal or non-principal), the following various factors are applied to determine if the income is generated by a business structure:*

- *Chris, Adrian and Simon operate a small firm.*
- *The firm has established a wide customer base.*
- *The services provided are accounting services that can only be provided by qualified accountants.*
- *The accounting services provided by Chris, Adrian and Simon require a high level of knowledge and skill, as well as substantial training and qualifications.*
- *The income-producing activities of the firm are dependent on the exercise of the personal skills, efforts and expertise of Chris, Adrian and Simon.*

175. *CAS Accounting Firm has established a wide customer base which suggests that it enjoys a measure of goodwill and its operations are quite extensive. On the other hand, it does not have substantial income-producing assets or employees, so its income is dependent upon the rendering of the personal skills of each of Chris, Adrian and Simon. The income of CAS Accounting Firm is therefore mainly derived from the personal efforts or skills of Chris, Adrian and Simon, rather than from a business structure. Chris, Adrian and Simon are considered to be test individuals and each has their own PSI to which they will have to separately apply the PSB tests to see if the PSI rules will apply.*

Determining whose personal services income it is

Example 9 – multiple individuals working through the same entity (teaming)

176. *Nicole and Caroline are both engineers who work predominantly in the mining industry. They receive work through their company, Canic Pty Ltd, which contracts to provide the services of Nicole and Caroline to one mining company. As they both provide*

their personal efforts and skills to the mining company, the income received by Canic Pty Ltd includes PSI of both Nicole and Caroline. This is the case whether Nicole and Caroline are contracted under one contract together or separate contracts.

Example 10 – multiple individuals working through the same entity (teaming)

177. *Andrea has been providing IT consultancy services through her company AIT Pty Ltd for the past 2 years. Andrea's friends Daisy, Bill and Ben, who provide services working in different fields that are mainly a reward for their personal effort and skills, would also like to work through her company structure. With Andrea's agreement, contracts to provide each of their services are entered into through AIT Pty Ltd with various service acquirers. Each individual works on their own contracts and therefore has their own PSI. They are all test individuals of AIT Pty Ltd as they are individually contracted through AIT Pty Ltd to perform the services that generates AIT Pty Ltd's income. AIT Pty Ltd's income may be attributed to them as their own PSI depending on whether AIT Pty Ltd passes or fails the PSB tests, by reference to each test individual.*

Example 11 – husband and wife partnership

178. *Annette is a qualified electrician and operates in partnership with her husband, Peter. Peter does the bookkeeping for the partnership in the evenings from a spare room in their home, but he is not an electrician. The partnership contracts to provide its services to Fix Electrics Pty Ltd, which undertakes electrical maintenance in large buildings. Fix Electrics Pty Ltd provides the partnership with the necessary electrical supplies to undertake any maintenance job.*

179. *The income the partnership receives for the electrician services is Annette's PSI as it is mainly a reward for her personal efforts and skills.*

180. *If none of the PSB tests are met, the PSI rules will apply and the net PSI will be attributed to Annette.*

Example 12 – multiple service providers

181. *Kim is a project manager who works through her company, Winner Pty Ltd, which does not meet any of the PSB tests. Winner Pty Ltd enters into a single 6-month contract with Big Co which states Kim is to provide the services. Kim is the test individual as she has contracted to perform, and is responsible for performing, the services that generate her PSI.*

182. *In the final month of the contract, Kim finds that she has too much work and employs David, a friend with project management skills, to assist her for that month.*

183. *In that final month, Kim does 45% of the work on the Big Co contract and David does 55%.*

184. *The net PSI generated under the contract is wholly attributable to Kim even though she employed David to assist her for the final month as Kim is the only test individual working through the PSE and the 6-month contract with Big Co is mainly for Kim's personal efforts and skills.*

Status: **legally binding**

Example 13 – multiple service providers

185. *Matthew is a management consultant who works through his company MC Pty Ltd, which enters into a contract with BC Energy Pty Ltd to provide its broad range of services. The contract does not stipulate a particular individual who is required to provide any of the particular services. MC Pty Ltd engages 3 subcontractors who, along with Matthew, perform the various services.*

186. *BC Energy Pty Ltd issues work orders for separate pieces of work required to be completed under the contract.*

187. *MC Pty Ltd issues invoices to BC Energy Pty Ltd each month for the work performed during the month on each work order. The invoices state which individual performed the services. While the contract between MC Pty Ltd and BC Energy Pty Ltd is broad, the relevant business records and communications (for example, invoices and emails) provide factual clarity that each individual performed specific work and it is their personal effort and skills that are being rewarded. Each discrete amount of income invoiced and received by MC Pty Ltd will be the PSI of the test individual who generated it as it is mainly a reward for their individual personal efforts and skills and may be attributed to and included in the assessable income of each test individual depending on whether MC Pty Ltd passes or fails the PSB test by reference to each test individual.*

