



# ***TR 2021/D2 - Income tax: personal services income and personal services businesses***

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This document has been finalised by TR 2022/3.

 There is a Compendium for this document: **TR 2022/3EC** .



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## Draft Taxation Ruling

# Income tax: personal services income and personal services businesses

### **❶ Relying on this draft Ruling**

This publication is a draft for public comment. It represents the Commissioner's preliminary view on how a relevant provision could apply.

If this draft Ruling applies to you and you rely on it reasonably and in good faith, you will not have to pay any interest or penalties in respect of the matters covered, if this draft Ruling turns out to be incorrect and you underpay your tax as a result. However, you may still have to pay the correct amount of tax.

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**What this draft Ruling is about**

1. This draft Ruling<sup>1</sup> is about the personal services income (PSI) rules contained in Part 2-42 of the *Income Tax Assessment Act 1997*<sup>2</sup> and how they apply to an individual or entity.
2. 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).<sup>3</sup>
3. The PSI rules ensure that the 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).
4. It is necessary to first establish whether the individual is an employee or independent contractor. Guidance on whether or not an individual is an employee or

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<sup>1</sup> All further references to 'this Ruling' refer to the Ruling as it will read when finalised. Note that this Ruling will not take effect until finalised.

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

<sup>3</sup> Paragraph 1.5 of the Explanatory Memorandum to the New Business Tax System (Alienation of Personal Services Income) Bill 2000 (EM).

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independent contractor can be found in Taxation Ruling TR 2005/16 *Income tax: Pay As You Go – withholding from payments to employees*.<sup>4</sup>

5. The PSI rules do not apply if an individual provides their personal services to a service acquirer as an employee. Any income derived in this capacity will be the ordinary assessable income of the individual.<sup>5</sup> If the individual is not an employee of the service acquirer, then the PSI rules may apply.

6. The PSI rules do not apply if the PSE or sole trader conducts a personal services business (PSB). A PSE or sole trader conducts a PSB if it meets at least one of four PSB tests or if they have received a Personal Services Business Determination (PSBD) from the Commissioner.

7. The four PSB tests are the:

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

8. This Ruling explains:

- the meaning of PSI (paragraphs 26 to 29)
- what is not PSI (paragraphs 30 to 43)
- determining whose PSI it is (paragraphs 44 to 49)
- who is not subject to the PSI rules (paragraphs 50 to 51)
- effect of the PSI rules (paragraphs 52 to 57)
- PSB (paragraphs 58 to 64)
- the PSB tests (paragraphs 65 to 139)
- PSBD (paragraphs 140 to 147), and
- application of Part IVA of the *Income Tax Assessment Act 1936* (ITAA 1936) (paragraphs 148 to 150).

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

- what is (and is not) PSI (paragraphs 151 to 163)
- determining who is earning PSI (paragraphs 164 to 176)
- PSBs – results test (paragraphs 177 to 191)
- PSBs – unrelated clients' test (paragraphs 192 to 205)
- PSBs – employment test (paragraphs 206 to 227), and

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<sup>4</sup> A clause in a contract stating that the individual is an independent contractor is not definitive as the courts look to the substance of the arrangement between the parties (*On Call Interpreters and Translators Agency Pty Ltd v Commissioner of Taxation (No 3)* [2011] FCA 366 (*On Call*) at [188]). 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 (*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 226; *ACE Insurance Limited v Trifunovski* [2013] FCAFC 3 and *Jamsek v ZG Operations Australia Pty Ltd* [2020] FCAFC 119).

<sup>5</sup> Subsection 6-5(1).

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- PSBs – business premises test (paragraphs 228 to 238).

10. A PSE or sole trader that conducts a PSB may still be subject to the anti-avoidance provisions contained in Part IVA of the ITAA 1936.<sup>6</sup> Part IVA gives the Commissioner the power to cancel a 'tax benefit' that has been obtained, 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). Regard must be had to the individual circumstances of each case in making a determination under section 177F to cancel a tax benefit. Part IVA 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 in 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.<sup>7</sup>

### Frequently used terms

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11. '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 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
  - 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.

12. 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.

13. 'Entity' includes a company, partnership, trust or individual.

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<sup>6</sup> Section 86-10.

<sup>7</sup> Taxation Ruling IT 2121 *Income tax: family companies and trusts in relation to income from personal exertion*, IT 2330 *Income Tax: Income Splitting*, IT 2639 *Income tax: personal services income*.

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14. A personal services business (PSB) is conducted if one of the personal services business tests is met or if there is a Personal Services Business Determination in force.

15. A Personal Services Business Determination (PSBD) is a notice from the Commissioner of Taxation stating that one of the personal services business tests is met.

16. A personal services entity (PSE) is a partnership, company or trust that receives the PSI of one or more individuals and is interposed between the individual providing the work or services and the service acquirer.<sup>8</sup>

17. 'Personal services income' (PSI) is income generated from your labour where the payment made is mainly a reward for that labour.

18. The personal services income rules (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.

19. 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.

20. A service acquirer contracts with an individual or PSE to obtain the services of a test individual. This term is not used in the legislation but is used in this Ruling for ease of reference.

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

22. A 'test individual' is an individual who earns PSI when working as a sole trader or through a PSE. This term is not used in the legislation but is used in this Ruling for ease of reference.

### Previous rulings

23. 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* and clarifies the ATO view to take account of several judicial decisions which have further clarified the law since the issue of those earlier Rulings.

## Ruling

### Sources of income

24. 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

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<sup>8</sup> Subsection 86-15(2).

