TR 2001/8 - Income tax: what is a personal services business

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Taxation Ruling
Income tax: what is a personal services business

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Preamble

The number, subject heading (the title), ***Class of person/arrangement, Date of effect*** *and* ***Ruling*** *parts of this document are a 'public ruling' for the purposes of Part IVAAA of the* ***Taxation Administration Act 1953*** *and are legally binding on the Commissioner. The remainder of the document is administratively binding on the Commissioner. Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a public ruling and how it is binding on the Commissioner.*

What this Ruling is about

1. This Ruling deals with the alienation of personal services income measure (the alienation measure) contained in Part 2-42 of the *Income Tax Assessment Act 1997* (ITAA 1997), and explains what is a personal services business. In particular it explains:

- the 'results' test in subsections 87-60(5) and 87-65(5);
- the three personal services business tests contained in Subdivision 87-A of the ITAA 1997; and
- the grounds for the Commissioner, making a determination under Subdivision 87-B of the ITAA 1997 that an individual's personal services income is from that individual or a personal services entity conducting a personal services business.

2. It also explains that the alienation measure does not apply to personal services income that is income from conducting a personal services business. However, the ruling reminds taxpayers who qualify as personal services businesses that they are in exactly the same position that they would have been prior to the enactment of the alienation measure. For example, Part IVA of the *Income Tax Assessment Act 1936* (ITAA 1936) may apply where income splitting occurs.

3. This Ruling incorporates the proposed legislative amendments announced in Treasurer's Press Release No. 47 of 29 June 2001 and Treasurer's Press Release No. 51 of 9 July 2001. Those aspects of the

ruling that relate to those announcements are not public rulings for the purposes of the *Tax Administration Act 1953* (TAA 1953).[1]

Class of persons

4. This ruling applies to:

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

Background

5. The *New Business Tax System (Alienation of Personal Services Income) Act 2000* (Alienation of Personal Services Income Act) amended the ITAA 1997 by inserting new Part 2-42 into that Act and, amended the TAA 1953 by inserting new Division 13 in Schedule 1 to that Act. Part 2-42 of ITAA 1997 contains the alienation measure that sets out the income tax treatment of the ordinary or statutory income of an individual or a personal services entity that is an individual's personal services income.

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

- were in the former prescribed payments system and were entitled to and had made a payee declaration to a payer; and
- the payee declaration was in force as of 13 April 2000; and
- the Commissioner had received the payee declaration for the payee from the payer on or before 13 April 2000.[2]

7. The alienation measure was introduced following recommendations made in the report of the *Review of Business Taxation: A Tax System Redesigned* (commonly called the Ralph

[1] After the enactment of the proposed amendments, the ruling will be reviewed and will be modified, if necessary.
[2] The Commissioner's declaration in relation to this deferral was published on 30 August 2000 in the Commonwealth of Australia Gazette No. GN 34.

Report)[3]. The relevant recommendations that relate to this measure are recommendations 7.2, 7.3 and 7.4. Those recommendations were aimed at improving the integrity and equity in the tax system. The recommendations arose out of concerns that substantial erosion of the income tax base had occurred as a consequence of the alienation of personal services income through the use of interposed companies, partnerships and trusts; and that there was a perception that individuals, as contractors, and interposed entities were able to claim a greater range of deductions than those available to individuals who provided personal services as employees[4].

8. The measure is intended to:

- Limit and clarify the deductions available against personal services income at both the individual and interposed entity level; and
- Ensure that, after allowing certain deductions to the interposed entity, any income remaining is attributed to the individual[5].

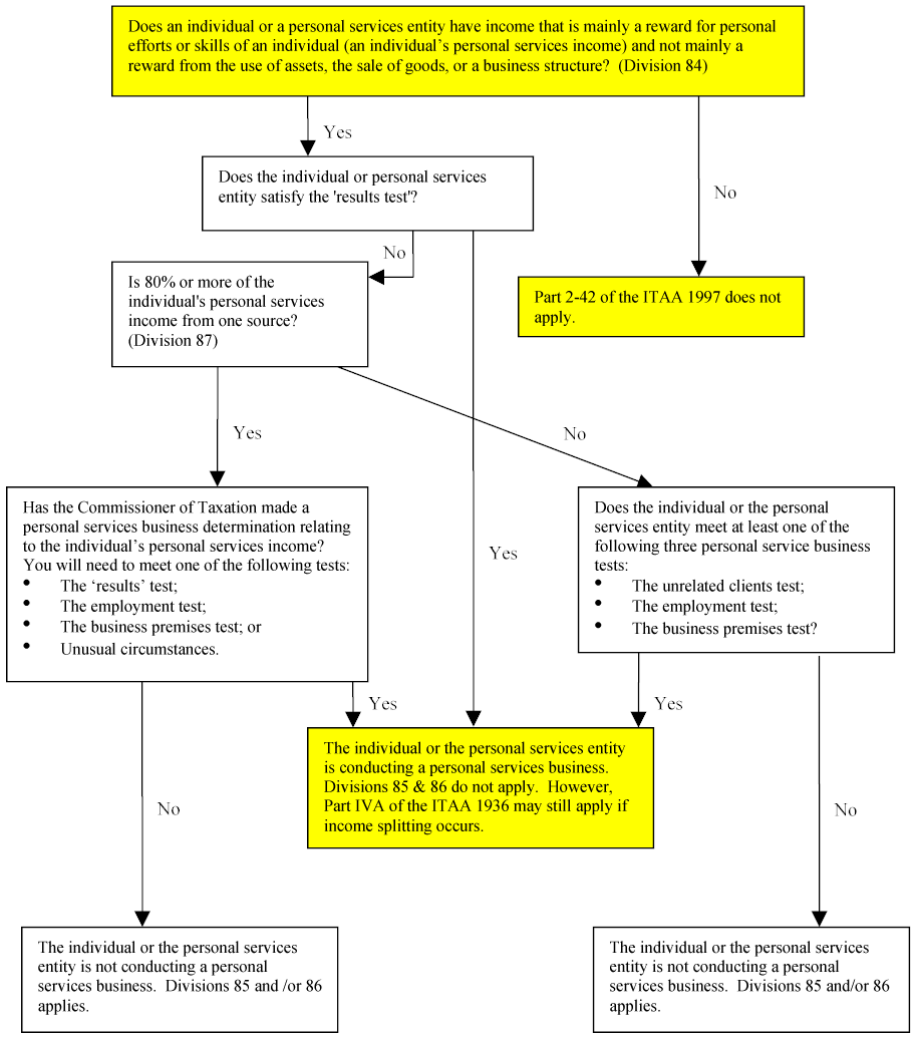
9. The application of Part 2-42 of the ITAA 1997 is predicated on the view that, contractually, income from personal services can be the income of any entity. However, subsection 84-5(2) of the ITAA 1997 ensures that for tax purposes, only an individual can have personal services income (as defined).

10. The application of Part 2-42 of the ITAA 1997 does not result in a change in the nature of contractual relationships between parties to an arrangement that involves the rendering of personal services (subsection 84-10. Individuals do not become employees of service acquirers as a consequence of the application of Part 2-42. Nor does the operation of Part 2-42 affect an individual's or a personal services entity's entitlement to an Australian Business Number, or entitlement to be registered for the purposes of the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act).

[3] See also Treasurer's Press Release No.74 of 11 November 1999.
[4] See also paragraphs 1.5 to 1.14 of the Explanatory Memorandum.
[5] See Explanatory Memorandum at page 3.

The following flowchart explains how Part 2-42 applies.

Diagram showing the operation of the Alienation Measures[6]



11. Note that you can apply for a Personal Services Business Determination (PSBD) to confirm that you are not within the measure, or if you are not sure whether you are within the measure, or if you are subject to unusual circumstances. If you believe that the alienation measure should not apply to you, you can request a PSBD from the Commissioner (see diagram above).

12. If:

(a) you or the personal services entity do not satisfy the 'results test'; and

[6] See Treasurer's Press Release No.47 of 20 June 2001 and Treasurer's Press Release No.51 of 9 July 2001.

(b) you or the personal services entity get 80% or more of the personal services income from one source.

you will be subject to the alienation measure, unless you have a PSBD.

The effect of the alienation measure

13. If the alienation measure applies to an individual or a personal services entity, the amount of the personal services income is included in the assessable income of the individual whose personal efforts or skills generate the income.

14. If the alienation measure applies, the individual or personal services entity will not be able to claim certain deductions. For example, rent expenses, mortgage interest payments, rates and land tax paid in respect of the individual's private residence will not be allowable deductions to the extent that those expenses are incurred in gaining or producing the individual's personal services income. Also, payments made to the individual's spouse (or any other associate) will not be deductible when the payment relates to non-principal work, such as bookkeeping for an individual who is a builder.

15. If the alienation measure applies, a personal services entity may also have additional withholding obligations in relation to personal services income that is attributed to an individual under the alienation measure.

Definitions

Personal services entity (entity)

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

Personal services income

17. Personal services income is income which is mainly a reward for an individual's efforts or skills (or would mainly be such a reward) if it had been derived by the individual) (subsection 84-5(1)).

Service acquirer(s)

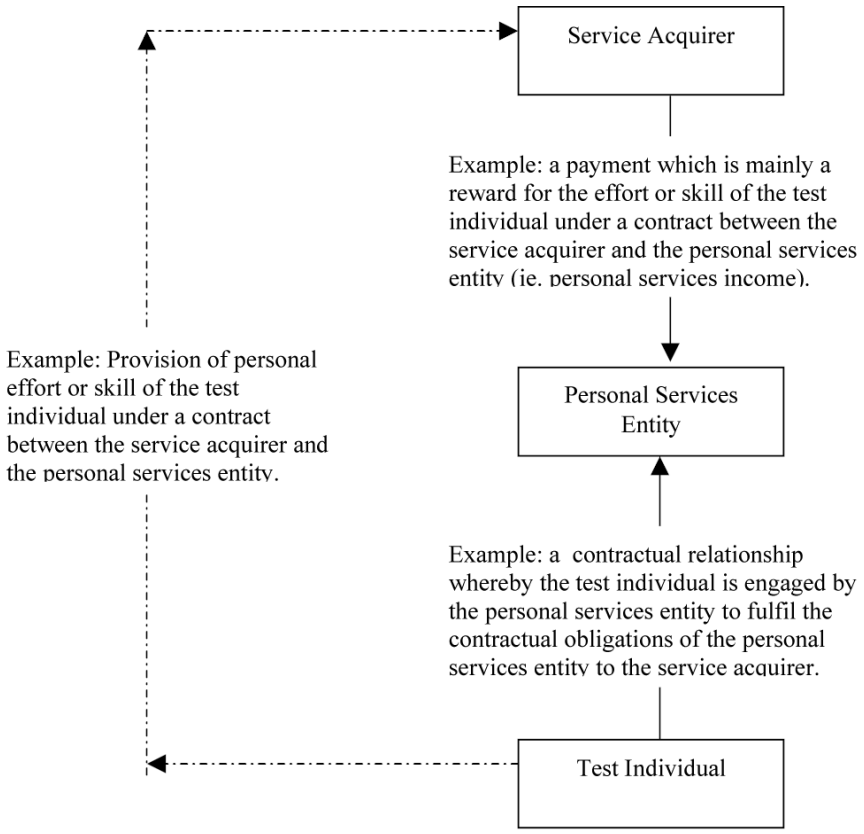
18. The service acquirer is/are the entity or entities that acquire the personal services of an individual directly from the individual or through a personal services entity. The service acquirer is the client of an individual or personal services entity and is the source of the

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

Test Individual

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

A diagrammatical representation of the above definitions is as follows:



Associate

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

21. 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.