188. *Each of the individuals are test individuals. The invoices issued under the contract evidence that they were responsible for performing the services that utilise their personal efforts and skill.*

Example 14 – employees of a personal services entity

189. *Maureen is an IT consultant who works through a PSE, Maur Pty Ltd. Maureen is the sole director and employee of the company. All contracts entered into are between Maur Pty Ltd and the relevant client. Maur Pty Ltd's income for providing the services is mainly a reward for Maureen's efforts and skills and is therefore her PSI. As Maureen is an employee of a PSE, the PSI rules will apply to Maureen's PSI unless the income is earned in the course of Maur Pty Ltd conducting a PSB.*

Example 15 – chain of personal services entities

190. *Keith forms 2 private companies, C Pty Ltd and PS Pty Ltd. Keith is employed by C Pty Ltd to perform computer consultancy services. C Pty Ltd contracts with PS Pty Ltd to provide services for clients of PS Pty Ltd as required. PS Pty Ltd contracts with the service acquirer for Keith to perform some consultancy services at their head office. C Pty Ltd and PS Pty Ltd are interposed between Keith (the test individual) and the service acquirer. C Pty Ltd and PS Pty Ltd form a chain of PSEs. Under the arrangement, the income gained by these entities is the PSI of Keith, as it is a reward for Keith's personal effort and skills in providing consulting services to the service acquirer.*

Example 16 – chain of personal services entities

191. *Sara is a mining engineer who is employed by her private company, Sara Engineering Pty Ltd. Sara sets up a trust, The Sara Family Trust, and forms a company, Sara Pty Ltd, to be trustee of the trust. The beneficiaries of the trust are Sara Engineering Pty Ltd, Sara, her partner and their 2 children.*

192. *Sara Engineering Pty Ltd contracts with Sara Pty Ltd (in its capacity as trustee) for Sara to provide services to clients of the trust. The trustee enters into various agreements with service acquirers. The only income of the trust is from the payments for work done by Sara. This income is mainly for the efforts and skills of Sara and is therefore her PSI.*

193. *The trust pays an agreed amount to Sara Engineering Pty Ltd for the services provided. The Sara Family Trust and Sara Engineering Pty Ltd are interposed between Sara (the test individual) and the service acquirers. The 2 entities form a chain of PSEs.*

194. *The Sara Family Trust also makes trust distributions to the beneficiaries out of the payments from the service acquirers. Unless a PSB test is met, the PSI rules apply and the net PSI is attributed to Sara.*[112]

Personal services business – results test

Example 17 – IT industry – results test not met

195. *A government department enters into a contract with Consultant Co for the provision of services by an individual who is nominated in the contract. The terms and conditions of the contract are that the individual is paid an hourly rate and works for a maximum of 8 hours per day. Departmental officers provide direction as to the required tasks and the manner in which they are to be performed. The individual is provided with an office, stationery and a desktop computer, and uses the department's computer system, software and data for carrying out the required tasks. He also uses his personal laptop to assist him in his tasks but is not required by the department to use it. If the work performed by the individual is unsatisfactory, the department is entitled to terminate the contract, but the company is not required under the contract to rectify any defects in the work performed. Consultant Co is a PSE because its income includes the PSI of the individual who does the work.*

196. *Applying the conditions of the results test:*

- *the income is for doing work and not producing a result, as the PSE is entitled to payment for each hour the individual works for the department with no risk of making a loss as a result of undertaking the work*
- *the PSE is not required to supply the plant, equipment or tools of trade needed to perform the work, even though the nominated consultant uses his personal laptop to assist him in his tasks*
- *the department is entitled to terminate the contract for unsatisfactory work, but the PSE does not have any liability to rectify any faulty work done by the individual.*

197. *All conditions must be satisfied for the results test to be met. In this example, none of the conditions are satisfied and the results test is not met. A sole trader or PSE engaged in these circumstances does not satisfy the results test.*

Example 18 – IT industry – results test met

198. *A government department enters into a contract with Consultant Co for the provision of services by an individual who is nominated in the contract. The terms and conditions of the contract are that the individual is required to develop a product for use on the department's IT system in accordance with functional specifications provided by the*

[112] Note: To avoid double taxation, the PSI attributed to Sara would be non-assessable non-exempt income of the trust. Refer to section 86-30 and paragraphs 28 and 42 of TR 2003/6.

department. The contract specifies a fixed amount by way of payment to Consultant Co for the development of the product, which is required to be produced within 12 months of the commencement of the contract. Instalments of the contract price are payable upon achievement of specified milestones. From time to time, the individual uses departmental equipment to access the department's IT system. However, the development work is undertaken primarily on the individual's own equipment located at her business premises. If the final product does not satisfy the functional specifications, the contract requires the work to be rectified and permits the department to seek damages from Consultant Co if not rectified. Consultant Co is a PSE because its income includes the PSI of the individual who does the work.

