TR 2001/D4 - Income tax: the meaning of personal services income

This cover sheet is provided for information only. It does not form part of *TR 2001/D4 - Income tax: the meaning of personal services income*

This document has been finalised by TR 2001/7.

Draft Taxation Ruling
Income tax: the meaning of personal services income

Contents	Para
What this Ruling is about	**1**
Definitions	**19**
Ruling	**21**
Date of effect	**37**
Previous Rulings	**38**
Explanations	**39**
Examples	**71**
Detailed contents list	**91**
Your comments	**92**

Preamble

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

What this Ruling is about

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

2. The four Rulings explain:

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

3. This Ruling will deal with the first of these topics focussing on the meaning of personal services income contained in Division 84 of Part 2-42 of the ITAA 97. It will also provide guidance in identifying circumstances in which an individual has personal services income.

4. Key terms used in this Ruling are defined in paragraphs 19 to 20.

Class of person/arrangement

5. This ruling applies to:

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

Background

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

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

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

8. This is in accordance with the application provision accompanying the Alienation of Personal Services Income Act. The Commissioner has made a declaration that they are to be treated as if they were conducting a personal services business until the end of the 2001-2002 income year. A copy of the Commissioner's declaration was published on 30 August 2000 in the Commonwealth of Australia Gazette No. GN 34.

9. The measure was introduced following recommendations made in the report of the *Review of Business Taxation: A Tax System Redesigned* (commonly called the Ralph Report). The relevant recommendations that relate to this measure are recommendations 7.2, 7.3 and 7.4. Those recommendations were aimed at improving the integrity and equity in the tax system. The recommendations arose out of concerns that substantial erosion of the income tax base had

occurred as a consequence of the alienation of personal services income through the use of interposed companies, partnerships and trusts; and that there was a perception that individuals, as contractors, and interposed entities were able to claim a greater range of deductions than those available to individuals who provided personal services as employees.

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

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

12. Division 84 of Part 2-42 sets out the meaning of 'personal services income'. This definition applies throughout the ITAA 97 and Schedule 1 to the TAA 1953.

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

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

15. Division 85 and/or Division 86 do not apply where an individual's personal services income is from that individual or a personal services entity conducting a personal services business. The attribution rule contained in section 86-15 of Subdivision 86-A does

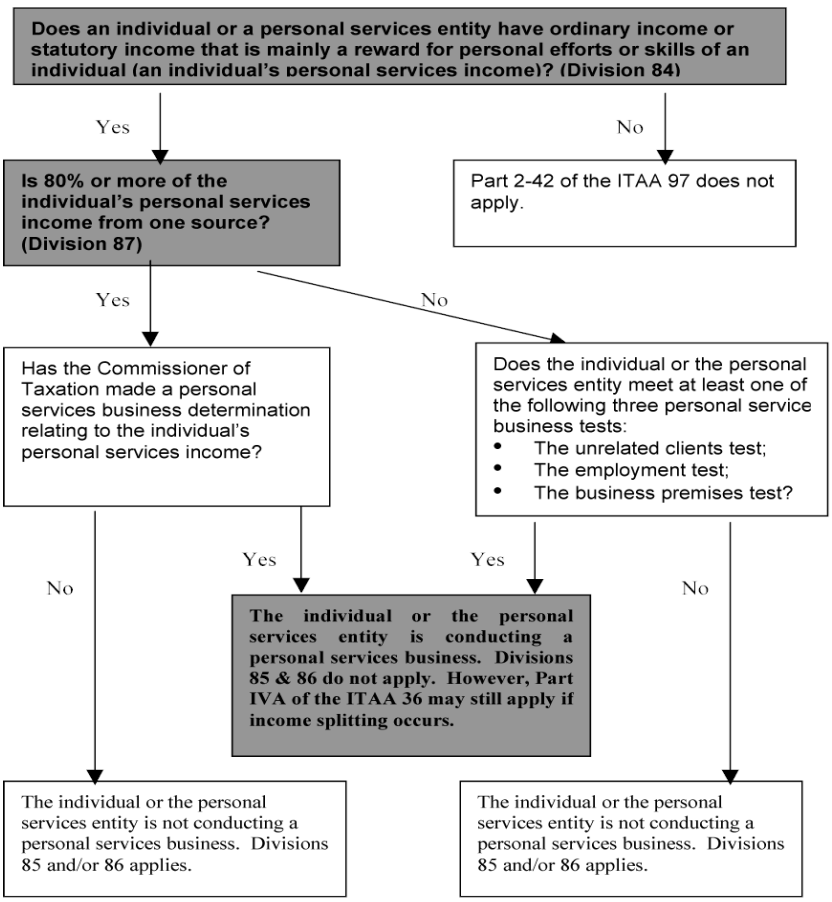
not apply where a personal services entity pays an individual's personal services income to that individual as salary and wages within 14 days after the end of the PAYG payment period in which that income became the income of the entity.