22. 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.

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

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

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

(i) Australian government agencies which is defined to mean:
- the Commonwealth, a State or a Territory; or
- an authority of the Commonwealth, a State or a Territory;

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

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

Related Rulings

- Taxation Ruling TR 2001/7 deals with the meaning of personal services income (Division 84);
- Taxation Rulings IT 2121, IT 2330, IT 2503 and IT 2639 deal with the application of Part IVA to the alienation of income from rendering personal services.

Ruling

Who is covered by the Alienation Measure?

26. The alienation measure only applies to personal services income. Personal services income is income earned mainly from the provision of a person's labour or skills.

27. You will not be within the alienation measure and can self-assess accordingly if you come within ONE of the following four situations:

- You satisfy the 'results test', that is:

  (a) You work to produce a result(s); and

  (b) You provide the tools and equipment necessary (if any) to produce the result(s); and

  (c) You are liable for the cost of rectifying any defective work.[7]

  OR

- None of your clients pay you 80% or more of your personal services income in the year of income and you have two or more unrelated clients (who were obtained as a result of you making offers to the public at large or to a section of the public)[8].

  OR

- None of your clients pay you 80% or more of your personal services income in the year of income and

  (d) You engage an individual(s) or an unrelated entity(ies) to perform 20% or more (by market value) of the principal work (ie the work that generates the personal services income) or

  (e) You employ an apprentice for at least half the year

  OR

- None of your clients pay you 80% or more of your personal services income in the year of income, and you exclusively use business premises that are physically separate from your home, or from the premises of the person for whom you are working.

28. If you cannot satisfy any of the tests outlined in the previous paragraph (for example, because you do not meet one of the three personal services business tests or the results test, and 80% or more of your personal services income comes from one source, you may be

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[7] See Treasurer's Press Release No.51 of 9 July 2001.

[8] See Treasurer's Press Release No.47 of 29 June 2001. If an agent satisfies the four conditions set out in that Press Release, they will not be subject to the alienation measure. The four conditions are that an agent:

- Receives personal services income from providing services (on behalf of the principal) to customers, and less than 80 per cent of that income is from services provided to each customer;
- Receives at least 75 per cent of that income as commission or results-based payments, (as opposed to retainers or salary-like payments);
- Actively seeks customers for their principal; and
- Does not provide services from the premises of their principal (or the principal's associate).

able to obtain a Personal Services Business Determination (PSBD) from the Commissioner that you are conducting a personal services business. You can also apply for a PSBD if you are not sure whether you satisfy any of the tests. If the Commissioner is satisfied that you are entitled to a PSBD, you will not be subject to the alienation measure.

29. If the alienation measure applies to an individual or a personal services entity, the amount of the personal services income is included in the assessable income of the individual whose personal efforts or skills generate the income.

30. In addition, the individual or personal services entity will not be able to claim certain deductions. For example, rent expenses, mortgage payments, rates and land tax paid in respect of the individual's private residence will not be allowable deductions to the extent that those expenses are incurred in gaining or producing the individual's personal services income. Also, payments made to the individual's spouse (or any other associate) will not be deductible when the payment relates to non-principal work, such as bookkeeping for an individual who is a builder.

31. A personal services entity may also have additional withholding obligations in relation to personal services income that is attributed to an individual under the alienation measure.

32. Note that the general anti-avoidance provisions of Part IVA of the ITAA 1936 may still apply to cases of alienation of personal services income that fall outside the alienation measure: see section 86-10 of the ITAA 1997.

The Results Test

33. The alienation measure does not apply to an individual or personal services entity if, having regard to the custom or practice in the relevant industry, when work of that kind is performed by an entity other than an employee:

(a) the work is for producing a result;

(b) the individual or personal services entity supplies the equipment or tools, if any, that are necessary to do the work; and

(c) the individual or personal services entity is liable for the cost of rectifying any defective work.

34. The 'results test' will be met where:

(a) The contract is to produce a specified outcome or result and payment is based on performance of the contract (i.e., for producing the outcome or result);

(b) You provide the equipment and tools, if any, necessary for doing the work; and

(c) You bear the commercial risks, including liability for defective work.

35. Paragraphs 87-60(5)(b) and 87-65(5)(b) are not failed merely because plant and equipment, or tools of trade are not needed to do the work. These paragraphs require the provision of the equipment or tools, if any, necessary to perform the work where, having regard to custom and practice in that particular industry, it would be expected that the equipment normally used to undertake the work will be provided by whoever performs the work. Where no plant and equipment or tools of trade are necessary to perform the work, this condition would be satisfied.

36. Paragraphs 87-60(5)(c) and 87-65(5)(c) will be satisfied where there is a liability for the cost of rectifying any defect in the relevant work performed, including situations where action is taken to rectify the error at the individual's or personal services entity's own cost prior to completion of the task or prior to the taking of legal action. This sort of voluntary action reflects the custom and practice in some industries, and is indicative of the entrepreneurial risk of an independent contractor in contrast to the "employee-like" contractor.

37. In addition, being liable for the cost of rectifying any defect is inclusive of rectification achieved by the service acquirer pursuing a legal remedy for damages, in circumstances where the defect is incapable of physical repair.

38. The liability for the cost of rectifying defective work covers only the cost of rectifying the defective work performed by the service provider.

The Three Personal Services Business Tests

39. You are not within the alienation measure and you can self-assess accordingly if none of your clients pay you 80% or more of your personal services income and you satisfy one of the three personal services business tests.

40. Section 87-15 sets out the three personal services business tests. That section reads as follows:

'(1) An individual or a personal services entity conducts a **personal services business** during an income year if the individual or entity meets at least one of the 3 personal services business tests.

(2) The 3 **personal services business** tests are:

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

(b) the employment test under section 87-25;

(c) the business premises test under section 87-30.

(3) However, if 80% or more of an individual's personal services income during the income year is income from the same entity (or from the same entity and that entity's associates), the individual's personal services income is *not* taken to be from conducting a personal services business unless:

(a) when the personal services income is gained or produced, a personal services business determination is in force relating to the individual's personal services income; and

(b) if the determination was made on the application of a personal services entity – the individual's personal services income is income from the entity conducting the personal services business.'

Where none of your clients pay you 80% or more of your personal services income

41. Where 80% or more of an individual's personal services income is not from the same entity (or from the same entity and that entity's associates), then the individual or personal services entity can self-assess as to whether they meet one of the 3 personal services business tests.

42. Income is derived from the entity with whom the individual or personal services entity has contracted to do the work. In other words, it is the entity that can sue the service provider for defective work, or an associate of that entity, that is taken into account in determining whether 80% or more of the personal services income is from the same entity.

Unrelated clients test

43. The unrelated clients test is set out in section 87-20 and reads as follows:

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

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

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

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

During the year

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

'Gains or produces income from providing services to 2 or more unrelated clients'[9]

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

[9] See Treasurer's Press Release No.47 of 29 June 2001. If an agent satisfies the four conditions set out in that Press Release, they will not be subject to the alienation measure. The four conditions are that an agent:

- Receives personal services income from providing services (on behalf of the principal) to customers, and less than 80 per cent of that income is from services provided to each customer;
- Receives at least 75 per cent of that income as commission or results-based payments, (as opposed to retainers or salary-like payments);
- Actively seeks customers for their principal; and
- Does not provide services from the premises of their principal (or the principal's associate).

46. In cases where the personal services income is the ordinary or statutory income of the individual, it is the 'entities' with whom the individual has contracted to provide services, and which gives rise to the ordinary or statutory income that is the individual's personal services income, that is contemplated in paragraph 87-20(1)(a) in terms of the phrase, 'providing services to 2 or more entities'.

47. In cases where the personal services income is the ordinary or statutory income of a personal services entity, it is the 'entities' with whom the personal services entity has contracted to provide services, and which gives rise to the ordinary or statutory income of the personal service entity which is the individual's personal services income, that is contemplated in paragraph 87-20(1)(a) in terms of the phrase, 'providing services to 2 or more entities'.

Associates

48. Associates are defined in section 318 of the ITAA 1936. If an independent contractor does not know or could not reasonably be expected to know that the service acquirers are associates, then the fact that the clients are associates of each other will not of itself be regarded as causing the test to be failed.

What is meant by 'direct result'?

49. The reference in paragraph 87-20(1)(b) to 'direct result' means that a clear link or a causal connection is required between the activities of making offers or invitations to the public and the provision of personal services to unrelated clients. However, a 'direct result' does not imply that there can be no step between the cause and effect. The question to be asked is whether the offers made to the public can reasonably be said to have given rise to the work.

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

50. The phrase 'making offers or invitations' is not restricted to the contract law usage but is to be given a broad meaning to include any form of solicitation to the public or a section of the public.

51. The manner in which the offer or invitation to the public may be made is not limited to activities like advertising, and can extend to any activity which demonstrates a willingness to enter into agreements to provide services to service acquirers generally, including a competitive public tender process. The essential character of those activities that constitute making offers or invitations to the public is to convey a holding out and the preparedness of the individual or

personal services entity to provide services to members of the public generally.

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

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

Employment test

53. The employment test is set out in section 87-25, which reads as follows:

> (1) An individual meets the employment test in an income year if:
>
> (a) the individual engages one or more entities (other than *associates of the individual that are not individuals) to perform work; and
>
> (b) that entity performs, or those entities together perform, at least 20% (by market value) of the individual's principal work for that year.
>
> (2) A *personal services entity meets the employment test in an income year if:
>
> (a) the entity engages one or more other entities to perform work, other than:
>
> (i) individuals whose *personal services income is included in the entity's *ordinary income or *statutory income; or
>
> (ii) *associates of the entity that are not individuals; and
>
> (b) that other entity performs, or those other entities together perform, at least 20% (by market value) of the entity's principal work for that year.
>
> (3) An individual or a *personal services entity also meets the employment test in an income year if, for at least half the income year, the individual or entity has one or more apprentices.

Engages

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

55. Any company, partnership or trust that would be considered to be an associate of either the individual or the personal services entity, according to the meaning in section 318 of the ITAA 1936, cannot be counted for the purposes of the employment test. This exclusion is contained in paragraph 87-25(1)(a) and subparagraph 87-25(2)(a)(ii), but does not apply to individuals who are associates of the test individual (e.g., a spouse).