199. *Applying the conditions of the results test:*

- *the income is for producing a result as the contract requires performance of a specific task that produces an outcome or result; payment is not made until the work is completed, although instalments are payable upon the achievement of particular specified milestones or outcomes*
- *any relevant assets and equipment required to perform the work are to be provided by the PSE; the need to access the department's IT system by using their equipment is incidental to the development of the product*
- *the contract requires the PSE to produce a product that complies with the functional specifications of the department; if the individual does not meet those specifications, further work without additional payment would be required and the department would also be able to seek a remedy in damages.*

Example 19 – civil engineer – results test not met

200. *Mick is a civil engineer and operates through his company, Mick Smith Pty Ltd. In June 2018, the company entered into a contract for an 18-month period to carry out assigned planning projects, such as highway upgrades, for a government department. The contract was renewed in December 2019 and June 2020. The contract stipulates that Mick is to carry out the work and he performs all the principal work under the contract. During the course of each contract, Mick is assigned responsibility for overseeing various projects and tasks. The majority of the work is undertaken at the government department's premises or on the job site. Mick has access to secretarial support and the use of the department's equipment as required.*

201. *The fee specified in the contract is capped at a total of $210,000. The fee is calculated on a maximum time basis of 2,800 hours (40 hours per week × 70 weeks), at a fixed rate of $75 per hour. Payment is made upon submission of a fortnightly invoice which includes a time sheet certified by a government department officer.*

202. *Mick is not required to remedy defects at his own expense or to indemnify the department for the cost of remedying such defects. If Mick is required to remedy defects in the work he has performed, this is done in the normal course of his work and the time taken to fix the defects would be subject to payment at the usual hourly rate, with no penalty. The contract can be terminated by the department if Mick's performance is unsatisfactory.*

203. *Applying the conditions of the results test:*

- *The payment of the amount is not contingent on a result being produced, even though the total contract amount is capped prior to the contract being undertaken. Mick Smith Pty Ltd is paid fortnightly for hours worked and must*

work on projects that are assigned to Mick. He may cease working on a project before the project is completed to start work on another project.

- *Mick does not provide his own equipment and the equipment provided by the department (including office facilities) is significant.*
- *Mick Smith Pty Ltd is not liable for the cost of rectifying any defects in the work performed by Mick.*

204. *All of the conditions of the results test must be met for Mick Smith Pty Ltd to satisfy the results test in respect of the PSI of Mick. As none of the conditions are satisfied, the test is not met and the net attributed PSI would be included in Mick's assessable income if the PSI rules apply.*

Example 20 – building industry contractor – results test met

205. *Joe offers his services to the public, installing air-conditioning ducts. He is engaged to install specific duct work in accordance with a set of plans. The contract price is based on installation of the duct work in accordance with those plans and any changes are subject to the variation clauses in the contract. He assumes the risk of not being able to complete the work to specification or for defective work as he must rectify defective work at his own cost. Joe brings the tools required to do the work, such as a hammer, tin-snips, dolly, hacksaw, electric drill, pop-rivet gun and ladder. Joe incurs his own expenses for duct tape, glue, pop-rivets, nuts, bolts and drill bits.*

206. *While performing the contract, Joe encounters an unforeseen problem installing the ducts. The plans did not identify a hidden internal wall and it will take Joe an extra 2 days of work to complete the contract than initially thought. Joe negotiates a variation to the contract to allow for the additional work involved to achieve the installation of the ducts.*

207. *Joe satisfies the results test because he is contracted to produce a result (installation of ducts), he brings his own tools to do the work and he is liable for rectifying defects. The variation to the contract price does not change the essence of the contract, being to produce a result.*

Example 21 – consultant – results test met

208. *John is a management consultant working as a sole trader. He contracts with MLS Pty Ltd to produce a report for the board of directors. The report must be completed by a specific date. John is paid a set amount at the end of the contract, once the report has been finalised and presented. John does all of the work from his home office and if any errors are detected when the report is completed, he is required to rectify them at his own cost within set timeframes.*

209. *John meets the results test as he is contracted to produce a specific result, is required to use his own equipment to complete the report and bears the cost in rectifying any defects in the report.*

Personal services business – unrelated clients test

Example 22 – engineer – unrelated clients test met

210. *Kevin is an engineer who provides his services as a sole trader.*

211. *Kevin produces income from providing services to his brother's company Lost Exploration Pty Ltd, which is an associate of Kevin. The contract with Lost Exploration Pty Ltd is a result of his relationship with his brother.*

212. *In addition, Kevin advertises his services on a website he has set up. Pebbles Pty Ltd and GemCo Pty Ltd contact Kevin after viewing his website. Kevin provides services to Pebbles Pty Ltd and GemCo Pty Ltd, neither of which is an associate of Kevin, or of each other, or of Lost Exploration Pty Ltd.*