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

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

17. A later Ruling will deal with what is a personal services business and the manner in which Division 87 and the three personal services business tests are to be applied. That Ruling will also explain the matters about which the Commissioner of Taxation must be satisfied before making a personal services business determination.

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



Definitions

Personal services entity

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

Service acquirer(s)

20. The entity or entities that acquire the personal services of an individual directly from the individual or through a personal services entity**.**

Ruling

21. Division 84 of Part 2-42 of the ITAA 97 sets out the meaning of personal services income. Subsection 84-5(1) of the ITAA 97 provides:

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

22. The definition of personal services income requires an analysis of the statutory or ordinary income of an individual or a personal services entity to determine those amounts or items that are mainly a reward for the individual's, or an individual's, personal efforts and skills. Only the income that has that character may be subject to the measure in Part 2-42.

23. The reference to '*statutory income of any other entity*' in the definition is a reference to an amount or item that would be statutory income of the other entity but for the operation of Division 86.

24. The phrase '*or would mainly be such a reward if it was your income*' in the definition ensures that the character of the income as being mainly a reward for an individual's personal efforts or skills is not altered in those circumstances where it is legally derived by another entity. The phrase requires a determination as to whether the income, if it was derived by an individual, would be mainly a reward for that individual's personal efforts or skills. If it would, then that amount or item of that entity's ordinary income or statutory income is an individual's personal services income.

25. Subsection 84-5(2) ensures that for tax purposes only individuals can have personal services income. The fact that income is

payable under a contract does not stop the income being mainly a reward for an individual's personal efforts or skills (subsection 84-5(4)). This provision is intended to overcome any argument that particular income does not fall within the definition of personal services income because it results from a contractual right to income as consideration for services rendered.

26. Subsection 84-5(3) extends the definition of personal services income to income that is for doing work or for producing a result. The result must be produced 'mainly' from the individual's personal efforts or skills.

27. The use of **'mainly'** in the definition means that the income referred to needs to be 'chiefly', 'principally' or 'primarily' a reward for the provision of the personal efforts of, or for the exercise of the skills of, an individual. Implicit in the use of the word '**mainly**' is that more than half of the relevant amount or item of the ordinary or statutory income must be a reward for the personal efforts or skills of an individual.

28. Whether this is the case is a question of fact to be decided having regard to all the circumstances of each case. It would be essential to establish the substance of any agreement under which services are to be provided. Whilst the formal terms and conditions of an agreement will be important, they will not necessarily be decisive in all cases.

29. The reference to the income that is **mainly** a reward for the personal efforts or skills of an individual does not preclude situations where the provision of personal services involves the use of some equipment. Where tools of trade or some plant and equipment are used in the performance of work, or in the exercise of skills, but the substance of an agreement is the provision, by an individual, of his or her personal efforts or the exercise of his or her skills, or for the production of a result from those efforts or skills, income would still be regarded as personal services income. For example, the use of:

- a personal computer by a computer consultant to perform work under a contract that is essentially for his personal skills;
- hand or electrical tools by a tradesperson;
- off-the-shelf computer software packages used by individuals; or
- the drawing board of a draftsperson,

will not alter the character of the income as personal services income if the substance of each contract is for the personal efforts or skills of an individual.