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- rental income.

25. The PSI rules only apply to PSI.

See Example 3 of this Ruling.

### **Meaning of personal services income**

26. PSI is 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).

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

28. The phrase 'or would mainly be such a reward if it was the income of the individual'<sup>9</sup> applies to situations where the income is legally derived by a PSE and not the individual. If a PSE fails to meet a PSB test in respect of a test individual, the PSI is deemed to be the income of the test individual and is attributed to that individual.

### **Meaning of 'mainly'**

29. 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.<sup>10</sup>

See Examples 1, 2, 7, 8 and 13 of this Ruling.

### **What is not personal services income**

#### *Supply or sale of goods*

30. Income that is mainly generated from the supply and sale of goods is not PSI.<sup>11</sup>

31. 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*

32. Income that is mainly generated from the supply and use of income-producing assets is not PSI.<sup>12</sup>

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<sup>9</sup> Subsection 84-5(1) reference to '(or would mainly be such a reward if it was your income)'.

<sup>10</sup> See examples in subsection 84-5(1); *Fawcett Properties Ltd v Buckingham County Council* [1961] AC 636 at page 669.

<sup>11</sup> Paragraph 1.23 of the EM.

<sup>12</sup> Example 2 of subsection 84-5(1).

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33. 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<sup>13</sup>:

- market value of the supply and use of the asset, compared with the market value of the personal services
- 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
- significance or uniqueness of the assets
- gross value of the asset compared to the income of the sole trader or PSE from the particular activity, and
- role the asset plays in generating the income.

See Example 4 of this Ruling.

### ***Business structure***

34. Income which is generated from the business structure of an entity is not PSI.<sup>14</sup>

35. Where income is derived by a firm or practice 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.

36. Sole traders and PSEs that are not practice companies 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<sup>15</sup>:

- the number of arm's length employees or others engaged by the sole trader or PSE to perform work
- 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.

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<sup>13</sup> Paragraphs 1.23 and 1.34 of the EM.

<sup>14</sup> Example 3 of subsection 84-5(1).

<sup>15</sup> See IT 2639.

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*Guidelines for determining whether the income from a practice company or trust is from a business structure*

37. As a practical matter, in determining whether the income of a practice company or trust is generated from the business structure and not from PSI, the Commissioner's starting point is to apply the following guidelines as a general rule of thumb:

- Where a practice company or trust has at least as many non-principal practitioners as principal practitioners, the income of the entity is considered to be derived from a business structure.
- Where a practice company or trust has fewer non-principal practitioners than principal practitioners, then whether the income is considered to be from a business structure will need to be determined by considering the various factors discussed at paragraph 36 of this Ruling.<sup>16</sup>

38. For the purposes of applying these guidelines:

- 'Practitioners' include both full-time professional and non-professional staff who derive material fees for the practice. Part-time staff are counted proportionately.
- 'Practitioners' does not include administrative, clerical, or support staff. For example, a nurse under the direction of a doctor, or a legal secretary under the direction of a solicitor, are not practitioners unless they earn material fees in their own right.
- 'Principal practitioners' are those who own or share in the ownership of the practice, whether directly or indirectly.
- 'Non-principal practitioners' are those who are not principal practitioners; that is, who do not own or share in the ownership of the practice, whether directly or indirectly.

See Examples 6, 7 and 8 of this Ruling.

39. The fact that services are performed through an entity that is not an individual does not automatically mean there is a business structure for the purposes of the PSI legislation. The factors listed in paragraphs 36 to 38 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***

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

41. 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

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<sup>16</sup> See IT 2639. When finalised, these guidelines are not intended to form a binding part of the Ruling.

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from the supply of the tap is less than 50% of the income received for the service overall, the whole amount is PSI.

42. 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.

43. 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 two 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***

44. 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.

45. 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 even if the PSE engages another individual to assist the test individual with principal work.

46. Where multiple test individuals work together through a PSE, each discrete amount of income received by the PSE under each contract is examined to determine which test individual mainly generated that income. This can be done by an analysis of contracts and invoices.

47. Contracts may indicate:

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

48. Invoices may indicate:

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

See Examples 9 to 12 of this Ruling.

49. Each discrete amount of income will be the PSI of the individual who mainly generated that income (more than 50%), even if they have been assisted by other individuals in performing the principal work under the contract.<sup>17</sup>

### ***Who is not subject to the personal services income rules***

50. The PSI rules do not apply to income received as an employee, except where an individual is an employee of a PSE and none of the PSB tests are met.<sup>18</sup>

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<sup>17</sup> *The Engineering Company and Commissioner of Taxation* [2008] AATA 934 at [18–19].

<sup>18</sup> See TR 2005/16 for information on the meaning of 'employee'.

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51. 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 individuals, or
- holds a PSBD in respect of the test individuals.

### ***Effect of the personal services income rules***

#### ***Sole trader***

52. In the case of a sole trader, the PSI rules restrict the types of deductions that the sole trader can claim.

#### ***Personal services entity***

53. 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<sup>19</sup>
- attribute the PSI received by the PSE to the test individual that mainly generated it (after deductions)<sup>20</sup>, and
- give rise to ‘pay as you go’ withholding obligations whether or not a test individual is an employee of the PSE.<sup>21</sup>

54. Where a sole trader or PSE qualifies as a PSB in an income year, the PSI rules do not apply in that income year and 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.

55. Individuals do not become employees of service acquirers as a consequence of the PSI rules applying to them.<sup>22</sup>

### ***Chains of personal services entities***

56. 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.