213. *In the income year, none of these sources provides Kevin with more than 80% of his PSI so he is able to self-assess whether he meets the unrelated clients test.*

214. *Although one of Kevin's clients does not qualify as an unrelated client because it is an associate of Kevin's, Kevin still meets the requirements of the unrelated clients test. This is because Pebbles Pty Ltd and GemCo Pty Ltd are 2 unrelated clients obtained as a direct result of Kevin making offers to the public at large or a section of the public (through his website). The PSI rules do not apply to Kevin.*

Example 23 – making offers or invitations – unrelated clients test

215. *Deb is a graphic artist who works through her company, Debart Pty Ltd. Deb is the sole director and shareholder of the company. Debart Pty Ltd advertises to provide services on a website and also through advertising in industry periodicals. Sometimes work is referred to her by word of mouth from Deb's industry contacts.*

216. *Any clients that Debart Pty Ltd sources from the website or as a result of advertising in the industry periodicals would meet the requirements of the unrelated clients test for making offers or invitations to the public at large or a section of the public, as these forms of advertising are capable of reaching a wide audience.*

217. As *Debart Pty Ltd does not provide services in an industry that could be described as a niche industry, any clients obtained through the word-of-mouth referrals would not be counted for the purposes of the unrelated clients test.*

Example 24 – work obtained through labour-hire arrangements – unrelated clients test not met

218. *Ian is a sole trader geologist who derives 70% of his PSI from Rock Pty Ltd. Ian entered into a contract with Rock Pty Ltd as a result of advertising in an industry publication. 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 5 service acquirers as a result of his registration with the labour-hire firm.*

219. *Ian's registration with the labour-hire firm is not treated as making an offer or invitation to the public at large or a section of the public to provide services as the work came about through his registration with the labour-hire firm. The services were not provided as a direct result of making an offer or invitation to the public. Ian does not meet the requirements of the unrelated clients test because he has only one entity (Rock Pty Ltd) to whom he is providing personal services as a direct result of making offers or invitations to the public.*

Example 25 – being referred to labour-hire arrangements – unrelated clients test met

220. *Sonya is a management consultant who assists government departments and other companies to find budget efficiencies. She advertises widely in industry-related publications and also regularly submits tenders for work. Sonya has already secured one contract from an unrelated entity for the income year as a result of her advertising. After seeing her advertisement, she was contacted directly by another unrelated company, Big Bank Ltd, to assist them with their latest efficiency project. During discussions, the company advised that most of their recruitment functions, especially the administrative work, was done through Management Specialists Pty Ltd, a company used to recruit high-level staff. Sonya was referred by Big Bank Ltd to Management Specialists Pty Ltd to finalise the contract to provide her services. Even though Sonya contracted with Management Specialists Pty Ltd to provide her services to Big Bank Ltd, the contract came about from Sonya's offer or invitation through her advertising to the public at large.*

221. *In this case, where there is clearly an offer made to the public or a section of the public (through Sonya's advertising) and then an individual or PSE is referred to a labour-hire firm or similar for administrative purposes, the unrelated clients test can be met.*

222. *However, the source of the PSI for the 80% rule will be Management Specialists Pty Ltd, as they have the contractual obligation to pay Sonya.*

Example 26 – word-of-mouth offers – unrelated clients test met

223. *Mike works as an undersea diver on offshore oil rigs. During the income year, he entered into 2 contracts with unrelated companies to provide his services. He heard about the availability of work from another diver and contacted the companies to offer his services. Undersea diving on offshore oil rigs is a niche industry and the work he does is highly specialised. Because of this, there are only a very small number of potential clients for him to access. In cases where there is a niche market for highly specialised skills and only a very small number of potential clients to make offers of work, the unrelated clients test will be met when an offer is made through word-of-mouth referrals.*

Personal services business – employment test

Example 27 – not principal work – employment test not met

224. *Glenn is a house builder, who provides building services as a sole trader. Glenn contracts with a major company to build houses. While Glenn does the physical building work, he pays his wife, Nan, to perform the tasks of contract administration, keeping track of costs, recording times worked, recording agreed or automatic variations and making progress payment claims on clients. Such contract administration activities are not part of Glenn's principal work, as they are not integral to and part of the principal work.*

225. *These types of activities are to be contrasted with work that is integral to and part of the principal work. For example, the work associated with building a brick wall includes the mixing of the sand and cement, the laying of the bricks and the cleaning of the brickwork. It would not include clerical or administrative activities.*

226. *As Glenn does not engage Nan to perform any principal work, he does not meet that element of the employment test.*