30. Income that is from a business structure (as distinct from a personal services business as defined in Division 87) is not personal services income within the meaning of subsection 84-5(1). In reaching conclusions on whether income is more likely to have been generated from the income yielding structure of a business as opposed to income from the rendering of personal efforts or skills, it will be necessary to have regard to a number of factors including:

- the nature of the activities being conducted that generate the income;
- the number of employees or contractors engaged to perform work;
- the extent to which the income depends upon the efforts, expertise or skills of an individual;
- the existence of goodwill or substantial income producing assets; and
- the size of the business operation.

31. Income that is mainly for the sale or supply of goods will not be personal services income within the meaning of section 84-5.

32. Income that is mainly for the granting of a right to use property will not be personal services income within the meaning of section 84-5.

33. Income that is mainly for the supply and use of assets held by an individual or by a personal services entity is not personal services income within the meaning of section 84-5.

34. Where personal services are provided that are incidental to:

- the sale or supply of goods;
- the granting of a right to use property; or
- the supply and use of assets that have a significant role in the generation of income,

and the cost of those services is incorporated into a price that is mainly for the sale or supply of goods, or for the granting of a right to use property, or for the supply and use of assets, that income will not be regarded as being mainly a reward for personal efforts or skills and will not be personal services income within the meaning of subsection 84-5(1).

35. The determination of whether income is "mainly" a reward for the personal efforts or skills of an individual requires the exercise of practical judgment as to whether the value contributed by the efforts or skills of the individual exceeds the value of all other inputs, such as the efforts of other workers, and the use of plant and equipment or

machinery, or intellectual or other property. In making that judgement, regard may be had to factors including:

- whether the amounts paid or payable by a service acquirer to an individual or a personal services entity under an agreement is primarily for the personal efforts or skills of an individual;
- whether the contract price has been calculated having regard to the costs to be borne by an individual or a personal services entity in providing and using assets or plant and equipment in the performance of the obligations of the individual or the personal services entity to the service acquirer;
- the size and significance of the plant and equipment or other assets that are used by the individual or the personal services entity in the income-producing activity;
- the value of the asset in relation to the total income generated in the performance of obligations under an agreement;
- the uniqueness and degree to which an asset is specialised in the performance of a particular function;
- whether amounts are paid by the service acquirer to an individual or a personal services entity for producing a result for that service acquirer;
- the uniqueness, level of skill or degree of specialisation of an individual to provide the particular services contracted for by the service acquirer; and
- whether the contractual payments made to an individual or a personal services entity is for the transfer of the ownership or a right in respect of an item that is produced by the individual or personal services entity.

36. Whilst the above is a list of factors that are relevant, no one factor may be decisive. Each may be considered having regard to all the circumstances of each case and one may be given greater weighting as the circumstances warrant.

Date of effect

37. This Ruling first applies to the 2000-2001 income year. The Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue

of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

Previous Rulings

38. The Ruling specifically sets out the Commissioner's views on the meaning of personal services income for the purposes of Part 2-42 of the ITAA 97. Income Tax Rulings IT 2121, IT 2330, and IT 2639 set out the Commissioner's views on the meaning of income from personal services in the context of the law in operation at the time of the issue of those Rulings.

Explanations

39. The definition of personal services income in subsection 84-5(1) requires an analysis of the ordinary or statutory income of an individual or a personal services entity to work out which amounts or items are mainly a reward for the rendering or provision by that individual, or an individual, of his or her personal efforts or skills. Where two or more individuals render their personal efforts or provide their expertise or skills through one personal services entity, the analysis will assist in the identification of the amount or amounts of the ordinary income or statutory income of that entity that is or are the personal services income of each individual.