One or more other entities

56. Where the personal services entity is a partnership, the partners are not "other entities" for the purposes of paragraph 87-25(2)(a).

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

57. The reference in sub-paragraph 87-25(2)(a)(i) to 'individuals whose personal services income is included in the entity's ordinary or statutory income' means the test individual(s) cannot be counted for the purpose of determining whether the personal services entity passes the employment test.

Principal work

58. The term 'principal work' in paragraphs 87-25(1)(b) and (2)(b) can be described as that work which fulfils the obligations under the agreement with the service acquirer. It is the work that generates the personal services income of the test individual or personal services entity under the contract.

59. The concept of principal work does not include work which is ancillary such as helping or aiding the work of the test individual, unless this directly contributes to the generation of the relevant personal services income under the agreement. Work that is associated with administration such as bookkeeping, answering telephones or other clerical work is ancillary and is not principal work (unless the work to be performed for the service acquirer includes that administrative work).

At least 20% (by market value)

60. The formula for determining whether at least 20% (by market value) of the principal work is performed by the entity (or entities) engaged is as follows :

$$\% = \frac{\text{market value amount}}{\text{contract price}} \times 100$$

61. The 'contract price' is the total amount paid under the agreement between the individual or personal services entity and the service acquirer.

62. The 'market value amount' is dependant upon whether all parties are dealing with each other at arm's length.

63. If the parties are dealing with each other at arm's length and the amount paid is at least 20% of the contract price, then it is the amount paid that is to be used as the 'market value amount' in the above formula. This represents an arm's length charge-out rate for the relevant work.

64. If the parties are not dealing with each other at arm's length, then the 'market value amount' is the market rate for the principal work performed by the entity (or entities).

65. In those cases where there are multiple contracts, the 'market value amount' and 'contract price' must be determined for each contract and those amounts separately aggregated. It is these aggregates which are used in the above formula to determine whether the entity(or entities) engaged perform at least 20% by market value of the principal work in the income year.

Apprentice

66. For the purposes of sub-section 87-25(3), an apprentice is a natural person who works for another for a fixed period of time with obligations to learn a trade, business or skill.

67. Apprenticeships or traineeships regulated by State and Territory Vocational Education and Training legislation have a primary object of education and therefore satisfy the common law meaning of apprentice.

68. The apprentice need not be apprenticed to the contractor. A series of apprentices supplied by a Group Apprenticeship Scheme to work for the contractor as part of their trade training would meet the requirement.

69. The employment test is satisfied where an individual or entity has, for at least half the income year, one or more apprentices. The

test does not require that the same apprentice be engaged or that the qualifying period comprises consecutive days.

Business premises test

70. The business premises test is in section 87-30 and reads as follows:

> (1) An individual or a *personal services entity meets the business premises test in an income year if, at all times during the income year, the individual or entity maintains and uses business premises:
>
> (a) at which the individual or entity mainly conducts activities from which *personal services income is gained or produced;
>
> (b) of which the individual or entity has exclusive use;
>
> (c) that are physically separate from any premises that the individual or entity, or any *associate of the individual or entity, uses for private purposes; and
>
> (d) that are physically separate from the premises of the entity to which the individual or entity provides services and from the premises of any associate of the entity to which the individual or entity provides services.
>
> (2) The individual or entity need not maintain and use the same business premises throughout the income year.

Maintain and use

71. Business premises are maintained where there is a right to occupy the premises that enables the individual or personal services entity to conduct activities which generate the individual's personal services income. In this context, business premises may be maintained by way of occupancy under a lease, sublease, licence or mere possession. However, not all of these occupancy arrangements satisfy the requirement of exclusive use - see paragraphs 221-230 below).

At all times in the income year

72. For the purposes of the business premises test the phrase 'at all times in the income year' is taken to mean the whole period during

which activities are conducted for the purposes of generating personal services income.

73. The context in which the phrase is used in the business premises test requires the individual or personal services entity to have business premises on each day during the income year in which activities are conducted which produce the individual's personal services income.

74. Where the individual or personal services entity commences or ceases activities during the income year, it is sufficient that the individual or personal services entity maintains and uses business premises for that part of the income year in which the activities are conducted.

75. Where the individual or personal services entity conducts activities which produce the individual's personal services income regularly on particular days in each week of the income year, it is sufficient if the individual or personal services entity has business premises on each of those days. For example, if the activities are conducted on each Monday and Tuesday in the income year, it is sufficient if the individual or personal services entity has business premises on those days.

Mainly

76. Business premises may be used for other activities and still satisfy the paragraph 87-30(1)(a) requirement provided the premises are predominantly used (i.e., more than half the use) for activities from which personal services income is gained or produced.

Business premises

77. The phrase 'business premises' in sub-section 87-30(1) means premises which, from a business and commercial perspective, are apt for the purpose of carrying on a business.

Exclusive use

78. Paragraph 87-30(1)(b) requires the individual or personal services entity to have exclusive use of the business premises. Where an individual or personal services entity leases premises together with another individual or entity on the basis that the total premises are shared, neither lessee has exclusive use of the premises. However, the relevant aspect of exclusive use is the business premises in relation to the relevant work and the relevant lease or other arrangements that deal with those particular premises. The exclusive use requirement

does not disqualify the shared use of common areas if they are the subject of separate arrangements.

79. An individual or personal services entity does not have exclusive use of premises where the premises are occupied under licence or mere possession.

Physically separate

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

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

81. In deciding whether business premises are disqualified premises, the issue to be determined is whether the physical impression or character of the business premises causes those premises to be seen as physically distinct from any adjoining or surrounding premises. This requirement is implicit in examples 1.14 and 1.15 of the Explanatory Memorandum.

82. Where business premises are within a larger building, the implication is that the business premises are not physically separate. This will also be the case where the business premises are within the curtilage of private premises. However, in both cases, this implication is not necessarily determinative and in situations where other factors sufficiently influence the overall impression, an alternative conclusion may be reached. For example, where an individual or personal services entity leases a discrete floor or part of a floor in a high rise building and those premises are not incorporated functionally with those where the services acquirer carries on business, the impression would be that the business premises are physically separate.

83. The factors listed below are to be considered in combination to reach a conclusion regarding the physical impression (or character) of the business premises as physically separate from any adjoining or surrounding premises and curtilage:

- The extent of physical separation of the premises;
- whether the physical appearance of the business premises makes them distinct and separate from adjoining or surrounding premises and curtilage;

- whether the business premises are detached from other building structures on the land and are not within the curtilage of those other premises;
- whether the business premises have discrete access for the individual and clients;
- whether the business premises are incorporated functionally into the surrounding premises, including the extent to which facilities and staff are shared with occupants of adjoining or surrounding premises.

Changing business premises

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

Personal Services Business Determination (PSBD)

85. You can apply to the Commissioner for a PSBD even if none of your clients pay you 80% or more of your personal services income if you do not wish to self-assess in relation to the alienation measure, or if you think unusual circumstances apply to you. [10]

86. If you (a) get personal services income; (b) you do not satisfy the 'results test'[11]; and (c) you get 80% or more of your personal services income from one source, you will need to get a PSBD from the Commissioner or the alienation measure will apply to you.

The 80% or more from one source rule

87. The source of income is determined by reference to the entity that has entered into the contractual obligation with the individual or personal services entity which gives rise to the relevant amount of ordinary or statutory income that is the personal services income of the individual or personal services entity.[12]

88. In the case of an individual or personal services entity engaged by a labour hire firm (where the labour hire firm is not a personal services entity), it is the labour hire firm which is the source of the item of ordinary or statutory income as it is the labour hire firm which

[10] Treasurer's Press Release No 51 of 9 July 2001.
[11] Treasurer's Press Release No 51 of 9 July 2001.
[12] See Treasurers Press Release No 47 of 29 June 2001 in relation to agents (refer to footnote 9).

has the contractual obligation to make payment to the individual or personal services entity. The contractual obligation on the part of the service acquirer is to make payment to the labour hire firm and accordingly the service acquirer is not the source of the individual's personal services income.

89. Subsection 87-15(3) requires that the personal services business determination relating to an individual's personal services income be in force when that personal services income is gained or produced. It would be prudent for affected individuals and personal services entities to consider making an application for a personal services business determination at the commencement of the relevant income year on the basis of there being a 'reasonable expectation' that, during the income year, 80% or more of an individual's personal services income will be from one source. In any event, under subsection 87-65(2), the Commissioner can specify the day on which the PSBD or variation takes effect or took effect. The Commissioner will specify that a PSBD took effect at an earlier time in the income year where it is reasonable to do so.

90. In the case of a personal services entity, where a determination in relation to an individual's personal services income does not take effect or is not in force in a particular PAYG payment period in which the income was gained or produced, a PAYG withholding obligation may arise.

91. The Commissioner is not able to make a determination unless satisfied that the requirements in subsections 87-60(3) for individuals, and 87-65(3) for personal services entities, are met.

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

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

Requirements for a PSBD

93. For the Commissioner to grant a PSBD, you will need to be able to answer 'yes' to ONE of the following (or have unusual circumstances):

(1) Do you (or your personal services entity) pass the 'results test'?[13]

OR

(2) Do you (or your personal services entity)engage other individuals (which may include your spouse) or non-related entities to do at least 20% of the principal work for that year?

OR

(3) Do you (or your personal services entity) have an apprentice for at least half the year?

OR

(4) Are you (or your personal services entity) the sole user of business premises that are physically separate from your home or from the premises of the person for whom you are working?

OR

(5) Even if you (or your personal services entity) do not pass any of the above tests, you (or your personal services entity) can still get a PSBD if unusual circumstances exist in that year. That is, the Commissioner will grant a Determination if, but for unusual circumstances, you (or your personal services entity) could reasonably be expected to:

(a) Have been able to answer yes to any one of the above 4 questions; or

(b) Have two or more unrelated clients in the current income year (for example, where you (or your personal services entity) only commenced operations during the year and you (or your personal services entity) reasonably expected to have more clients next year, or where you (or your personal services entity) had more clients last year and you (or your personal services

[13] Currently the results test is in subsections 87-60(5) and 87-65(5), but see Treasurer's Press Release No.51 of 9 July 2001. Also, under that announcement, taxpayers will be able to seek a PSBD where they are not sure whether the alienation measure applies to them.

entity) reasonably expect to have more clients next year).

Reasonable expectation

94. Subsections 87-60(3), (4) and (5) and 87-65(3), (4) and (5) have regard to whether the relevant criteria could reasonably be expected to be met.

95. There would be a reasonable expectation if the criteria were as likely as not to be met.

Unusual circumstances

96. The term 'unusual circumstances' used in subparagraphs 87-60(3)(a)(ii) and 87-65(3)(a)(ii) refers to exceptional circumstances that are temporary, with the likelihood that the usual circumstances will resume in the short term.