57. 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 14 and 15 of this Ruling.

### ***Personal services business***

#### ***Self-assessment as a personal services business***

##### ***Sole trader***

58. 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, or

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<sup>19</sup> Division 85 and Subdivision 86B.

<sup>20</sup> Division 86.

<sup>21</sup> Division 13 of Schedule 1 to the *Taxation Administration Act 1953*.

<sup>22</sup> Section 84-10 and *Skiba and Commissioner of Taxation* [2007] AATA 1705 at [46] (*Skiba*).

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- less than 80% of their income is from the same entity and its associates (the 80% rule) and they satisfy one or more of the other PSB tests.

#### *Personal services entity*

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

- it meets the results test in relation to at least 75% of the PSI of that test individual, or
- less than 80% of the test individual's income is from the same entity and its associates and the test individual satisfies one or more of the other PSB tests.

60. In the case of a PSE, the 80% rule must be applied to the income 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**

61. The source of the PSI is determined by referring to the entity that has the contractual obligation to pay the service provider.<sup>23</sup>

62. 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.<sup>24</sup>

63. What is required is consideration of the immediate source of the PSI, that is, who has the contractual obligation to make the payments?<sup>25</sup>

See Example 24 of this Ruling.

64. If self-assessment is unavailable to a sole trader or PSE in relation to a test individual, then the PSI rules will apply to the PSI of that test individual for the relevant income year, unless the Commissioner issues a PSBD.<sup>26</sup>

#### **The personal services business tests**

65. The PSB tests are the:

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

66. 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

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<sup>23</sup> The Commissioner's position is affirmed in both *BRMJQC Pty Limited and Commissioner of Taxation* [2010] AATA 311 (*BRMJQC*) and *Skiba. Confidential and Commissioner of Taxation* [2011] AATA 682 is distinguishable on its facts.

<sup>24</sup> *BRMJQC* at [87].

<sup>25</sup> *Skiba* at [83].

<sup>26</sup> Section 87-1.

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arrangements where the dominant purpose is to obtain a tax benefit for the individual whose personal efforts or skills generated the income.

67. Where more than one individual provides their services through a PSE, the tests must be applied to each 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 income 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***

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

- the income is for producing a result, and
- 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 liable for the cost of rectifying defects.

69. 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 three results test conditions are absent, the sole trader or PSE will not satisfy the test.<sup>27</sup>

70. When working out if an individual or PSE meets the three conditions of the results test, the custom or practice in the particular industry is a relevant consideration.

71. 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.<sup>28</sup>

72. However, it is not intended to override the three 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.<sup>29</sup>

### ***The income is for producing a result***

73. To satisfy the first condition, the income must be for producing a result.<sup>30</sup>

74. In results-based contracts, payment is usually made for a negotiated contract price, as opposed to an hourly or daily rate, and is only paid when the contractual conditions have been fulfilled. Where remuneration is payable on the contractual conditions being fulfilled, the remuneration is for producing a result.<sup>31</sup> The essence of the contract must be

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<sup>27</sup> *IRG Technical Services Pty Ltd v Deputy Commissioner of Taxation* [2007] FCA 1867 (*IRG Technical*) at [37].

<sup>28</sup> *Taneja and Commissioner of Taxation* [2009] AATA 87 at [22].

<sup>29</sup> *Taneja and Commissioner of Taxation* [2009] AATA 87 at [23], and *Douglass v Commissioner of Taxation* [2019] FCA 1246 at [34] and [43–44].

<sup>30</sup> Paragraphs 87-18(1)(a) for individuals and 87-18(3)(a) for PSEs.

<sup>31</sup> *Skiba* at [64].

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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 result if those tasks merely form part of the work being paid for on an ongoing basis.<sup>32</sup>

75. The condition will not be satisfied merely because the contract states that the PSI 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.<sup>33</sup>

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

76. 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<sup>34</sup> and which a service acquirer would expect the sole trader or PSE to provide<sup>35</sup> or which the sole trader or PSE is contractually required to provide.

77. 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.<sup>36</sup>

78. 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*

79. To satisfy the third condition, the sole trader or PSE must be liable for the cost of rectifying any defects in the work.<sup>37</sup> There is no requirement that they actually perform the work which rectifies the defect so long as they pay for it.

80. The main consideration is whether they are exposed to commercial risk.

81. 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.

82. A requirement to have 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.

83. Where rectification can occur during usual working times, for example, if there are quality checks in the process of delivering the work and errors fixed quickly, this condition will not be met as the sole trader or PSE will not have borne the cost of rectification.<sup>38</sup>

84. 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 would be satisfied.

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<sup>32</sup> *IRG Technical* at [110].

<sup>33</sup> *IRG Technical* at [50].

<sup>34</sup> Paragraphs 87-18(1)(b) for individuals and 87-18(3)(b) for PSEs.

<sup>35</sup> *IRG Technical* at [113–114].

<sup>36</sup> *IRG Technical* at [113–114].

<sup>37</sup> Paragraphs 87-18(1)(c) for individuals and 87-18(3)(c) for PSEs.

<sup>38</sup> *IRG Technical* at [105].

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However, the term must not be merely ‘window dressing’. All circumstances of the case may be considered in determining whether the relevant liability exists.<sup>39</sup>

85. Where a client refuses 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 16 to 20 of this Ruling.

### ***The unrelated clients test***

86. 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 two or more entities. Those entities cannot be associates of each other or associated to the sole trader or PSE<sup>40</sup>, 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.<sup>41</sup>

87. 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.<sup>42</sup>

### ***Direct result of making offers or invitations***

88. To meet this condition, the offer or invitation must be the reason why the sole trader or PSE obtained the work from the client and there must be a close and significant connection between the offer or invitation and obtaining the work.<sup>43</sup>

89. 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.