40. The identification of an individual's personal services income is necessary to ensure that, for the purposes of subsection 86-15(1), only that individual's personal services income and not the personal services income of other individuals is included in his or her assessable income. The identification is also relevant for the purposes of ensuring that those individuals whose personal services income is included in the entity's ordinary or statutory income are not treated as having been engaged by the entity for the purposes of the meeting the employment test. These individuals are specifically excluded by subparagraph 87-25(2)(a)(i).

41. In determining whether another entity's ordinary income, or statutory income is an individual's personal services income regard must be had to the phrase **'or would mainly be such a reward if it was your income'**. The phrase requires an inquiry as to the character of the income if that income was the ordinary income or statutory income of an individual. If the character of the income would be mainly a reward for the personal efforts or skills of an individual, then that income is the individual's personal services income within the meaning of subsection 84-5(1), although it is legally derived by the other entity. That conclusion is required to be reached in respect of each amount or item of the entity's ordinary or statutory income.

42. The reference to the income that is **'mainly'** a reward for an individual's personal efforts or skills requires a conclusion as to the substance of contractual arrangements between the relevant parties to those contracts and what the payments under the contract are for. The Macquarie Dictionary (Second Revision) defines '**mainly**' as *'chiefly; principally; for the most part.'* In *Fawcett Properties Ltd v Buckingham County Council* [1961] AC 636 the term mainly was discussed, by Lord Morton of Henryton who stated (AC at 669):

> 'The word 'mainly' at once gives rise to difficulties. Probably it means 'more than half' and this was the meaning which this House gave to the phrase in *Bromley v Tyron* [1952] AC 265.'

43. In the context of subsection 84-5(1), the reference to 'mainly' requires that more than half of the relevant amount or item of the ordinary income or statutory income be a reward for the personal efforts or skills of an individual. Where the income is derived under a contract, and that contract is for the rendering of personal efforts or the provision of the skills or expertise of a particular individual, the income derived under that contract would mainly be a reward for that individual's personal efforts or skills. The use of the word 'mainly' in this context does not preclude the use of some materials, tools or plant and equipment in the rendering or provision of personal services.

44. Conversely, situations will arise where the rendering or provision of personal efforts or skills is incidental or secondary to the sale or supply of goods, or to the granting of a right to use property, or to the supply and use of income-producing assets. Income in these situations will not be mainly a reward for personal efforts or skills and will not be personal services income within the meaning of subsection 84-5(1).

45. Decisions on this will be made on a case by case basis. Whilst the terms and conditions of a contract will be important, regard will be had to all the circumstances to determine the true nature of the contractual obligations of one party to another.

Distinction between personal services income and income from the supply or sale of goods

46. Where personal efforts or skills are used in the production of something that is to be sold, then any later contract for the sale of that item or property would be for the sale or supply of goods. The payments made to the personal services entity would not be in respect of an individual's personal efforts or skills but would be made by another to acquire ownership (legal and beneficial) of the item produced. Income, in these circumstances, is not mainly a reward for personal efforts or skills but is from the sale of goods, even though an individual's personal efforts or skills may produce those items. In

these cases, income would not be personal services income as defined in subsection 84-5(1). Part 2-42 of the ITAA 97 would have no application in these circumstances.

47. Where, however, the substance of a contract is for the personal labour or efforts, or the exercise of the skills of an individual for a service acquirer; or where a result is produced for a service acquirer from that work or from the exercise of those skills, the fact that ownership of materials that are used passes to the service acquirer does not alter the substance of the contract, that is for the efforts and skills of the individual. Income in these circumstances will be personal services income within the meaning of subsection 84-5(1).

Example 1

48. Donna is a computer programmer who writes programs under a contract with Big Computer Co. Under the contract, Donna is required to do the work at the premises of Big Computer and has no ownership of the programs that are written. In the evenings, at home, Donna also writes and produces computer games that she sells to Internet service providers for online computer games players. She usually approaches the Internet service providers and sells the game to the highest bidder.

49. The ordinary income of Donna that is derived under her contract with Big Computer Co is mainly a reward for Donna's personal efforts or skills and would be personal services income under subsection 84-5(1).