97. Unusual circumstances that exist (or are likely to exist) for less than 12 months would not be regarded as having become usual circumstances, except where that time period is significant having regard to the nature of the activity.

Operation of Division 87

98. Division 87 operates to ascertain whether personal services income is income from conducting a personal services business during an income year. The tests can be applied at any stage throughout the income year based on activities that have already occurred or on the reasonable expectation that certain activities will occur or continue to occur.

99. If you have personal services income and you conduct a personal services business (either by satisfying the results test or one of the three personal services business tests, or you have a PSBD), the alienation measure does not apply to you.

100. If you have personal services income and you do not conduct a personal services business (because you do not satisfy the results test or one of the three personal services business tests and you do not have a PSBD), the alienation measure applies to you.[14]

[14] The Commissioner proposes to issue draft rulings dealing with deductions relating to personal services income (Division 85 and Subdivision 86-B) and the attribution rules (Subdivision 86-A).

The tax effect where an individual or personal services entity is conducting a personal services business

101. Where an individual or a personal services entity is conducting a personal services business (either by satisfying the results test or one of the three personal services business tests, or the individual or personal services entity has a PSBD), Divisions 85 and 86 of the ITAA 1997 and Division 13 in Schedule 1 to the TAA 1953 have no operation in relation income derived from that business.

102. It is important to note, however, that all relevant provisions in the remainder of the ITAA 1997 and those in the ITAA 1936 continue to operate[15]. This means that other provisions of the ITAA 1997 and ITAA 1936 as discussed in Income Tax Rulings such as IT 2121, IT 2330, IT 2503 and IT 2639 may still apply to cases that fall outside Part 2-42 of the ITAA 1997. For example, Part IVA of the ITAA 1936 might apply in appropriate cases. The same applies where an individual or entity has a Personal Services Business Determination (PSBD). A PSBD accepts that an individual or entity is conducting a personal services business. This does not mean that Part IVA could not apply where the dominant purpose of an arrangement was the splitting of income.

Date of effect

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

Explanations

104. The alienation measure applies only to income from personal services. Moreover, even where there is personal services income, the alienation measure does not affect individuals or other entities that conduct personal services businesses.[16] Division 87 defines the three personal services business tests and the 'results test'. If one of these tests is satisfied, there is a personal services business and, therefore, the alienation measure does not apply.

105. The object of Division 87 is to define personal services businesses in a way that ensures the measure in Part 2-42 does not

[15] See Note to section 86-10, paragraph 1.17 of the Explanatory Memorandum, and page 292 of the Ralph Report.
[16] Section 84-1.

apply to genuine businesses but applies to those situations that are merely arrangements for dealing with personal services income of individuals.[17]

The Results Test

106. The 'results test' is found in subsection 87-60(5) for an individual and in subsection 87-65(5) for a personal services entity.[18]

107. The test comprises the following three conditions, all of which must be satisfied, in order for the individual to be taken to be conducting a personal services business:

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

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

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

108. In determining whether you meet the above tests in relation to particular work, it is appropriate to have regard to the custom or practice when work of that kind is performed by an entity other than an employee.[19] The Commissioner may also have regard to the custom and practice when work of a particular kind is performed by an entity other than an employee [subsections 87-60(6) and 87-65(6)] in considering whether the 'results test' is satisfied for the purposes of making a PSBD.

109. As subsections 87-60(7) and 87-65(7) are linked to situations where the Commissioner is considering whether the individual or the personal services entity or the individual meets the 'results test', the requirements of paragraphs 87-60(3)(a) and (b) and 87-65(3)(a) and

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[17] Section 87-10.
[18] Note the Treasurer's Press Release No 51 of 9 July 2001 which announces that the Government will make the 'results test' available irrespective of whether 80% or more of their income derives from one source.
[19] Subsections 87-60(6) and 87-65(6) are drafted on the basis that it is the Commissioner that can take these matters into consideration. As the Government has announced that taxpayers can now self-assess on the basis of the 'results test' (Treasurer's Press Release No 51 of 9 July 2001), it is logical that in those circumstances taxpayers should also have regard to similar considerations.

(b)[20] do not need to be met where taxpayers self-assess on the basis of the 'results test'. Similarly, the Commissioner may make a PSBD where the 'results test' is satisfied even where the requirements of paragraphs 87-60(3)(a) and (b) and 87-65(3)(a) and (b) are not met.

110. The 'results test' is based on the traditional criteria for distinguishing independent contractors from employees. Guidance on this distinction is provided in Taxation Ruling TR 2000/14. In summary, the following factors are relevant to this distinction:

1. The contractual obligations	An independent contractor enters into a contract for a specific task or series of tasks.
2. How the work is performed.	The independent contractor maintains a high level of discretion and flexibility as to how the work is to be performed. However, the contract may contain precise terms as to materials used and methods of performance and still be one for a result.
3. Risk	An independent contractor stands to make a profit or loss on the task. They bear the commercial risk. The independent contractor bears the responsibility and liability for any poor workmanship or injury sustained in performance of the task. Often an independent contractor would carry their own insurance and indemnity policies.
4. Tools and Equipment	An independent contractor provides the assets, equipment and tools, if any, necessary for the work.
5. Hours of work and Place of Work	An independent contractor may set their own hours of work, or place of work, depending on the contract or the nature of the work.
6. Leave and other entitlements	A contract for a result usually does not contain leave provisions, or allowances.
7. Payment	Payment to an independent contractor is often based upon performance of the contract rather than being paid a hourly rate, piece rates or award rates.
8. Expenses	An independent contractor usually incurs their

[20] These requirements are that the individual or personal services entity could reasonably be expected to meet, or met, the 'employment' or 'business premises' test, or, but for unusual circumstances, could reasonably have been expected to meet, or would have met, at least one of the 3 personal services business tests ("unrelated clients", "employment" or "business premises" test); that the personal services income could reasonably be expected or was from the individual conducting activities that met these requirements.

	own expenses.
9. Appointment	An independent contractor is likely to advertise their services to the public at large, and the contract for a result is often the direct result of this activity.
10. Termination	An independent contractor is contracted to complete a set task. The payer may only terminate the contract without penalty where the worker has not fulfilled the conditions of the contract. The contract usually contains terms dealing with defaults made by either party.
11. Delegation	An independent contractor may delegate all or some of the tasks to another person, and may employ other persons.

111. While these factors are indicative of there being a results-based contract, not all of the factors need to be present for the purposes of the results test.

112. The results test is based on the tests used to distinguish independent contractors from employees. Accordingly, there is significant overlap and the totality of the relationship between the parties will be relevant to whether the contract is properly to be construed as one for the production of a result. This approach accords with paragraph 1.114 of the Explanatory Memorandum, which says:

> "An individual will not satisfy the test in paragraph 87-60(5)(a) merely because the contract states that the personal services income is for producing a result."

Personal Services Income is for producing a result

113. Sheller JA in *World Book (Australia) Pty Ltd v. FC of T* 92 ATC 4327; 23 ATR 412 at ATC 4334; ATR 420, said as follows in relation to 'the production of a given result':

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

> have any right to direct or control him in any respect whatsoever."

114. Therefore, the meaning of the phrase 'producing a result' means the performance of a service by one party for another where the first-mentioned party is free to employ his/her own means (i.e., third party labour, plant and equipment etc) to achieve the contractually specified outcome. As the cases show, the essence of the contract has to be to achieve a result and not to do work.[21]

115. The consideration often is a fixed sum on completion of the particular job as opposed to an amount paid by reference to hours worked.

116. This also accords with paragraph 1.114 of the Explanatory Memorandum where it says:

> "The individual must actually be paid on the basis of achieving a result, rather than for example, for hours worked." [22]

117. In results-based contracts, payment is often made for a negotiated contract price, as opposed to an hourly rate. For example, in *Vabu Pty Ltd v. FC of T*, the couriers were "paid a prescribed rate for the number of successful deliveries" they made and not per time period engaged.[23]

118. Similarly, in *Stevens v. Brodribb Sawmilling* (1985 – 1986) 169 CLR 16 payment was determined by reference to the volume of timber delivered, and in *Queensland Stations Pty Ltd v. FC of T* (1945) 70 CLR 539 where it was a fixed sum per head of cattle delivered. On the other hand, the payments in *Wright v. Attorney-General for the State of Tasmania and Ors* were hourly rates adjusted by a mileage allowance over certain specified mileages, and in *Humberstone v. Northern Timber Mills* payment was based on a weight-mileage basis.

119. The provision of labour for an hourly wage is to be distinguished from cases where, during performance of a result based contract, there is a variation in the contract. Such scenarios are common in the building industry. For example, a result based contract might specify only the replacement of plaster board, however, in the course of performing that contract, the tradesperson identifies the need for rotten framework to be replaced. The contract itself may cater for

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[21] Meagher JA in *World Book (Australia) Pty Ltd v FC of T* 92 ATC 4327 at p4331.
[22] However, the Commissioner recognises that there may be situations where the amount payable by a service acquirer for the result contracted for is not determined until after the work has been completed: eg 'do and charge' contracts. There may also be situations where the service acquirer may be able to negotiate a reduction in the amount payable after completion of the work by the service provider.
[23] Cf *Hollis v. Vabu Pty Ltd* [2001] HCA 44, 9 August 2001.

such circumstances, or the contract may be varied, or a supplementary contract might be negotiated to perform that work.

120. Similarly, if remuneration is payable when, and only when, the contractual conditions have been fulfilled, the remuneration is for producing a given result.[24]

121. Where there is a contract, regard should be had to its true essence[25] and the circumstances surrounding the formation of the contract may be of assistance[26] to determine the true character of the contract. Having regard to the true essence of the contract, the manner in which payment is structured will not of itself exclude genuine result based contracts. For example, there are results based contracts where the contract price is based on an estimate of the time and labour cost that is necessary to complete the task, or may even be calculated on that basis, subject to reasonable completion times.