Example 28 – principal work – employment test met

227. *Kate and Lawrence have established a company, Palatial Pty Ltd, through which Kate provides her personal services as a drafter. Palatial Pty Ltd has entered into a contract to provide Kate's drafting services. Kate is the test individual as Palatial Pty Ltd has contracted with the service acquirer to provide Kates services and Kate is responsible for performing the services. Kate drafts the plans for residential dwellings as stipulated in the contract. Palatial Pty Ltd engages Lawrence, who is also a qualified drafter, to prepare all variations that are required and check all of Kate's work against the client specifications, and make any corrections that are required. In addition, Lawrence also performs clerical duties, such as banking and bookkeeping. Lawrence's work in preparing variations, checking Kate's work and making corrections using a drafting software package forms part of the principal work that produces Kate's PSI under this agreement. Lawrence's banking and bookkeeping work does not form part of the principal work.*

228. *The principal work performed by Lawrence counts towards the 20% (by market value) threshold required for Palatial Pty Ltd to meet the employment test. If the 20% threshold is met, Palatial Pty Ltd will meet the employment test in relation to Kate's PSI.*

Example 29 – 20% by market value – employment test met

229. *Jack is a sole trader engineer who contracts with Big Mining Co to provide his services. Big Mining Co is Jack's only client in the income year. Jack works on the contract for 250 days in the income year and is paid a daily rate of $480.*

230. *Jack occasionally hires Tom, who is not his associate, to assist him in his engineering work. The work done by Tom is principal work. Tom is paid a daily rate of $160 by Jack; however, Big Mining Co is charged an arm's length rate of $180 a day for the work Tom performs. Tom works a total of 200 days for Jack during the income year.*

231. *Adopting the method set out at paragraphs 118 to 122 of this Ruling, the market value of Tom's work on the Big Mining Co contract is $36,000 (200 days × $180).*

232. The *market value of Jack's work for Big Mining Co is $120,000 (250 days × $480).*

233. *The total amount paid under the contract is $156,000 ($36,000 + $120,000).*

234. *The work done by Tom represents 23% of the total value of the principal work required to fulfil Jack's contract:*

($36,000 ÷ $156,000) × 100 = 23%.

235. *As this is more than 20% (by market value) of the principal work, Jack meets the employment test.*

Example 30 – 20% by market value – multiple contracts in one income year – employment test not met

236. *Jodie is a draftsperson who has been engaged by 2 clients in the income year. Both contracts are for the provision of drafting services. Jodie engages her spouse Ian, who is also a draftsperson.*

237. *Jodie uses the method at paragraphs 118 to 122 of this Ruling to determine whether she meets the employment test in the income year.*

238. *Jodie invoices the first client for $100,000 upon completion of the work. Ian assisted Jodie with the principal work and the market value of his contribution to the*

principal work, which was billed to the client, was *$22,000 equalling 22% of the principal work.*

239. *Jodie bills the second client for $40,000 upon completion of the work. Ian assisted with the principal work and the market value of his contribution to the principal work, which was billed to the client, was $4,000, equalling 10% of the principal work.*

240. *During the income year, the total amounts paid under the contracts were $140,000 ($100,000 + $40,000).*

241. *The total market value of Ian's work for Jodie was $26,000 ($22,000 + $4,000).*

242. *The market value of the work done by Ian represents 19% of the total value of the principal work:*

($26,0000 ÷ $140,000) × 100 = 19%.

243. *Jodie does not satisfy the employment test because Ian did not perform at least 20% by market value of the total principal work for that income year, even though on the larger contract he performed 22% of the principal work.*

Example 31 – apprentice – employment test met

244. *Meg is an apprentice electrician who is sent by the Group Apprentice Scheme to work for Joe as part of her trade training. Meg works for 2 months, takes a 3-week break and then works for a further 2 months, for a total of 4 months. Later in the same income year, another apprentice electrician, John, is placed with Joe for 3 months. In total, Joe has an apprentice working with him for 7 months in the income year.*

245. *Joe satisfies the employment test because for at least half of the income year, he has one or more apprentices working with him.*

Personal services business – business premises test

Example 32 – not mainly conducting activities producing personal services income – business premises test not met

246. *Byte Pty Ltd contracts with Net Pty Ltd to provide IT services to Net Pty Ltd. The contract requires Byte Pty Ltd to engage Ralph to provide the services to Net Pty Ltd. Byte Pty Ltd leases business premises at the local shopping mall, but 90% of the time uses the premises for retail sale of computing hardware and software.*

247. *While the business activities are all IT-related, Byte Pty Ltd does not use the premises to 'mainly' conduct activities that gain or produce Ralph's PSI. The premises are mainly used for the purposes of the retail sale activities. Byte Pty Ltd does not pass the business premises test.*

Example 33 – mainly conducts activities producing personal services income – business premises test met

248. *Colin, a professional geologist, contracts through his PSE, 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 business premises leased by Col Pty Ltd at arm's length 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 PSI and passes the business premises test.