90. 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, registering with labour hire firms or similar intermediaries, or responding to advertisements on web-based recruitment sites will not meet this condition.<sup>44</sup>

91. Where it can be demonstrated that an offer has been made to the public at large or a section of the public and, as a direct result of that offer, the service acquirer directs the sole trader or PSE to a labour hire firm or similar as part of the service acquirer's requirements, then the service acquirer will count as part of the unrelated clients test. 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.

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<sup>39</sup> *Fair Work Ombudsman v Quest South Perth Holdings Pty Ltd (No 2)* [2013] FCA 582; *On Call* at [290].

<sup>40</sup> Paragraph 87-20(1)(a).

<sup>41</sup> Paragraph 87-20(1)(b).

<sup>42</sup> Subsection 87-20(2).

<sup>43</sup> *Commissioner of Taxation v Fortunatow* [2020] FCAFC 139 at [17], *Hananeia v Secretary, Attorney-General's Department* [2016] FCAFC 36 at [75] and [96].

<sup>44</sup> *Commissioner of Taxation v Fortunatow* [2020] FCAFC 139 at [19] and [20].

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*The public or a section of the public*

92. An offer or invitation is made to ‘the public at large’ where any interested member of the public is capable of accepting it.<sup>45</sup> 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, for example, in relation to competitive tenders.<sup>46</sup>

93. A ‘word of mouth’ referral is not generally considered to satisfy the requirements of the unrelated clients test.<sup>47</sup> 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 specialised or niche industry where there are only a very small number of potential service acquirers may, in limited circumstances, meet this condition.<sup>48</sup>

94. Where there is a prior or subsisting relationship between the parties to an offer or invitation, the following factors are relevant when determining whether the offer or invitation 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 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/provided services to an entity sometime in the past does not necessarily operate to exclude the sole trader or PSE from satisfying this test.<sup>49</sup>

*Who must make the ‘offer’*

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

96. 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.<sup>50</sup>

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<sup>45</sup> *Lee v Evans* [1964] HCA 65; 112 CLR 276 at [287].

<sup>46</sup> *Corporate Affairs Commission (SA) v Australian Central Credit Union* [1985] HCA 64.

<sup>47</sup> *Metaskills Pty Limited and Commissioner of Taxation* [2005] AATA 647 at [55]; *Cameron and Commissioner of Taxation* [2011] AATA 386 at [30].

<sup>48</sup> *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]).

<sup>49</sup> *Corporate Affairs Commission (SA) v Australian Central Credit Union* [1985] HCA 64; 3 ACLC 792 at [795].

<sup>50</sup> *Yalos Engineering Pty Ltd and Commissioner of Taxation* [2010] AATA 408 at [21].

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97. Where an offer is made to a sole trader or PSE this element is not satisfied because it is the potential client making the offer rather than the sole trader or PSE.

See Examples 21 to 25 of this Ruling.

### ***The employment test***

#### ***Sole trader***

98. 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.

99. 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.<sup>51</sup>

#### ***Personal services entity***

100. 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.

101. Any other individual who is not a test individual and who is engaged by the PSE to perform principal work may count towards the employment test, including individuals who are associates of the PSE. Other types of entities engaged to perform principal work only count towards the employment test if they are not associates of the PSE.

102. 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.

103. 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.

104. 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.<sup>52</sup>

105. A sole trader or PSE will also meet the test if for at least half the income year it has one or more apprentices.<sup>53</sup>

See Examples 26 and 27 of this Ruling.

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<sup>51</sup> Subsection 87-25(1).

<sup>52</sup> Subsection 87-25(2A.)

<sup>53</sup> Subsection 87-25(3).

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### *20% (by market value)*

106. 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):

$$\% = (\text{market value amount} \div \text{contract price}) \times 100$$

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

108. 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).

109. The market value amount would normally exceed the amount that the sole trader or PSE pays to the entity they have engaged.<sup>54</sup>

110. 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 28 and 29 of this Ruling.

### *Multiple contracts in the income year*

111. 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 regardless of whether an entity was engaged to assist the sole trader or PSE's principal work.

112. 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
- 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*

113. 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*

114. 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.

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<sup>54</sup> This is because the market value amount would include mark-up for on-costs and profit margin for the sole trader or PSE.

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115. 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.

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

See Example 30 of this Ruling.

### ***The business premises test***

117. The business premises test requires that at all times during the income year the sole trader or PSE maintains and uses business premises<sup>55</sup>:

- where the main activities conducted there gain or produce PSI<sup>56</sup>
- of which they have exclusive use<sup>57</sup>
- that are physically separate from any premises that they (or any associate) uses for private purposes<sup>58</sup>, and
- that are physically separate from the premises of the service acquirer (or any associate of the service acquirer).<sup>59</sup>

### ***Business premises***

118. '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.

### ***Maintains and uses***

119. 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.<sup>60</sup>

120. 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.

121. 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***

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

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<sup>55</sup> Subsection 87-30(1).

<sup>56</sup> Paragraph 87-30(1)(a).

<sup>57</sup> Paragraph 87-30(1)(b).

<sup>58</sup> Paragraph 87-30(1)(c).

<sup>59</sup> Paragraph 87-30(1)(d).

<sup>60</sup> Paragraph 1.97 of the EM.