50. Income under the contracts for sale of the computer games would not be mainly a reward for Donna's personal efforts or skills but would be from the sale of the software. This income would not be personal services income within the meaning of subsection 84-5(1).

51. The issue of contracts that are for the work and labour of an individual, where the use of some materials occurs, was discussed by Slesser LJ in *Robinson v Graves* (1935) KB 579. At page 591 Slesser LJ expressed the view, in the context of the facts of that case, that

> '… it is here shown that the material, the paint and the canvas, were merely ancillary to the technical work of producing the work of art and that therefore this is a contract for work and labour'.

52. It is important, therefore, to distinguish between cases where the supply of materials is ancillary or incidental to the work to produce a result and those where the supply of materials is the principal obligation under the contract and where the use of labour to do some work in connection with that supply is ancillary or incidental.

53. If the supply of materials is ancillary or incidental to the doing of work, then the contract would be for work and labour and income under that contract would be regarded as being mainly a reward for personal efforts or skills. If the supply of labour or the doing of work is ancillary or incidental to the supply of materials, then any income under a contract where the principal obligation is the supply of materials would not be personal services income within the meaning of subsection 84-5(1). Conclusions in relation to this would be made having regard to the circumstances of each case.

54. 'Ancillary' in various contexts, has been held to mean 'not necessary thereto or a primary part *thereof' (Pearce v London & South Western Railway* [1900] 2 QB 100), or 'auxiliary or appurtenant to the purpose for which the business is carried on' (*Green v Britten* [1904] 1 KB 365.

55. Some instances where the use of materials may be regarded as ancillary to the rendering of personal services are:

- the use of art supplies by a graphic designer in doing design work for a service acquirer;
- the use of nails and glue by a carpenter in carrying out repairs on behalf of a building company;
- the use of paint by a painter in carrying out his work for a painting company;
- the use of wiring by an electrician in connection with the installation of wiring into a building; and
- the use of paints, canvas and other consumables by an artist who has been commissioned to paint a portrait.

Distinction between personal services income and income from a business structure

56. The definition of personal services income recognises the distinction between income that is personal services income and income from a business structure (see Example 3 to section 84-5). It is not practicable to state with any precision the circumstances in which it may be said that income is from a business structure rather than being mainly a reward for an individual's personal efforts or skills. Regard may be had to factors such as the number of arms length employees or others engaged to perform work, the presence of goodwill, the extent to which income producing assets 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 an individual's own personal skills, efforts or expertise, in reaching conclusions on a case by case basis.

57. Example 3 contained in subsection 84-5(1) provides an illustration of a situation where income is considered to be from a business structure.

Distinction between personal services income and income from the supply and use of income-producing assets

58. Distinctions will be drawn between those cases where plant and equipment or tools of trade are used by an individual or a personal services entity under an agreement that is for the personal efforts or skills of an individual, and those where the supply and use of the plant or equipment or other assets (income-producing assets) are the source of the income of the individual or the entity. The distinction will be made on a case by case basis having regard to the substance of the contract or arrangement under which the income-producing assets or plant or equipment are used.

59. Where the substance of a contract or arrangement is that the individual or the personal services entity is to supply and use income producing assets, and the service acquirer pays the individual or the entity for the supply and use of those assets, those payments will not be mainly a reward for the personal efforts or skills of an individual.

60. The expression 'income producing assets' is used, in this context, to include any investment of the individual or a personal services entity in significant tangible business assets such as premises, fixtures and fittings, plant, equipment, industrial property (whether owned or leased) or intellectual property.

61. In determining if income is from the supply and use of income-producing assets, the significance, size, or economic value of the asset in the income-producing activity, or its value in relation to the income of the individual or personal services entity from the particular activity, and the role it plays in generating the income, will be important considerations. It may also be relevant to examine the basis on which the contract price has been calculated and whether that contract price has regard to the costs that are borne by an individual or a personal services entity in supplying and using the plant and equipment or other assets in the income-producing activity.