Example 34 – not exclusive use – business premises test not met

249. *Dale is an insurance agent who has an office in commercial premises leased by Hill Pty Ltd. The agreement between Dale and Hill Pty Ltd does not give Dale exclusive possession of the room. Hill Pty Ltd reserves the right to use the room if the need arises. Dale does not pass the business premises test as he does not have exclusive use of the room. In order to have exclusive use, Dale would need to lease the room from Hill Pty Ltd.*

Example 35 – exclusive use – business premises test met

250. *Norm is a draftsperson who leases an office from Morn Pty Ltd where he conducts his drafting activities. Norm's office is adjacent to a suite of offices occupied by other professionals. Each occupant jointly leases a shared reception and waiting area from Morn Pty Ltd. None of Norm's drafting activities are done at the premises of his clients (or their associates) or from his (or his associates) private premises. Norm has exclusive use of the relevant premises because he has a discrete lease over his office and all of the principal work of drafting is carried out in the office. Therefore, the business premises test is met.*

Example 36 – not physically separate – business premises test not met

251. *Melanie is an executive editor who provides consulting services to various publishing companies. She works from home in an office she has set up on the top floor of her garage. It contains everything she needs to run her business.*

252. *The garage is a separate structure to her home and consists of vehicle storage and an entertainment room on the ground floor with the office taking up the whole top floor. The office is used to undertake her editing work and occasionally she will meet clients there.*

253. *Melanie and her family often entertain and frequent use is made of the entertainment room on the ground floor.*

254. *Melanie will not meet the 'physically separate' requirement of the business premises test as her business premises are not physically separate from premises that she, and her family, uses for private purposes.*

Example 37 – physically separate – business premises test met

255. *Robert is an architect who contracts through his company, Robbo Enterprises Pty Ltd. Robert owns 2 adjoining duplexes. He lives in one duplex and rents the adjoining duplex to his company to use as its business premises. The duplexes are on separate titles and have a dividing wall which prevents internal access between premises. Each duplex has its own front and back entrance and a fence separating the 2 properties. The duplex used by Robbo Enterprises Pty Ltd for its business premises displays the business' signage.*

256. *The only activities undertaken at the business premises generate Robert's PSI. The business premises are physically separate from Robert's private premises and those of his clients. The business premises test is met.*

Status: **legally binding**

Personal services business determination – unusual circumstances

Example 38 – unusual circumstances – first year of operation

257. *Sarah is a business consultant who commenced her business on 1 May 2019. She generates PSI through her company, SBC Pty Ltd. Sarah's friend, Jayne, works at EB Pty Ltd and told her they were looking for a consultant. Jayne arranged an interview for Sarah and, on 10 May 2019, SBC Pty Ltd entered into a 3-month contract to provide Sarah's services to EB Pty Ltd. This was SBC Pty Ltd's only contract in the 2018–19 income year.*

258. *SBC Pty Ltd applied for a PSBD for the 2018–19 income year on the basis that unusual circumstances prevented it from meeting the unrelated clients test. The application stated that the unusual circumstances were that it was its first year of operation and therefore only had one client. SBC Pty Ltd had already entered into contract negotiations for 2 other unrelated clients in the 2019–20 income year and was confident that the test would be met in that year. Sarah had approached the 2 new clients after hearing about the availability of work from a friend at a birthday party she attended.*

259. *It would be considered that it was an unusual circumstance for SBC Pty Ltd to have only one client for the 2018–19 income year as 2 unrelated clients have been secured for the 2019–20 year. However, under the relevant provisions for unusual circumstances in the first year of operation, unusual circumstances is only accepted in relation to the number of clients obtained. For a PSBD to issue in this situation, SBC Pty Ltd also needs to evidence that there were unusual circumstances that prevented it from obtaining clients through making offers or invitations to the public in its first year of operation. Consequently, as this is not the case based on the facts that the only client obtained was by word of mouth, the Commissioner cannot issue a PSBD on the basis that unusual circumstances prevented the unrelated clients test from being met.*

260. *Although SBC Pty Ltd could evidence that it had 2 unrelated clients in the 2019–20 income year, those clients were not obtained as a result of making offers or invitations to the public or a section of the public as required by the unrelated clients test. While it was reasonable to expect SBC Pty Ltd would have 2 or more unrelated clients in the subsequent income year, it was usual for SBC Pty Ltd to obtain its clients through word of mouth. The Commissioner cannot issue a PSBD for these circumstances.*

Example 39 – unusual circumstances – business premises test

261. *Penny and Jill are lawyers who both earn PSI through a partnership, Penny & Jill Legal. The partnership owns an old cottage in the city that they have used as a business premises for the last 10 years. Penny and Jill would like to expand the partnership but require a larger business premises. The cottage has substantially increased in value so they agree to sell. They also enter into a contract to purchase larger modern premises that are more conveniently located.*

262. *Prior to moving, the new premises suffers significant flood damage. The partnership relocates temporarily to office premises that are leased by one of Jill's lawyer friends. Penny and Jill have to share the premises with others and mostly use the rooms to meet with clients. They also work out of a home office that they set up at Penny's house. It takes 4 months for the damage to the new premises to be repaired. The partnership moves its business to the new premises as soon as the building can be reoccupied.*

263. *Penny and Jill Legal did not have exclusive use of a business premises for the purposes of the business premises test for a period of 4 months of the year. The home office is also unable to be counted because it is not physically separate from the premises that Penny uses for private purposes. Therefore, the partnership does not pass the*

business premises in respect of either Penny or Jill because a business premises was not maintained at all times during the year.