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123. 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*

124. A sole trader or PSE is not required to maintain and use the same business premises throughout the whole year.<sup>61</sup>

#### *Main activities generate personal services income*

125. 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. If more than 50% of the activities conducted at the premises are directed at producing PSI, this requirement will be met.<sup>62</sup>

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

See Examples 31 and 32 of this Ruling.

#### *Exclusive use*

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

128. 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.

129. 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.<sup>63</sup>

130. 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.<sup>64</sup>

See Examples 33 and 34 of this Ruling.

#### *Shared areas*

131. 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.

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<sup>61</sup> Subsection 87-30(2).

<sup>62</sup> *Cameron v Commissioner of Taxation* [2012] FCAFC 76.

<sup>63</sup> *Radaich v Smith* [1959] HCA 45; 33 ALJR 2014 at [218].

<sup>64</sup> Paragraph 1.99 of the EM.

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### ***Physically separate***

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

133. For example, a PSE may lease a shed in an associate's back yard as its business premises. As the shed is part of the premises used by the associate for private purposes, the shed is not physically separate. The visual impression of the premises is that the entirety of the dwelling and surrounds (curtilage) is for private purposes.<sup>65</sup>

134. 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, then the shed may be considered as physically separate. The visual impression in this case is that the business premises are physically separate to the associate's private premises.

135. 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.

136. 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 35 and 36 of this Ruling.

### ***Special rules for agents***

137. 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.<sup>66</sup>

138. 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

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<sup>65</sup> *Commissioner of Taxation v Dixon Consulting Pty Limited* [2006] FCA 1748 at [48]. See also Example 1.14 of the EM.

<sup>66</sup> Section 87-40.

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- 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.

139. If it follows that less than 80% of the agent's PSI is from one source, the agent may access the unrelated clients test and treat the customers of the principal as their clients.

See Example 39 of this Ruling.

### **Personal services business determination**

140. 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 are unsure or unable to self-assess whether they met (or could be reasonably expected to meet) the results, employment or business premises tests<sup>67</sup>
- unusual circumstances prevented the results, employment or business premises test from being met<sup>68</sup>
- the unrelated clients test was met but unusual circumstances prevented the 80% rule from being satisfied<sup>69</sup>, or
- unusual circumstances prevented the unrelated clients test and 80% rule from being met.<sup>70</sup>

### **Unusual circumstances**

141. To issue a PSBD the Commissioner must be satisfied that, if not for the unusual circumstances, the test individual or PSE would have met, or could reasonably be expected to meet, the test or tests applied for.

142. A reasonable expectation of an event requires more than a possibility, risk or chance of the event occurring.<sup>71</sup>

143. Unusual circumstances are those circumstances that are not usual, not common, and out of the ordinary.<sup>72</sup> For example, if a sole trader or 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.

144. The unusual circumstances must apply to the sole trader or PSE that requests the PSBD. A sole trader or PSE cannot rely on industry-wide circumstances, such as economic downturn affecting a particular industry, as an unusual circumstance.<sup>73</sup>

145. 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

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<sup>67</sup> Subsections 87-60(3A) and 87-65(3A).

<sup>68</sup> Subsections 87-60(3B) and 87-65(3B).

<sup>69</sup> Subsections 87-60(5) and 87-65(5).

<sup>70</sup> Subsections 87-60(6) and 87-65(6).

<sup>71</sup> *News Corp Ltd & ors v National Companies and Securities Commission* [1984] FCA 446; 57 ALR 550 at [561]; 5 FCR 88 at [101].

<sup>72</sup> *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 1708.

<sup>73</sup> *Scimitar Systems Pty Ltd and Deputy Commissioner of Taxation* [2004] AATA 720 at [29].

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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.

146. 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.

147. '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.<sup>74</sup>

See Examples 37 and 38 of this Ruling.

#### **Application of Part IVA of the ITAA 1936**

148. The general anti-avoidance provisions of Part IVA of the ITAA 1936 may still apply to cases where a PSB is being conducted and the PSI rules do not apply. The ATO will 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 or splitting an individual's PSI.<sup>75</sup>

149. In deciding whether the PSB 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 interposed entity for those services
- whether the interposed entity distributes income to associates and does not distribute any income to the test individual (that is, the employee) who provided the actual services, and
- whether the salary or wages paid to associates by the sole trader or PSE is not commensurate with the skills exercised and services provided; and the income received by the sole trader or interposed entity is for services performed by the test individual.

150. An example of a situation where there may be income splitting to which Part IVA could apply would be where an independent contractor, conducting business through an interposed entity, is paid substantially less than the market value for their work, and the profit made as a result of paying less than a market value salary is distributed to the contractor's relatives who are on a lower marginal tax rate, or accumulated in the interposed entity at a lower marginal rate of tax.

See Example 40 of this Ruling.

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<sup>74</sup> Subsections 87-60(4) and 87-65(4).

<sup>75</sup> See section 86-10 and paragraph 1.17 of the EM. Further guidance is also provided in IT 2121, IT 2330 and IT 2639.

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**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*

151. *Andre is a plumber who operates as a sole trader. He receives a contract to fix a blocked toilet and repair three 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*

152. *Judy is an information technology consultant who provides systems analysis services through her company, J.I.T. Pty Ltd. J.I.T. Pty Ltd 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.*

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

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

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

154. *The contract receipts are 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) so is not PSI.*

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

155. *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.*

156. *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.*

157. *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.*

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*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*

158. Grace is a carpenter who operates a partnership with her spouse, Chris. Grace designs and constructs bespoke furniture and sells it 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*

159. 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 but engages three full-time employees who undertake electrical work for him. The partnership owns two 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*

160. 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.