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

122. In *Brodribb Sawmilling* the Court observed that working on one's own account [27] often involves "the provision by him of his own place of work or **of his own equipment**, the creation by him of goodwill or saleable assets in the course of his work, the payment by him from his remuneration of business expenses of any significant proportion and payment to him of remuneration without deduction for income tax." (emphasis added) [28]

123. Similarly in *Queensland Stations* the droving contractor was required to find and pay for all the men, plant, horses and rations necessary and sufficient for the task. In *Vabu Pty Limited v. FC of T*[29] the carriers supplied their own vehicles and the necessary plant and equipment (and bore the considerable expenses of providing for and maintaining those vehicles). In other words, they employed their own means to accomplish a result.[30]

124. Having regard to the custom and practice in relation to particular work there may be an expectation that a genuine

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[24] *Neale v. Atlas Products (VIC) Proprietary Limited* (1955) 94 CLR 419 at 424-425.
[25] Re Porter: *re Transport Workers Union of Australia* (1989) 34 IR 179.
[26] For example, *Readon Smith Line Ltd v. Hansen-Tangen* [1976] 1 WLR 989 at 997; *Codelfa Construction Pty Ltd v. State Rail Authority of New South Wales* (1982) 149 CLR 337 at 347-352. See also Taxation Rulings TR 2000/14 at paragraph 26.
[27] See *Australian Timber Workers Union v. Monaro Sawmills Pty Ltd* (1980) 29 ALR 322 at 329 and *FC of T v. Barrett* (1973) 129 CLR 395 at 407.
[28] *Stevens v. Brodribb Sawmilling* (1985 – 1986) 160 CLR at 36-37.
[29] 96 ATC 4898; (1996) 33 ATR 537.
[30] Rich J in *Queensland Stations Pty Ltd v. FC of T* (1945) 70 CLR 539 at 548.

independent contractor would be required to supply the plant and equipment or tools of trade necessary to perform the work. Where such an expectation exists, or where the contractual arrangements require the supply of necessary equipment or tools, such equipment or tools have to be supplied in order to meet the 'results test'.

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

126. This condition is to be considered on a substantive basis and de minimus usage of the tools or equipment of others will not of itself disqualify the taxpayer. For example, the use of the service acquirer's pen or telephone by an electrician or even the temporary use of tools (where it is more convenient to do so because, for example, the electrician's tool kit is not readily available at a particular time) would not cause this condition to be failed. In relation to the work more generally, the common practice and requirement in such a case may be that the electrician would be expected to supply and would be required, as a practical matter, to supply the necessary tools for the job.

127. There are situations where, having regard to the custom and practice of the work, or the practical circumstances and nature of the work, no plant or equipment or tools of trade are necessary to perform the work from which the individual or personal services entity produces the result. In policy and logic, a strict condition requiring the supply of tools or equipment in order for the test to be met is not apt for work of this nature, nor is it apt for an integrity measure which operates across the whole spectrum of economic activity.

128. However, the Explanatory Memorandum provides at 1.115

> "To satisfy the test in paragraph 87-60(5)(b), the individual must be able to demonstrate that he or she is required to provide all necessary plant, tools and other equipment to produce the result. If no plant and equipment or tools of trade are needed to perform the work, the condition is not satisfied."

129. Nevertheless, having regard to the words of the law and the purpose of the provision, a different interpretation is open. For

example, the individual is required to supply "the" equipment or tools "needed" to perform work. So, if no equipment or tools are needed, it is arguable that the provision will always be met in these circumstances. Also, subsections 87-60(6) and 87-65(6) allow regard to the custom or practice of individuals or entities (other than employees) "to be required to supply" the equipment or tools "needed to perform the work", "as the case requires" suggesting that equipment and tools are not required if they are not needed to perform the work. They also highlight the distinction between independent contractors and employees. This reflects the purpose of the 'results test', the object of the condition in subsections 87-60(5) and 87-65(5) being to ensure that individuals or personal service entities who claim to be independent contractors do in fact provide the necessary equipment or tools where genuine independent contractors would be expected to do so.[31]

130. Having regard to these considerations, it is considered open and appropriate to adopt an interpretation of paragraphs 87-60(5)(b) and 87-65(5)(b) which reads the test as requiring an individual or personal services entity to supply plant and equipment or tools of trade, **if any**, needed to perform the work from which the individual or personal services entity produces the result.[32] Accordingly, the Commissioner adopts that construction rather than the alternative view suggested in the Explanatory Memorandum.[33]

Liable for the cost of rectifying any defect in the work performed

131. The emphasis here is on "liability for the cost" of rectifying faulty work. That is, the key underlying consideration is whether the individual or entity is exposed to commercial risk in terms of a liability to cover the cost of rectifying defective work. This is consistent with the focus on "the chance of profit and the risk of loss"

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[31] Note also that the Treasurer's Press Release No 51 of 9 July 2001 which indicates the Government's intention that plant and equipment or tools of trade only need to be supplied "if required".

[32] Whether on the words of the legislation having regard to considerations of logic, policy and purposive intent, or having regard to these considerations to correct a drafting mistake - see *Cooper Brookes (Wollongong) Pty Ltd v. FC of T* 81 ATC 4292; (1981) 11 ATR 949; (1981) 147 CLR 297.

[33] Tax professional bodies agree with this interpretation. They argue that "where two possible interpretations are available the ruling should adopt the more beneficial, rather than the more restrictive… Perhaps an interpretation which uses the concept of the contractor providing the equipment normally used in undertaking his services would be more appropriate, and in line with the objectives of the provisions." (Joint Submission of Institute of Chartered Accountants in Australia, the Taxation Institute of Australia, CPA Australia, Taxpayers Australia Inc and the National Institute of Accountants of 18 May 2001).

as a traditional indicator that a taxpayer is an independent contractor conducting their own business.[34]

132. Paragraphs 87-60(5)(c) and 87-65(5)(c) make it a requirement of the 'results test' that the individual or entity must meet the costs associated with rectifying the defect. It is only the cost of rectification of their defective work that must be met by the individual or entity. There is no requirement that the individual or entity actually perform the work which rectifies the defect so long as they pay for it. Nor does it matter whether the relevant exposure to a liability for the cost of defective work arises before or after payment by the service acquirer or delivery of the result.

133. The existence of a term in an agreement that the individual or personal services entity is liable for the cost of rectifying any defect in the work performed would support the conclusion that liability to make good any faulty workmanship exists, particularly where the individual or personal services entity and the service acquirer are dealing with each other at arm's length. However, the term in the agreement should not be merely 'window dressing', and regard may be had to all the circumstances of the case in determining whether the relevant liability really exists.

134. The phrase 'rectifying any defect' literally means to put right any fault or imperfection. Clearly, not all work of any individual or entity is capable of rectification if that phrase is given its narrow literal meaning. It is arguable on this narrow view that if the work is not capable of rectification then the 'results test' cannot be passed.

135. The Explanatory Memorandum is more ambivalent on this point than it is in relation to equipment and tools. At paragraph 1.116 the Explanatory Memorandum provides:

> "To satisfy the test in paragraph 87-60(5)(c), the individual must actually cover the cost of rectifying defects to the work that he or she performs - not merely have a term in a contract including such an obligation."

136. The purpose of the 'results test' (and the other personal services business tests) is to distinguish genuine business undertakings from arrangements that are merely arrangements for dealing with the personal services income of individuals.[35] If the emphasis in paragraphs 87-60(5)(c) and 87-65(5)(c) is on the liability for the cost of defective work, the reference to "rectifying" any defect in the work performed may be capable of a wider meaning, particularly where the

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[34] *Ready Mixed Concrete (South East) Limited v. Minister of Pensions and National Insurance* [1968] 2 QB 497 at 526; and *Vabu Pty Limited v. FC of T* 96 ATC 4898 at 4901; (1996) 33 ATR 537 at 539.

[35] Section 87-10 and paragraph 1.14 of the Explanatory Memorandum.

'results test' is intended to cover a wide spectrum of economic activity.

137. For example, the Macquarie Dictionary definition of "rectify" includes to "remedy" which can mean "legal redress or the legal means of enforcing a right or redressing a wrong". Consequently, being liable to rectify the cost of any defect could be inclusive of a rectification achieved by the acquirer of the services pursuing a legal remedy for damages, in circumstances where the defect is incapable of physical repair.[36]

138. Consistent with the approach adopted in relation to paragraphs 87-60(5)(b) and 87-65(5)(b), there is no compelling rationale for construing paragraphs 87-60(5)(c) and 87-65(5)(c) in a narrow way.[37] The policy underlying the alienation measure, as stated in section 87-10 would support a wider interpretation. An independent contractor in a genuine business undertaking assumes the entrepreneurial risks associated with the relevant activities. This will include liability for the cost of rectifying defective work, where rectification in the narrow sense is possible, and/or would be liable to an action for damages for negligent performance of the contract, 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 individual or personal services entity is or would be liable for the relevant component of damages awarded for the faulty or defective work.[38]

139. Consistent with the approach adopted in relation to paragraphs 87-60(5)(b) and 87-65(5)(b), the wider interpretation of paragraphs 87-69(5)(c) and 87-65(5)(c), explained above, is preferred to the narrower view.

80% or more of personal services income from one source

140. Subsection 87-15(3) uses the "80% or more of an individual's personal services income during the year from the same entity (or from the same entity and that entity's associates)" benchmark as the

[36] The Joint Submission of the professional bodies supports this interpretation
[37] They should both be construed narrowly or they should both be construed more liberally.
[38] A requirement to have indemnity insurance is an indicator that the individual or personal services entity 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 results test.

criterion requiring the test individual or personal services entity to have in force a PSBD if the alienation measure is not to apply.[39]

141. The source of derivation (as distinct from the timing of derivation) is determined by reference to the contract under which the obligation to provide the services and to make the payment arises. The party who physically makes the payment is not necessarily the source of an amount of ordinary income. The party who makes the payment will be the source where they are also the party with whom the individual or personal services entity has contracted. This means that, where payment is made by an agent on behalf of their principal, the source of the item of ordinary income is the principal and not the agent. This is because the individual or personal services entity has contracted with the principal and it is the principal which is ultimately obligated to make the payment.[40]

Example 1

142. Bob is a mining engineer who enters into discrete contracts for the provision of his personal services with 3 joint venture partners (Pebble Ltd, Rock Ltd and Boulder Ltd). On completing each of his contracts, Bob invoices the relevant company for payment. Pebble Ltd, Rock Ltd and Boulder Ltd have an agreement between themselves whereby Pebble Ltd makes payment on all invoices received by any venture partner in relation to joint venture activities. Rock Ltd and Boulder Ltd reimburse Pebble Ltd for payments made on their behalf. In each case, the source of Bob's personal services income is the company which has been invoiced. This is because in each case it is the company with which Bob has contracted and who he will need to pursue in the event of non-payment.

Example 2

143. Dr Paul is a medical practitioner operating in private practice who returns his income on a 'accruals basis'. When Dr Paul sees a patient, the patient is either invoiced or bulk billed. Those who are invoiced may make payment entirely from their own funds and then seek a Medicare refund or may make payment partly out of their own funds and partly by way of cheque from Medicare. Those who are bulk billed complete the appropriate forms and make payment for their consultation by assigning their Medicare refund entitlement to

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[39] The legislative changes announced by the Government in the Treasurer's Press Release No 51 of 9 July 2001 will allow independent contractors who satisfy the 'results test' to self-assess on the basis of that test (without needing a PSBD) even where 80% or more of the income is from the same entity.

[40] However see the Treasurer's Press Release No 47 of 29 June 2001 in relation to agents (refer to footnote 9).

Dr Paul in accordance with the relevant provisions of the Health Insurance Act.