264. *However, the circumstances that prevented the business premises from being met would be considered to be unusual circumstances because, had the flooding not happened, Penny and Jill Legal would have moved straight into the new premises and the test would have been satisfied in the relevant income year. The test was also satisfied in prior years and is reasonably expected to be met in future years.*

265. *In these circumstances, the Commissioner could issue a PSBD in respect of Penny and Jill Legal that, but for unusual circumstances applying to the partnership entity in that year, the entity could reasonably have been expected to meet the business premises test.*

Special rules for agents

Example 40 – special rules for agents – not bearing entrepreneurial risk

266. *Chris provides financial services as an agent for Big Finance Pty Ltd. In the relevant income year, Chris receives a payment of $70,000, which represents an 80% commission on the services he provides to clients on behalf of Big Finance Pty Ltd. Over the course of the year, Big Finance Pty Ltd also pays Chris a regular amount of $2,500 per month (totalling $30,000 for the year). Even though Chris receives a commission payment of more than 75%, the retainer he is paid is also taken into account in determining whether this requirement of the agents test is met. Chris' total income for the year from Big Finance Pty Ltd is $100,000. Only $70,000 out of the $100,000 (that is, 70%) is paid as a commission. As less than 75% of Chris' income is a performance-based payment, he does not bear the level of entrepreneurial risk required. Chris is therefore unable to use the modified rules for agents.*

Potential application of Part IVA of the ITAA 1936

Example 41 – potential application of Part IVA of the ITAA 1936

267. *Jason Banks is a computer systems analyst who provides his personal services through a family trust, The JB Trust. He also forms a company, JB Pty Ltd, to be trustee of The JB Trust. The beneficiaries of The JB Trust are Jason, his wife and 3 children. Jason's wife and 3 children are in the lowest marginal tax bracket. JB Pty Ltd (in its capacity as trustee) enters into an agreement with XYZ Pty Ltd to perform specific computing tasks, for a total contract price of $120,000 in the income year, to provide the personal services of Jason. The work will be performed by Jason. No work will be performed by any of the other beneficiaries. Instalments of the contract price are payable on achieving agreed milestones. The contract also provides that JB Pty Ltd provide the necessary equipment and is liable for the cost to remedy any defects.*

268. *In the income year, JB Pty Ltd pays Jason a salary of $50,000, which is less than the contracted price for Jason's services, and claims deductions amounting to $25,000. JB Pty Ltd distributes the balance of The JB Trust's net income, namely $45,000, to each of the 3 children who receive $416 (making a total of $1,248) and the remainder to Jason's wife. No trust income is distributed to Jason as a beneficiary of The JB Trust. No tax is payable by Jason's children and Jason's wife pays tax on her trust distribution at her marginal tax rate, but the total amount of tax paid between Jason, his wife and children is less than what would have been paid if Jason had returned the entire net PSI from his personal effort and skills in his personal tax return. The splitting of any of the income that is mainly the reward for Jason's personal effort and skill to an associate that results in less overall tax being paid is a tax benefit.*