62. However, the significance of these assets would have to be weighed in each case against their relevance to the gaining or producing of income. The use of equipment such as the personal computer or the general programming software of a computer programmer, or the heart monitor/blood pressure machine of a medical practitioner, would not suffice to alter the character of income from being mainly a reward for personal efforts or skills into one for the supply and the use of income-producing assets.

63. There may be other situations where assets that are used are of significant value, but nevertheless the analysis of results from the use of the assets depends on the personal skills or qualifications of the individual. In these cases, the conclusion would still be reached that income is personal services income within the meaning of subsection 84-5(1) on the basis that the payments are for the exercise of the particular skills or expertise of the individual in analysing the results from the use of those assets, rather than for the use of those assets.

Example 2

64. Robyn is a radiologist who has x-ray machines and other equipment worth $1,200,000 that she uses in her sole practice. Robyn is the only one who is qualified to analyse and report on the results that are produced from the machinery and equipment that she uses.

65. Robyn's income from her practice will be personal services income as defined in subsection 84-5(1) Her income is mainly a reward for her skills in interpreting the images that are produced by the machines that she uses.

66. Where a contract is for doing work or for the production of a result from the doing of work and the work involves the use of some plant and equipment, then the income would still be regarded as personal services income. Where a contract does not require the supply or use of assets, but where some plant and equipment is used by the individual in that activity, the contract would be regarded as one that is mainly a reward for the personal effort or the skills of the individual. Income from that effort or the exercise of those skills, in these circumstances, would be regarded as personal services income.

67. Conclusions in relation to this would be made having regard to the circumstances of each case.

68. Having regard to the distinctions that have been drawn in this Ruling, it can be said that the following would clearly constitute personal services income as defined in section 84-5(1):

- Income earned by an individual as an employee (salary or wages income);
- income of a professional person practising on his or her own account without professional assistance, for example, a medical practitioner in a sole practice;
- income payable under a contract which is wholly or principally for the labour or services of a person;
- income derived by a professional sports person or entertainer from the exercise of his or her professional skills, including appearance monies, personal

appearances for the purposes of endorsing sponsors products; and

- income derived by consultants, for example, computer consultants or engineers, from the exercise of personal expertise.

69. Attention has been drawn to the possibility of restructuring contracts such that specific obligations arise for an individual or a personal services entity to supply and use assets in doing the work that is required to be done under that contract and that a greater portion of the income gained or produced under that contract is for the supply and use of assets. It is our view that, having regard to all the circumstances, it may still be concluded that the substance of the contracts is one for the rendering of personal services. Income would be regarded as personal services income within the meaning of subsection 84-5(1). Alternatively, the application of Part IVA of the *Income Tax Assessment Act 1936* to these arrangements may be warranted.

70. Similar considerations apply to those cases where contracts are restructured to allocate greater amounts to the supply and use of materials in the performance of contractual obligations that are essentially for the efforts and skills of an individual.

Examples

Example 3

71. AB is a computer consultant who provides his personal services through a family company, AB Pty Ltd. The company has a contract with Megabite Computer Ltd to provide the services of AB. AB provides those services at the premises of Megabite. The contract requires AB to be at the premises of Megabite between 9.00am and 5.00pm Monday to Friday and the company is paid at an hourly rate of $75.00.

72. AB Pty Ltd also operates a computer spare parts business that sells both computer hardware and software. AB provides his personal services to install software for clients of that business. He provides these services in the evening. The cost of installation is usually built into the price for the hardware.

73. In this situation, income of the company that is from the contract with Megabite Computer Ltd is personal services income of AB. However, the income that the company gets from the provision of AB's services to install or fix software problems is ancillary to the sale of hardware and software. Therefore, income from those services

would not be personal services income of AB but would properly be regarded as income of the company.