144. In all these cases Dr Paul has contractual relations with each of his patients. The terms of the contract are that Dr Paul will provide a medical consultation in return for an agreed payment. In each case, the patient discharges their obligation to Dr Paul albeit in different ways and it is the performance of this discharge which causes Dr Paul's personal services income to be derived. The source of Dr Paul's personal services income is each of his patients as these are the parties with whom he has contracted and who are obligated to make payment.

Example 3

145. Don is a solicitor in sole practice. Don engages Donna Pty Ltd to invoice clients in his name and collect payments on his behalf. Don pays Donna Pty Ltd a commission for those services. The source of Don's personal services income is each of Don's clients and not Donna. This is because Don has contracted with each of his clients to provide services and it is his clients who Don must pursue in the event of non-payment. Donna Pty Ltd is merely acting as Don's agent in invoicing and collecting payments on Don's behalf.

None of the clients pays you 80% or more of the personal services income

146. Where none of the clients of an individual or personal services entity pays the individual or personal services entity 80% or more of the personal services income, the individual or personal services entity conducts a personal services business (and, therefore, is outside the scope of the alienation measure) if ONE of the 3 personal services business tests are met.[41]

147. The 3 personal services business tests are:

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

(b) the employment test under section 87-25;

(c) the business premises test under section 87-30.

[41] The legislative change announced by the Government in the Treasurer's Press Release No 51 of 9 July 2001 means that there will in practical effect be 4 personal services business tests, but the 'results test' is covered separately in this ruling.

The Unrelated Clients Test

During the year

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

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

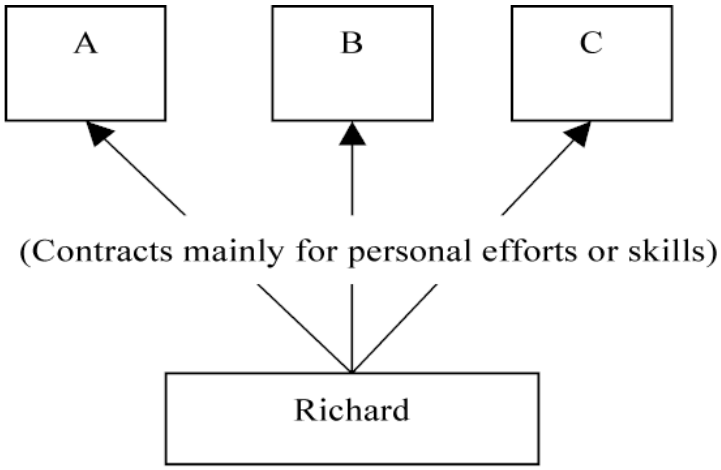
Gains or produces income from providing services to 2 or more entities[42]

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

150. In cases where the personal services income is the ordinary or statutory income of the individual, it is the 'entities' with whom the individual has contracted to provide services, and which gives rise to the ordinary or statutory income that is the individual's personal services income, that is contemplated in paragraph 87-20(1)(a) in terms of the phrase, 'providing services to 2 or more entities'.

[42] See Treasurer's Press Release No.41 of 29 June 2001.

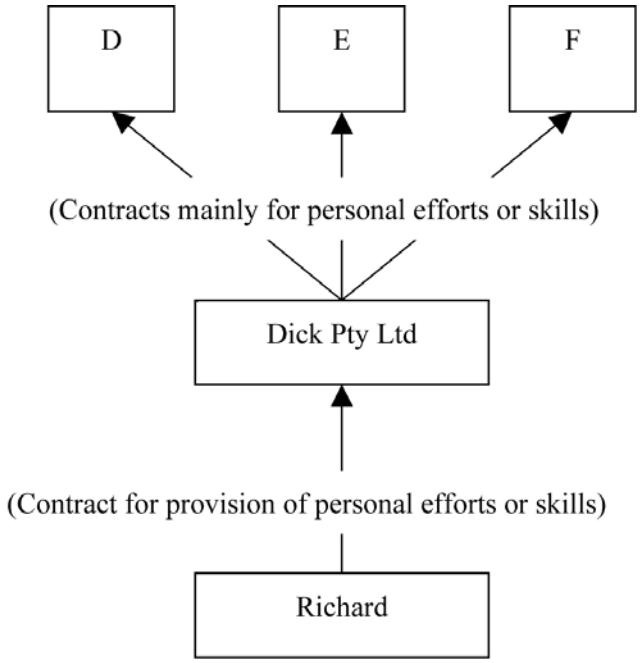
Example 4



151. In this example, Richard has contracted to 3 clients 'A', 'B' and 'C' for the provision of his personal efforts and skills and the consideration under each contract is the personal services income of Richard. Assuming that 'A', 'B' and 'C' are not associates of each other or of Richard, Richard would satisfy the requirements of paragraph 87-20(1)(a). The reference to 'entities' in the phrase "providing services to 2 or more entities", is a reference to each of 'A', 'B' and 'C'.

152. In cases where the personal services income is the ordinary or statutory income of a personal services entity, it is the 'entities' with whom the personal services entity has contracted to provide services, and which gives rise to the ordinary or statutory income of the personal services entity that is an individual's personal services income, which is contemplated in paragraph 87-20(1)(a) in terms of the phrase 'providing services to 2 or more entities'.

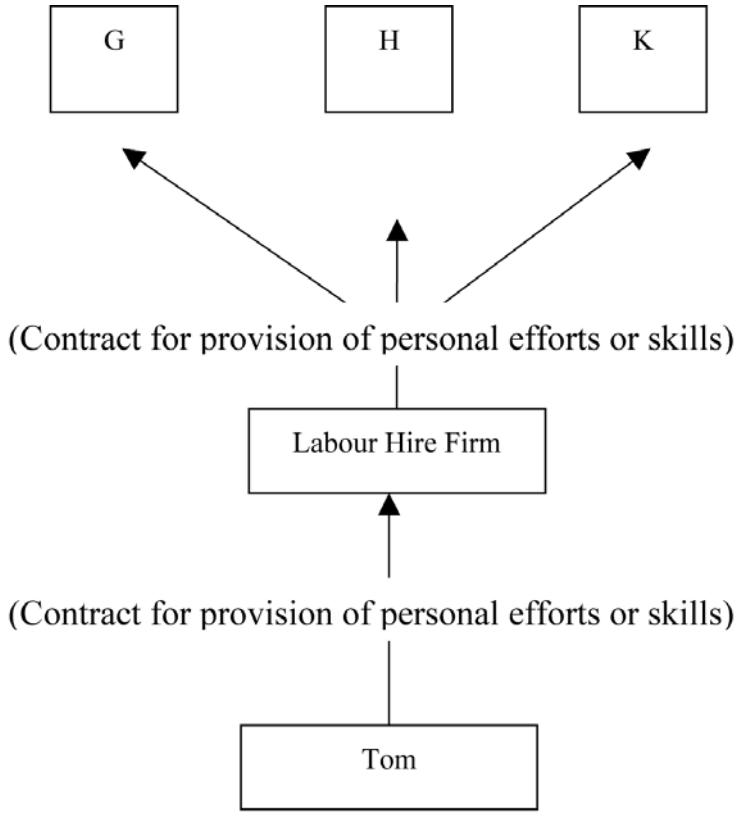
Example 5



153. In this example, Dick Pty Ltd has contracted with 3 clients 'D', 'E' and 'F' to provide the personal efforts and skills of an individual and Richard has contracted with Dick Pty Ltd to provide the personal efforts and skills which enables Dick Pty Ltd to fulfil its contractual obligations with each of 'D', 'E' and 'F'. Dick Pty Ltd is a personal services entity because it has ordinary income which is mainly a reward for the personal efforts or skills of Richard. Assuming that 'D', 'E' and 'F' are not associates of each other or of Richard or Dick Pty Ltd, Dick Pty Ltd would satisfy the requirements of paragraph 87-20(1)(a). Again, the reference to 'entities' in the phrase "providing services to 2 or more entities" is a reference to each of 'D', 'E' and 'F'.

154. In cases where the individual or personal services entity has contracted with a labour hire firm, and the labour hire firm is not a personal services entity, it is the clients of the labour hire firm to which the word, 'entities' is a reference in paragraph 87-20(1)(a).

Example 6



155. In this example, the labour hire firm (a business structure) has contracted with 3 clients 'G', 'H' and 'K' to provide the personal efforts and skills of an individual. Tom has contracted with the labour hire firm to provide his personal efforts and skills and his labour is utilised to fulfil the labour hire firm's contractual obligations with each of 'G', 'H' and 'K'.

156. The consideration on the contract between the labour hire firm and Tom is Tom's personal services income. Assuming 'G', 'H' and 'K' are not associates of each other or of Tom, then Tom satisfies the requirements of paragraph 87-20(1)(a). However, Tom does not satisfy the requirements of paragraph 87-20(1)(b) because of the operation of subsection 87-20(2) which has particular application to labour hire firms: see further discussion below under the heading, "What is 'a business of arranging for persons to provide services'".

Associates

157. Whether two entities or individuals are 'associated' within the meaning of section 318 of the ITAA 1936 is a matter of fact. However, for the purposes of section 87-20, where the fact of that association is not known or could not reasonably be expected to be

known to a contractor, the clients will be treated as unrelated. This approach is taken because of arm's length nature of the contractual arrangements contemplated by the unrelated clients test, and the (unintended) compliance costs associated with a strict literal construction of the word associate.

158. The statutory context, the (unintended) compliance costs and uncertainty that would otherwise arise for genuine independent contractors in the application of the unrelated clients test provides good cause, whether in law or practice, to read a purposive limitation into the requirement that the clients must not be associates.[43]

159. For example, where a contractor works for two apparently unrelated companies during the year with different names, different business premises and different managers, but both of which are, in fact, controlled by a third company or another individual, the contractor could still pass the unrelated clients test if the contractor did not know, or could not reasonably be expected to know, of the fact of common control.

Direct result

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

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

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

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

162. Taken together, the comments in *Dixon's* case and those in the *Boiler Inspection and Insurance Co.* case, provide guidance on the term 'direct result'. In short, it requires a traceable and substantive connection between the offer to the public (or a section of the public) and the engagement for the work.

What is meant by 'making offers or invitations'?

163. For the purposes of paragraph 87-20(1)(b), making an offer or invitation to the public in general or to a section of the public is an

[43] However, as "associates" is an asterixed term, there is a strong alternative view.

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

164. As the meaning of the phrase 'making offers or invitations' is not given in the ITAA 1997, for the purposes of the unrelated clients test the meaning is based on the ordinary usage of the terms and may include a wide variety of activities, including word of mouth attempts to attract general business.

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

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

167. Advertising is an example of making an offer or invitation to the public given in the legislation. The ordinary meaning of the word 'advertise' is 'to make generally or publicly known, or to give public notice of' (*Deputy Commissioner of Taxation v Rotary Offset Press Pty Ltd* 71 ATC 4170; (1971) 45 ALJR 518; 1971) 2 ATR 411). Advertising may be effected by providing information to the public, by the making of public announcements, by publications in periodicals or professional journals, by printed posters, by broadcasting over the radio, television, Internet etc, or by placing an advertisement in a newspaper, magazine, or business directory.