*Example 8 – personal services income – not business structure*

161. Chris, Adrian and Simon are lawyers who provide their services as principals through CAS Law 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 Law Firm to operate. In the past three years, CAS Law Firm has established a wide customer base. Chris, Adrian and Simon each receive income from CAS Law Firm only in their capacity as trustees of their family trusts.

162. 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 Law Firm has three principal practitioners (Chris, Adrian and Simon) and no other practitioners (principal or non-principal), the following various business structure 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 legal services that can only be provided by qualified lawyers.

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- *The legal 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.*

163. *In this example, CAS Law 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 Law 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 each have 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)*

164. *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 under separate contracts to one mining company. As they work under separate contracts, they both receive their own PSI as it is mainly a reward for each of their personal efforts and skills.*

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

165. *Andrea has been providing IT consultancy services through her company AIT Pty Ltd for the past two years. Andrea's friends Daisy, Bill and Ben, who provide services working in different fields that are mainly 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. Each individual works on their own contracts and therefore has their own PSI.*

*Example 11 – husband and wife partnership*

166. *Peter is a qualified electrician and operates in partnership with his wife, Annette. Annette does the bookkeeping for the partnership in the evenings from a spare room in their home but she 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.*

167. *The income the partnership receives for the electrician services is Peter's PSI as it is mainly a reward for his personal efforts and skills.*

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

*Example 12 – multiple service providers*

169. *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 contract with Big Co to provide Kim's services. During the course of the contract, Kim finds that she has too much*

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*work and asks David, a friend with project management skills, to assist her for a month. Kim invoices Winner Pty Ltd on a monthly basis for the work she has done. In that particular month, Kim does 45% of the work on the Big Co contract and David does 55%. Winner Pty Ltd issues an invoice to Big Co with a total amount for the work done in that month. The amount received by Winner Pty Ltd in that month will be mainly a reward for Kim's personal efforts or skills and will be her PSI as, being the only test individual working through the PSE, the contract with Big Co is for Kim's personal efforts or skills even though David did more than 50% of the work.*

*Example 13 – employees of a personal services entity*

170. *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 personal services business.*

*Example 14 – chain of personal services entities*

171. *Keith forms two private companies, C Pty Ltd and PS Pty Ltd. Keith is then 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 15 – chain of personal services entities*

172. *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 two children.*

173. *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 or skills of Sara and is therefore her PSI.*

174. *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 two entities form a chain of PSEs.*

175. *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 as the service provider and would be non-assessable non-exempt income in the hands of the beneficiaries.<sup>76</sup>*

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<sup>76</sup> Section 86-35.

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176. *If the PSE's were able to pass the PSB tests, Part IVA may apply as the arrangement involves the tax benefit of Sara splitting her personal service income with other associated entities on a lower tax bracket.*

*Personal services business – results test*

*Example 16 – IT industry – results test not met*

177. *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 eight 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 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.*

178. *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.*

179. *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 and the PSI rules apply.*

*Example 17 – IT industry – results test met*

180. *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 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. Consultant Co is a PSE because its income includes the PSI of the individual who does the work.*

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181. *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.*
- *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.*

182. *In this example, all of the conditions of the results test are satisfied. A sole trader or PSE engaged in these circumstances meets the results test and the PSI rules do not apply.*

*Example 18 – civil engineer – results test not met*

183. *Mick is a civil engineer and operates through his company, Mick Smith Pty Ltd. In June 2014, 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 2015 and June 2016. 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.*

184. *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 x 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.*

185. *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.*

186. *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 is paid fortnightly for hours worked and must work on projects that are assigned to him. 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.*

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187. *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.*

*Example 19 – building industry contractor – results test met*

188. *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 and bolts, and drill bits.*

189. *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.*

*Example 20 – consultant – results test met*

190. *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.*

191. *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 21 – engineer – unrelated clients test met*

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

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

194. *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.*

195. *Not one of these sources in the income year in question provides Kevin with more than 80% of his PSI so he is able to self-assess as to whether he meets the unrelated clients test.*

196. *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 two unrelated clients obtained as*

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*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 22 – making offers or invitations – unrelated clients test not met*

197. *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.*

198. *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.*

199. *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 23 – work obtained through labour hire arrangements – unrelated clients test not met*

200. *Ian is a 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 five service acquirers as a result of his registration with the labour hire firm.*

201. *Ian's registration with the labour hire firm is not treated as making an offer or invitation 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 24 – being referred to labour hire arrangements – unrelated clients test met*

202. *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 by another unrelated company, Big Bank Pty 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 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 Pty Ltd, the contract came about from Sonya's offer or invitation through her advertising to the public at large.*

203. *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.*

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204. 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 25 – word of mouth offers – unrelated clients test met*

205. Mike works as an undersea diver on offshore oil rigs. During the income year, he entered into two 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 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 26 – not principal work – employment test not met*

206. 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, paying subcontractors, 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.

207. 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.

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

*Example 27 – principal work – employment test met*

209. 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 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 the PSI under this agreement. Lawrence's banking and bookkeeping work does not form part of the principal work.

210. 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.

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*Example 28 – 20% by market value – employment test met*

211. Jack is a contract engineer who contracts with Big Mining Co to provide his services. Jack works on the contract for 250 days in the income year and is paid a daily rate of \$480.

212. 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 \$180 a day for the work Tom performs. Tom works a total of 200 days for Jack during the income year.