Status: **legally binding**

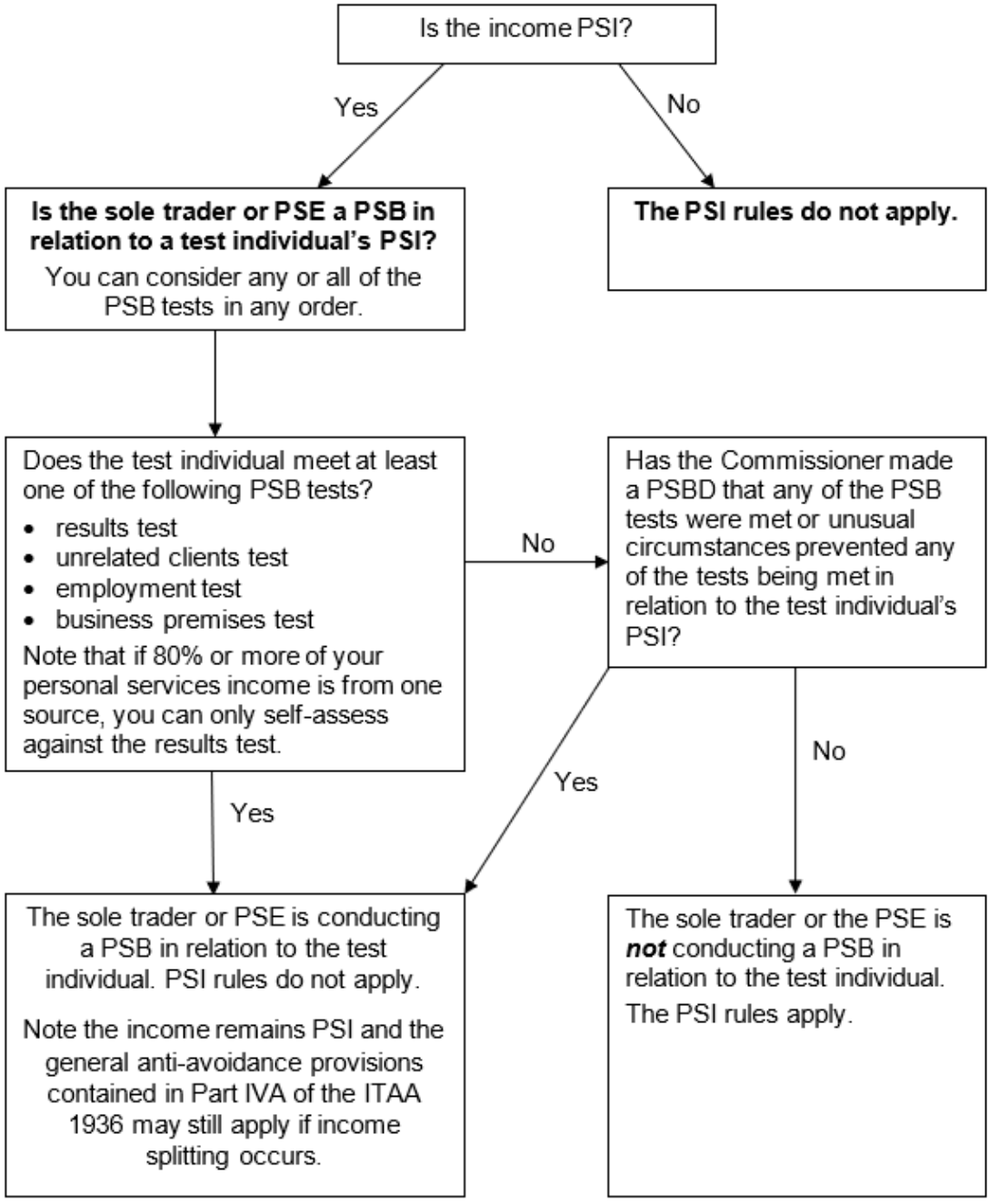
269. *The JB Trust is a PSE because its income includes the PSI of the individual who does the work. JB Pty Ltd is able to self-assess because it meets the results test in relation to at least 75% of the PSI. The JB Trust self-assesses it is a PSB because it meets the results test in respect of the PSI of Jason. Accordingly, JB Pty Ltd determines that the PSI rules will not apply to Jason's PSI. However, in this case, the Commissioner would consider the application of Part IVA to cancel the tax benefit. Part IVA would apply if, having regard to the matters in subsection 177D(2) of the ITAA 1936, it would be concluded that there was a dominant purpose of enabling Jason to obtain a tax benefit by splitting the income. This would require a detailed consideration of all the circumstances. A likely conclusion would be that the dominant purpose of the arrangement is income splitting to which Part IVA applies.*

Status: **legally binding**

Operation of the personal services income rules

270. The flow chart in Diagram 1 of this Ruling demonstrates the operation of the PSI rules and can be used to determine whether the PSI rules apply.

Diagram 1: Operation of the personal services income rules



Status: **legally binding**

Date of effect

271. This Ruling applies to years of income commencing both before and after its date of issue. However, the Ruling 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 Ruling (see paragraphs 75 to 76 of Taxation Ruling TR 2006/10 *Public Rulings*).

Commissioner of Taxation
23 November 2022

Status: **not legally binding**

References

Previous draft:

TR 2021/D2

Related Rulings/Determinations:

TR 2005/16; TR 2003/6; TR 2003/10; IT 2121; IT 2330; IT 2503; IT 2639

Previous Rulings/Determinations:

TR 2001/7; TR 2001/8

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Cases distinguished:

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Explanatory Memorandum to the New Business Tax System (Alienation of Personal Services Income) Bill 2000

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Miscellaneous ~~ Personal services business determination ~~ Employment test
Miscellaneous ~~ Personal services business determination ~~ Results test
Miscellaneous ~~ Personal services business determination ~~ Unrelated clients test
Miscellaneous ~~ Personal services business determination ~~ Unusual circumstances test

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