Example 4

74. Jim is a carpenter who operates in partnership with his wife. He is a qualified tradesman. The partnership subcontracts with a large building contractor to do maintenance work on various sites for that contractor. The partnership supplies the tools of trade and provides some materials eg nails, glue and occasionally buys timber to do the work that it is contracted to do. The partnership invoices the building contractor at the completion of each job (which usually takes about a week). The invoices are broken down into labour and materials supplied with the bulk of them consisting of labour.

75. In this instance, although some materials are supplied in doing the work, the substance of the contract is for Jim's personal labour. The bulk of the income that the partnership gets is for Jim's labour or for a result that is produced by Jim's personal efforts. The income is mainly a reward for Jim's personal efforts or skills or for producing a result from Jim doing the work. Income is personal services income as defined in subsection 84-5(1).

Example 5

76. Bob owns an earthmoving company, Bob's Earthworks Pty Ltd, with assets including two trucks, a backhoe tractor and small grader. The company has six employees, five of whom are plant operators. Bob is employed by Bob's Earthworks Pty Ltd as the managing director but does not normally do any of the work that generates the income of his company. The assets that are operated by the other employees are the means by which the company generates its income even though the plant operators use their personal skills to contribute to income production. The income of the company is not reliant on the skills of any one individual; it can derive income as long as it owns or has access to the necessary equipment.

77. In this example, the income of the company is derived from a business structure. The company has income-producing assets and a number of employees who are employed to perform the services. The income of the company would not be personal services income of any individual within the meaning of section 84-5 of the ITAA 97.

Example 6

78. Shirley is a courier driver who operates through a company, Shirl Pty Ltd. The company has a contract with a large courier company to deliver parcels and other small goods. Under its contract

with the courier company, Shirl Pty Ltd is required to supply its own one-tonne van and to maintain it in good working order. There is no requirement in the contract that the van be driven by Shirley, although she is the only one employed by Shirl Pty Ltd to do so. The payment to Shirl Pty Ltd is set by the courier company having regard to the number of deliveries that are made. For the year ended 30 June 2000 Shirl Pty Ltd derived $31,000 under this contract. The set delivery rate paid by the courier company to Shirl Pty Ltd is calculated on the basis of 40% being cost recovery for use of the van and 60% being for the services of the driver.

79. In this case, the asset is not unique or specialised and there is no underlying business structure. The value of the asset input in generating the income of the company is not greater than the value of the labour input. The income of Shirl Pty Ltd is mainly a reward for the personal efforts or skills of Shirley as 60% of the payment made by the courier company is for her services as the driver of the van. The income is personal services income of Shirley within the meaning of subsection 84-5(1).

Example 7

80. Bill is a cyclist courier who enters into a contract with Big Courier Company to do deliveries in the confines of a capital city. Bill bought a bicycle for $1,000 to allow him to fulfil his contractual obligations. Bill is paid $7.00 per delivery and usually averages about 15 deliveries per day.

81. In this example, the asset that Bill uses is neither unique nor significant and there is no underlying business structure. The value of Bill's personal efforts is greater than the value and significance of the bicycle in the generation of the income. Income would be considered to be mainly a reward for Bill's personal efforts and would be personal services income for the purposes of Part 2-42.

Example 8

82. Dihanne is a welder who operates through a partnership with her spouse. The partnership contracts with SkyWeld Pty Ltd to provide the services of Dihanne on a major project. The contract is for a term of 18 months and the contract specifically states that the individual nominated to do the work is Dihanne. The partnership is paid on an hourly basis and Dihanne works on the project site, which is about 50 kilometres from where she lives.

83. Dihanne has a one tonne van that she uses to transport her welding equipment to and from the site.

84. In this case income from the welding work that Dihanne does is her personal services income. The use of the van to transport her plant and equipment does not generate the income for the company. That income is from the personal efforts and skills of Dihanne as a welder.

Example 9

85. Rick is a tax expert who writes a book on the new Alienation measures. He approaches a number of publishing houses to get it printed and finally enters into a contract under which he sells the copyright to the book for $20,000 plus a royalty of 40 cents per book.