213. Adopting the method set out at paragraphs 106 to 110 of this Ruling, the market value of Tom's work on the Big Mining Co contract is \$36,000 (200 days × \$180).

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

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

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

$$(\$36,000 \div \$156,000) \times 100 = 23\%.$$

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

*Example 29 – 20% by market value – multiple contracts in one income year – employment test not met*

218. Jodie is a drafts person who has been engaged by two clients in the income year. Both contracts are for the provision of drafting services. Jodie engages her spouse Ian, who is also a drafts person.

219. Jodie uses the method at paragraphs 106 to 110 of this Ruling to determine whether she meets the employment test in the income year.

220. Jodie invoices the first client for \$100,000 in total. Ian assisted Jodie with the principal work and the market value of his contribution to the work, which was billed to the client, was \$22,000 equalling 22% of the principal work.

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

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

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

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

$$(\$26,000 \div \$140,000) \times 100 = 19\%.$$

225. 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.

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*Example 30 – apprentice – employment test met*

226. 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 two months, takes a three-week break, and then works for a further two months, for a total of four months. Later in the same income year another apprentice electrician, John, is placed with Joe for three months. In total, Joe has an apprentice working with him for seven months in the income year.

227. 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 31 – not mainly conducting activities producing personal services income – business premises test not met*

228. 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. 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.

229. 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 would not pass the business premises test.

*Example 32 – mainly conducts activities producing personal services income – business premises test met*

230. 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 arms-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 would pass the business premises test.

*Example 33 – not exclusive use – business premises test not met*

231. 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 34 – exclusive use – business premises test met*

232. Norm is a draftsman 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

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*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 35 – not physically separate – business premises test not met*

233. *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.*

234. *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.*

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

236. *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, use for private purposes.*

*Example 36 – physically separate – business premises test met*

237. *Robert is an architect who contracts through his company, Robbo Enterprises Pty Ltd. Robert owns two 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 two properties. The duplex used by Robbo Enterprises Pty Ltd for its business premises displays the business’ signage.*

238. *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.*

*Example 37 – unusual circumstances – first year of operation*

239. *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 three-month contract to provide Sarah’s services to EB Pty Ltd. This was SBC Pty Ltd’s only contract in the 2019 income year.*

240. *SBC Pty Ltd applied for a PSBD for the 2019 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 two other unrelated clients in the 2020 income year and was confident that the test would be met in that year. Sarah had approached the two new clients after hearing about the availability of work from a friend at a birthday party she attended.*

241. *It would be considered that it was an unusual circumstance for SBC Pty Ltd to have only one client for the 2019 income year as two unrelated clients have been secured for the 2020 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*

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*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, the Commissioner cannot issue a PSBD on the basis that unusual circumstances prevented the unrelated clients test from being met.*

242. *Although SBC Pty Ltd could evidence that it had two unrelated clients in the 2020 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 the unrelated clients test requires. While it was reasonable to expect SBC Pty Ltd would have two or more unrelated clients in the subsequent income year, it was usual for SBC Pty Ltd to obtain its clients through word of mouth.*

*Example 38 – unusual circumstances – business premises test – personal services business determination*

243. *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; however, they need more room. 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.*

244. *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 four 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.*

245. *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 four 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.*

246. *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.*

247. *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.*

*Example 39 – not bearing entrepreneurial risk – special rules for agents*

248. *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 that 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*

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*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.*

*Example 40 – potential application of Part IVA of the ITAA 1936*

249. *JB 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 JB's wife and three children, who are in a 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. The understanding is that JB will personally undertake the required work. No work will be performed by any of the beneficiaries. Instalments of the contract price are payable on achieving agreed milestones. JB Pty Ltd also agrees to provide the necessary equipment, and to remedy any defects.*