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

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

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

169. An offer or invitation is made to 'the public at large' where any interested member of the public is capable of accepting it (*Lee v. Evans* (1964) 112 CLR 276 at 287).

170. An offer or invitation to 'a section of the public' is made in situations where only a select group is chosen to whom the invitation is made. Making an offer or invitation to a 'section of the public' could include offering to provide services to one entity (*Nash v. Lynde* [1929] AC 158; *Corporate Affairs Commission* (*South Australia) & Anor v. Australian Central Credit Union* (1985) 3 ACLC 792), for example in relation to competitive tenders.

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

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

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

- The number of persons or entities to which the offer or invitation is made. While not determinative, it is likely to be a public offer or invitation if more entities are involved;
- 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 an individual or personal services entity may have worked for/provided services to an entity sometime in the past does not necessarily operate to exclude the individuals or personal services entity from satisfying this test.

173. The question of whether providing services, as a result of a tender, is rendering services to the public was considered in *Behmer & Wright Pty Ltd v. Commissioner of State Revenue (Vic)* 94 ATC 2067; (1994) 28 ATR 1082. Section 3C(1)(e)(v) of the *Pay-roll Tax Act 1971* (Vic) exempts payments made under a contract for services where those services are rendered by a person who 'ordinarily renders services of that kind to the public generally'. The contractor in this case undertook a small number of relatively large contracts and was one of a few contractors selected to tender to carry out specific carpentry work for the applicant. While the contractor had previous contracts with the applicant, he was considered to be genuinely independent of the applicant because the tendering process was competitive, other parties were invited to tender for the contracts, the applicant was not the only significant client of the contractor, and the successful tenderer was chosen on commercial grounds. Such a public tender process would satisfy the requirements of subsection 87-20(2).

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

174. The operation of paragraph 87-20(1)(b) is subject to subsection 87-20(2) which provides that an offer or invitation is not made by an individual or personal services entity who is merely available to provide services through an entity that conducts a business of arranging for persons to provide services to its clients. As a consequence of this provision, individuals or personal services entities who obtain clients merely through registration with employment agencies, labour hire firms, personnel agencies or any arrangement involving an entity hiring the services of a individual or personal services entity in a manner similar to that of a labour hire firm, are taken not to have made an offer or invitation to provide services to the public at large or to a section of the public.

175. This is to be contrasted with the situation where an individual or personal services entity makes offers or invitations to the public at large (e.g., by newspaper advertisement) as well as registering with a labour hire firm. The test would be met in this case if two or more

unrelated clients engaged the individual or personal services entity as a result of the advertisement.

Employment test

Engages

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

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

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

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

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

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

Who can be 'engaged'?

178. Paragraph 87-25(1)(a) and sub-paragraph 87-25(2)(a)(ii) state that individuals and personal services entities cannot engage associated entities, other than individuals, as a means of passing the employment test. This excludes any company, partnership or trust that would be considered an associate of the individual or personal

services entity under section 318 of the ITAA 1936.[44] Related individuals (e.g., a spouse of the relevant individual) are able to be taken into account for the purpose of satisfying the employment test. However, the test requires the person or entity engaged to perform 20% (by market value) of the principal work.

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

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

Partnerships

180. In *Ellis v. Joseph Ellis & Co.* [1905] 1 KB 324 it was concluded that a partnership cannot legally employ a partner and that a partner cannot be an employee of the other partners because the individual cannot be both master and servant. Even though 'engages' is a more neutral term than employment, the ordinary meaning of 'engages' connotes the action taken by one entity to contract with another entity to perform work. Accordingly, it is considered that individual partners in a partnership are not engaged by that partnership for the purposes of the employment test.

Principal work

181. Principal work can be described as that work that is central to meeting the individual's obligations under agreements between the individual or a personal services entity and the acquirer of the services. It is work that produces a given result or outcome and which generates the personal services income of the relevant individual.

182. The term 'principal work' refers to the work that an individual or a personal services entity is required to perform to meet the key contractual obligations to the service acquirer and for which the individual or personal services entity is paid. It is the work that

[44] The context of section 87-25 does not require any limitation to the exclusion of associates from the employment test.

directly gains or produces personal services income, and as such would often be specifically required under a contract.

183. The nature of the activity being undertaken may be such that the principal work to be carried out may not be the sole activity required or done in the course of undertaking the work. The aim of using the adjective 'principal' in the legislation is to exclude work that is not (in a commercial sense) integral to the fulfilment of the contractual obligation from consideration of the relevant work for the purposes of Part 2-42 of the ITAA 1997. In other words it is not integral to the work that generates the income.

184. Activities such as clerical or administrative work that do not have the relevant connection with the generation of the personal services income do not form part of the principal work from which personal services income is derived.

Example 7

185. Glenn is a house builder. He contracts with a major company to build houses using an industry standard form contract which provides for progressive payment claims, allowances for Prime Cost items, and Provisional Sums for work which may be needed but cannot be ascertained until construction commences. He engages contractors at arm's length, but they do not perform 20% of the principal work during the income year.

186. While Glenn does the physical building work, his wife Nan performs the task 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.[45]

187. 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. However, there are situations where the provision of clerical or administrative activities is the principal work required under a contract: for example, see *Wells v. FC of T* 2000 ATC 2077; (2000) 45 ATR 1145 where it was a requirement of the arrangement between Mr Wells and the Bank of Melbourne that, in order to earn the commission on a loan

[45] It has been argued that the work undertaken by Glenn's wife in this example should be regarded as principal work. The Commissioner does not accept that argument. However, in this example, Glenn would be able to satisfy the 'results' test, and therefore there is no need to consider the employment test.

application, he would provide to the bank a fully detailed and set out loan application, including all documentation, so that the bank was presented with a file of documents in the form required by the bank and set up as required by the bank. Solicitors charged a fee of $300 if the documentation had to be retyped because of errors.[46]

20% (by market value)

188. The market value of the principal work will depend on the nature and components of the principal work. The payment by a service acquirer will, in an arm's length dealing, reflect the total value of all the principal work to be performed under the contract. However, different components of this principal work performed by the entity (or entities) engaged may have different market values.

189. In an arm's length dealing, the market value of all the principal work is the total of the payments made by a service acquirer to the individual or personal services entity (i.e., the contract price)).

190. The market value of the work performed by the entity or entities engaged by an individual or personal services entity is what the individual or personal services entity would charge the service acquirer on an arm's length basis for the principal work performed by the entity (or entities) engaged (i.e., the 'charge-out' rate). This is consistent with the approach adopted in relation to the market value of 'all the principal work' discussed above.

191. For example, where a bricklayer contracts with a service acquirer to lay bricks and engages a labourer to cart the bricks and mix the mortar etc, the market value of the work performed by the labourer is what the bricklayer would charge the service acquirer on an arm's length basis for the work performed by the labourer. This amount would normally exceed the amount the bricklayer actually pays to the labourer because it would include recoupment of the 'on costs' relating to engagement of the labourer as well as a profit margin to the bricklayer.

192. Therefore, in cases where the contractor and the entity (or entities) engaged are dealing with each other at arm's length and the amount actually paid to the entity (or entities) engaged for the performance of principal work is greater than 20% of the contract price, the amount actually paid is sufficient to establish that the employment test is passed. In such cases, it is unnecessary to consider what the individual or personal services entity would have charged the service acquirer for the principal work performed by the entity (or entities) engaged.

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[46] It should be noted that the decision in *Wells* was not in relation to the distinction between principal work and other work. It relates only to the deductibility of an expense and its nexus to the derivation of assessable income.

193. It is only in cases where the parties are not dealing with each other on an arm's length basis, or the amount actually paid to the entity (or entities) engaged for the performance of principal work is less than 20% of the contract price, that one might want to consider what would have been charged to the service acquirer on an arm's length basis.[47]

194. In cases where it is necessary to determine what the individual or personal services entity would have charged the service acquirer on an arm's length basis, and the entity (or entities) engaged is a natural person, a suitable proxy for that amount would be what a labour hire firm would charge to provide the labour of the natural person(s). This is because the amount charged by a labour hire firm incorporates not only the cost of labour but also the 'on costs' of employment and the profit margin to the labour hire firm. This is broadly consistent with what the individual or personal services entity would charge the service acquirer (i.e., the remuneration of the natural person for performing the principal work, an amount to cover the 'on costs' of employment and a profit margin), and provides an acceptable arm's length benchmark.

195. In cases where multiple entities are engaged by the individual or personal services entity to perform principal work, and each entity performs different types of tasks, the market value of these tasks may vary depending on the level or types of skills required and the market remuneration for those particular skills. That is, the market would charge the service acquirer different amounts for the discrete principal work components performed by each entity engaged.

196. This is demonstrated in the case of a personal services entity which contracts with a service acquirer for performance of work which requires a combination of conventional bricklaying, tuck pointing and general site labour (and the personal services entity engages separate entities to perform each type of work). The majority of the work is standard bricklaying and this would have a particular market value. However, tuck pointing is usually remunerated higher than conventional bricklaying and general labour lower in the market place.

197. While these considerations of different market values for different components of the principal work may be relevant in marginal cases, it will usually be a relatively simple task to determine whether 20% or more of the value of the principal work is done by others.

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[47] Where, the individual or personal services entity is able to pass one of the other tests (i.e., the unrelated client, or business premises, or 'results' test) then there would be no need to consider the employment test.

198. In relation to this and the other tests, a reasonable and commercial approach based on the substance of the arrangements is what is required.

Apprentice

199. The employment test is satisfied if, for at least half the income year, the individual or entity has one or more apprentices. The legislation uses the word "apprentices".

200. The meaning of apprenticeship is discussed in Halsbury's Laws of Australia as follows:

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

201. Similar guidance on the meaning of 'apprentice' is provided by Halsbury's Laws of England (4th ed):

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

202. In determining whether persons engaged in non-regulated contracts satisfy the common law meaning of apprentice the critical considerations are the teaching and learning aspects of the arrangement, together with other attributes such as a 'period of the learning' so as to become 'qualified' in a particular industry, trade or vocation.

203. An apprentice need not be apprenticed to the contractor. A series of apprentices supplied by a Group Apprenticeship Scheme to work for the contractor as part of their trade training would meet the requirement.

Business premises test

Maintain and use

204. The Explanatory Memorandum at paragraph 1.97 provides:

> "this means that the individual or entity must do more than merely have leased premises in its name to pass the test. The premises should actually be used to produce the personal services income."

205. The Macquarie Dictionary definition of the word 'maintain' includes:

> "1. to keep in existence or continuance; preserve; retain."