86. Income from the sale of the copyright is not personal services income. There is a transfer of property and income is consideration for the transfer of the proprietary rights from Rick to the publishing house.

Example 10

87. Rick is a tax expert who is commissioned by a renowned publisher of taxation books to write a book on the new Alienation measures. The contract specifies that when the book is finished Rick will be paid a sum of $150,000.

88. Rick's income from the contract is personal services income. Rick produces a result for the publishing house (the service acquirer) and is paid for his efforts and skills in producing that result.

Example 11

89. Jim is an medical practitioner who operates his practice through a company, Jim Pty Ltd. Jim Pty Ltd makes a payment of $100,000 to Jimbo Pty Ltd as trustee of the Jim Family Trust. Jim Family Trust holds all the assets that are used in the medical practice. Jimbo Pty Ltd also employs the administrative staff (3 in number) whose services are used in the medical practice. The payment by Jim Pty Ltd to Jimbo Pty Ltd as trustee is in line with guidelines established by *Phillips v FC of T* 78 ATC 4,361; (1978) 7 ATR 345 for payments to service entities.

90. As the payment of $100,000 is a lump sum to cover a number of services, it cannot be said that the payment is mainly a reward for an individual's efforts or skills. In these circumstances, income of the trust is not personal services income as defined.

Detailed contents list

91. Below is a detailed contents list for this Ruling:

	Paragraph
What this Ruling is about	**1**
Class of persons/arrangement	5
Background	6
Definitions	**19**
Personal services entity	19
Service acquirer(s)	20
Ruling	**21**
Date of effect	**37**
Previous Rulings	**38**
Explanations	**39**
Distinction between personal services income and income from the supply or sale of goods	46
Example 1	48
Distinction between personal services income and income from a business structure	56
Distinction between personal services income and income from the supply and use of income-producing assets	58
Example 2	64
Examples	**71**
Example 3	71
Example 4	74
Example 5	76
Example 6	78
Example 7	80
Example 8	82
Example 9	85
Example 10	87
Example 11	89
Detailed contents list	**91**
Your Comments	**92**

Your comments

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

Comments by Date: **18 May 2001**
Contact Officer: **Wade Miklavs**
E-Mail address: **wade.miklavs@ato.gov.au**
Telephone: **(08) 9268 5988**
Facsimile: **(08) 9268 5014**
Address: **PO Box 9990**
Northbridge WA 6001

Commissioner of Taxation
4 April 2001

Previous draft:
Not previously issued in draft form

Related Rulings/Determinations:
IT 2121; IT 2330; IT 2503; IT 2639; TR 92/20

Subject references:
- alienation of personal services income
- employee
- entity
- income
- income alienation
- independent contractor issues
- mainly,
- master/servant relationship issues
- ordinary income
- PAYG
- personal efforts or skills
- personal services en
- result
- service acquirer
- service provider
- statutory income

Legislative references:
- ITAA 1997 2-42
- ITAA 1997 Div 84
- ITAA 1997 84-5
- ITAA 1997 84-5(1)
- ITAA 1997 84-5(2)
- ITAA 1997 84-5(3)
- ITAA 1997 84-5(4)
- ITAA 1997 84-10
- ITAA 1997 Div 85
- ITAA 1997 Div 86-A
- ITAA 1997 Div 86-B
- ITAA 1997 86-15(1)
- ITAA 1997 86-15(2)
- ITAA 1997 Div 87
- ITAA 1997 87-25(2)(a)
- ITAA 1997 995-1
- ITAA 1936 Part IVA

Case references:
- *Bromley v Tyron* [1952] AC 265
- *Fawcett Properties Ltd v Buckingham County Council* [1961] AC 636
- *Green v Britten* [1904] 1 KB 365
- *Pearce v London & South Western Railway* [1900] 2 QB 100
- *Phillips v FC of T* 78 ATC 4,361; 7 ATR 345
- *Robinson v Graves* (1935) KB 579

ATO references:
NO T2000/19812
BO
ISSN: 1039-0731