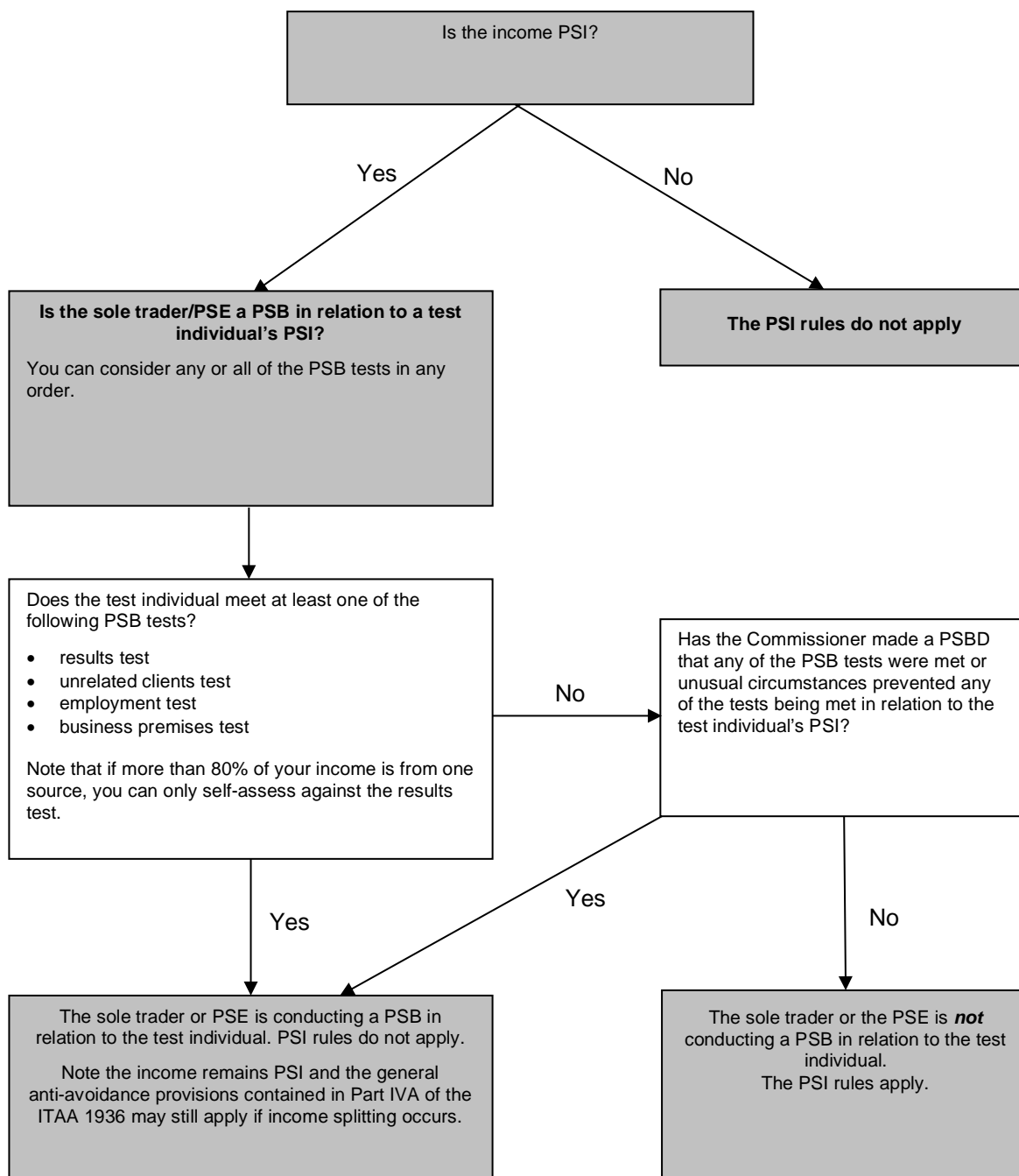
250. *In the income year, JB Pty Ltd pays JB a salary of \$50,000, which is less than commensurate with the value of JB's services (more likely valued around \$90,000) and claims deductions amounting to \$25,000. JB Pty Ltd distributes the balance of The JB Trust's net income, namely \$45,000, as follows: each of the three children receives \$416 (making a total of \$1,248), and the remainder is distributed to JB's wife. No trust income is distributed to JB as a beneficiary of The JB Trust. No tax is payable by JB's children, and JB's wife pays tax on her trust distribution at her marginal tax rate, but the total amount of tax paid between JB, his wife and children is less than what would have been paid if JB 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 JB's personal effort and skill to an associate that results in less overall tax being paid is a tax benefit.*

251. *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 that The JB Trust meets the results test in respect of the PSI of JB. Accordingly, JB Pty Ltd determines that the PSI rules will not apply to JB'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 section 177D(2) of the ITAA 1936, it would be concluded that there was a dominant purpose of enabling JB 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.*

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252. This flow chart demonstrates the operation of the PSI rules and can be used to determine whether the PSI rules apply.



**Note: Even if you consider you pass a PSB test, you may still apply to the Commissioner for a PSBD to remove any doubt.**

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## Date of effect

253. When the final Ruling is issued, it is proposed to apply to arrangements begun to be carried out from the day after TR 2001/7 and TR 2001/8 are withdrawn.

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**Commissioner of Taxation**

11 March 2021

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Status: **draft only – for comment**

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## **Appendix – Your comments**

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

255. A compendium of comments is prepared when finalising this Ruling, and an edited version (names and identifying information removed) is published to the Legal database on [ato.gov.au](http://ato.gov.au)

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

**Due date:** 9 April 2021

**Contact officer details have been removed following publication of the final ruling.**

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## References

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### *Previous draft:*

Not previously issued as a draft

### *Related Rulings/Determinations:*

TR 2005/16; TR 2006/10

### *Previous Rulings/Determinations:*

IT 2121; IT 2330; IT 2639; TR 2001/7;  
TR 2001/8

### *Legislative references:*

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- BRMJQC Pty Limited and Commissioner of Taxation [2010] AATA 311; 2010 ATC 10-135; 79 ATR 220; [2010] ALMD 5414
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- Cameron v Commissioner of Taxation [2012] FCAFC 76; 202 FCR 301; 2012 ATC 20-320; 88 ATR 518; [2012] ALMD 3662
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- Commissioner of Taxation v Fortunatow [2020] FCAFC 139; 2020 ATC 20-758
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- Fawcett Properties Ltd v Buckingham County Council [1961] AC 636; [1960] 3 All ER 503; [1960] 3 WLR 831
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- Hananeia v Secretary, Attorney-General's Dept [2016] FCAFC 36; 240 FCR 54; 152 ALD 1; [2016] ALMD 4742
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- Metaskills Pty Limited and Commissioner of Taxation [2005] AATA 647; 2005 ATC 2204; 60 ATR 1055; [2007] ALMD 571
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ATO references

NO: 1-9ONJTRO  
 ISSN: 2205-6122  
 BSL: IAI  
 ATOLaw topic: Income tax ~~ Assessable income ~~ Personal services income  
 Income tax ~~ Deductions ~~ Personal services entities  
 Miscellaneous ~~ Personal services business determination ~~ Business premises test  
 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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