206. The context in which the word 'maintained' is used merely requires that the individual or personal services entity keeps in existence or continuance, preserves or retains the business premises. An individual or personal services entity may satisfy this requirement by occupying business premises by way of ownership, lease, licence or possession (but see discussion on 'exclusive use' at paragraphs 221-230). There is no requirement that the individual or personal services entity bear running costs associated with the premises such as cleaning or utility costs.

At all times in the income year

207. The requirement that the individual or personal services entity have business premises at all times in the income year is aimed at ensuring there are business premises at all times during which activities are conducted to produce the individual's personal services income. The business premises test is not aimed at discriminating against cases where activities are commenced or ceased in the income year or in cases where the activities are conducted on a part-time basis, even though the wording of the legislation is open to a more restrictive interpretation.

208. Nevertheless, the meaning of 'income year' is to be determined by reference to the context in which the phrase is used in the particular provision. Having regard to the context of the alienation measure, a purposive interpretation of the phrase 'at all times in the income year' is adopted because it avoids the anomalous result referred to above that would arise under the alternative view.

Business premises at which the individual or entity mainly conducts activities producing personal services income

209. The use of the word 'mainly' means the generation of personal services income must be the primary usage to which the business premises are put. More than 50% of the activities conducted at the business premises by the individual or entity must be directed at producing personal services income.

Example 8

210. Byte Pty Ltd contracts with Net Pty Ltd to provide information technology 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. Byte Pty Ltd does not "mainly" conduct, at those premises, activities that gain or produce personal services income. The premises are mainly used for the purposes of the retail sale activities.

Example 9

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

Premises

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

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

213. The meaning of 'premises' is variable. For example, in *Frost v. Caslon; Frost v. Wilkins* [1929] 2 KB 138 it was given a wide meaning to cover "any kind of structure or building (or part thereof) capable of being occupied.

214. For the purposes of the business premises test in subsection 87-30(1) there is no reason to limit the ambit of the word 'premises'

provided they are 'business premises' as explained below. Accordingly, premises may merely comprise land, merely buildings or both.

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

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

216. Even on this wide and practical view of premises a caravan situated in a public place under licence may be a 'premise' in the relevant sense, but a car (for example of a travelling salesman) would not.

Business Premises

217. The requirement in paragraph 87-30(1)(a) is that the individual or personal services entity has 'business premises' at which the individual or entity conducts income earning activities.[48]

218. The inclusion of paragraph 87-30(1)(a) suggests that the adjective 'business' adds more to the word 'premises' than just the notion of a place where business is carried on.[49] Rather, to give it meaning in the context of section 87-30 which includes paragraph 87-30(1)(a), it is arguable that it describes premises which have the usual physical attributes and fixtures associated with commercial or business usage.

219. A broader construction which does not draw such a stark distinction between business premises and residential premises is also open for the meaning of 'business premises'. For example, it is arguable that 'business premises' refers to premises from which a

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[48] The Explanatory Memorandum provides at 1.98:
"The business premises must be used mainly by the individual or entity to conduct activities producing personal services income. This means that the individual or entity must do more than merely have leased premises in its name to pass the test. The premises should actually be used to produce the personal services income". *[Schedule 1, item 3, paragraph 87-30(1)(a)]*.

[49] The operation of the word 'business' on the word 'premises' in the context of section 87-30 of the ITAA 1997, could be compared with the operation of the word 'business' in relation to the word 'profits' in the different context discussed by the High Court in *Thiel v Federal Commissioner of Taxation* (1990) ATC 4717; (1990) 21 ATR 531; (1990) 171 CLR 338. In that case the High Court held the phrase 'business profits' did not mean profits from carrying on a business.

business is conducted.[50] Drawing a distinction between business premises and premises used for private purposes lends some support to this broader construction. In any event, the requirements of the business premises test in subsection 87-30(1) would, in many cases, produce a similar result under either interpretation. As Example 1.14 of the Explanatory Memorandum shows, the use of Rose's brother's garden shed does not satisfy the business premises test:

> "Rose leases the shed in her brother's back garden from which to conduct her business. As the shed is part of the premises used by Rose's brother for private purposes, Rose does not meet the business premises test."

220. The Commissioner takes the view that the critical distinction between business premises and other premises is that, viewed from a business and commercial perspective, business premises must be apt for carrying on a business. This character of business premises is relevant in considering whether the conditions in paragraphs 87-30(1)(a) to (d) are satisfied. Paragraph 87-30(1)(a) requires that the individual or entity mainly conducts activities at those business premises from which personal services income is gained or produced.

Exclusive use of business premises

221. The Macquarie Dictionary defines 'exclusive' as:

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

222. Where premises are occupied under ownership or lease, the legal nature of the proprietary interest allows the holder to determine

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[50] See *Burt v. Commissioner of Taxation* (1912) 15 CLR 469 at 475, where Griffith CJ said at page 475:
"A good definition of 'business premises' may be taken from the New Zealand case which has been cited to us, where one learned Judge said it meant land or buildings or land and buildings used for the actual purposes of business."
However, the emphasis there was on the meaning of premises rather than business premises, the Court concluding that in relation to business premises there is no fixed area to begin with (for example, in the case of a laundry, the drying ground is part of the business premises). *Esso Australia Limited v. FC of T* 98 ATC 4953; (1998) 40 ATR 76 also considered the term 'business premises' but the term 'business purposes' was specifically defined in subsection 136 of the *Fringe Benefits Tax Assessment Act 1986* (FBT Act) to mean 'premises, or part of the premises used, in whole or in part for the purpose of business operations'. In that case Merkel J found that the Commissioner in Taxation Ruling TR 96/27 correctly adopted a broad view of the meaning of 'business operations' for the purpose of the definition of 'business premises' in s 136(1) of the FBT Act. However, as 'business premises' are a defined term for the purposes of s 136(1) of the FBT Act, the case is not directly relevant to the interpretation of 'business premises' in subsection 87-30 of the ITAA 1997.

who may or may not enter upon the premises. An individual or personal services entity who occupies their premises under ownership or lease may ensure others do not use the premises and, therefore, have exclusive use in the relevant sense.

223. In the case of joint lessees, neither lessee has exclusive use of the premises.[51] This is confirmed by paragraph 1.99 of the Explanatory Memorandum which provides as follows:

> "The individual or entity must also have exclusive use of the premises. This means that the individual or entity cannot lease premises together with another individual or entity on the basis that they share the premises."

224. Occupancy by way of ownership or lease is to be contrasted with occupancy by way of licence or possession. With each of the latter, the individual or personal services entity does not have a proprietary interest in the land which allows the individual or personal services entity to ensure that others may not use the premises.[52]

225. The rights attaching to a licence were discussed by the High court in *Radaich v. Smith* (1959) 33 ALJR 214. A relevant extract from the judgment of Windeyer J at 218 is as follows:

> "What then is the fundamental right which a tenant has which distinguishes his position from that of a licensee. It is an interest in land as distinct from a personal permission to enter the land and use it for some stipulated purpose or purposes. And how is it to be ascertained whether such an interest in land has been given? By seeing whether the grantee was given *a legal right of exclusive possession* … A right of exclusive possession is secured by the right of a lessee to maintain ejectment, and after his entry, trespass."

226. The salient point in the present context is that an individual or personal services entity cannot have exclusive use of premises if they do not have exclusive possession of those premises.[53] If an owner of premises grants permission for an individual or personal services entity to occupy premises on such terms that the agreement amounts to a licence and not a lease, the owner may also use the premises as he/she sees fit and as such the individual or personal services entity

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[51] In *Esso Australia Limited v FC of T* 98 ATC 4953; (1998) 40 ATR 76 one of the issues was whether the premises were those "of" an employer. Merkel J held that there was no requirement that Esso's possession in that case had to be 'exclusive' for the purposes of s 136(1) and s 47(2) of the FBT Act. However, subsection 87-30(1)(b) of the 1997 Act specifically requires that the individual or entity maintains and uses business premises 'of which the individual or entity has exclusive use'.

[52] For example, the use of a site shed on a building site would not satisfy the requirement for 'exclusive use'.

[53] We do not agree with the alternative argument that it is not necessary to have exclusive possession in order to satisfy the exclusive use requirement.

cannot be said to have exclusive use of the premises. What the individual or personal services entity has is exclusive use of the premises against all parties except for the owner.[54]

227. On the basis of the comments in *Burt v. Commissioner of Taxation* (see footnote 50 above), it is arguable that reception areas and waiting rooms are part of the business premises. However, the context of the alienation measure focuses on those principal activities that generate the personal services income. Having regard to this focus, areas such as reception and waiting rooms are ancillary to the business premises which the individual or entity has exclusive use of for the generation of the relevant personal services income. The nature of the contractual lease or proprietary arrangements dealing with shared services are different from those applying to those areas where the taxpayer has exclusive possession. A distinction can, therefore, be made between shared facilities and the relevant business premises. Accordingly, and consistent with modern commercial and business practices, it is considered that facilities of this kind are not the relevant business premises referred to in section 87-30.

Example 10

228. 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 have exclusive use of the room. In order to have exclusive use, Dale would need to lease the room from Hill Pty Ltd.

Example 11

229. Norm is a draftsman who leases an office from Morn Pty Ltd. Norm's office is adjacent to a suite of offices occupied by other professionals. Each occupant also jointly leases a shared reception/waiting area from Morn Pty Ltd. Norm has exclusive use of the relevant premises for the purposes of section 87-30 of the ITAA 1997 because he has a discrete lease over his office and all or substantially all of the principal work is carried out in the office.

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

[54] An alternative construction might be to read 'exclusive use' as referring to exclusive use in practice. However, there is little contextual support for this view.

Physically separate

231. The Macquarie Dictionary defines 'separate', in the relevant sense, as 'being or standing apart; cut off from access: separate houses'. Similarly, the New Shorter Oxford English Dictionary defines it as:

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

232. Neither the Macquarie or Oxford Dictionaries give a definition of the word 'physically' which may be applied in the relevant sense.

233. Example 1.14 of the Explanatory Memorandum (see paragraph 219 above) gives guidance on the requirement that the business premises have to be physically separate from any premises used for private purposes of the individual, the personal services entity or an associate of the individual or entity.

234. In this example even though the garden shed is detached from the building structure which comprises the brother's residence, it is not physically separate because the physical impression of the property is that the shed forms part of the dwelling and curtilage which comprises the brother's private residence. The entire property has the visual impression of being a private residence (as distinct from business premises).

235. Where business premises are incorporated into a dwelling employed for private purposes by the individual or an associate, the physical impression of the dwelling and curtilage does not usually allow for any division of the property into two parts. This accords with the ordinary notion that one thing which is incorporated into another, does not usually constitute two physically separate things.

236. A distinction may be made in the case of conjoint buildings such as in *Truscott v. Repatriation Commission*, AAT (Veteran's Appeals Division) W96/51, 1997. In these cases, there is legal and physical division of the structure into two parts. That is, conjoint buildings are usually on separate title and have a dividing wall which prevents internal access between premises. Such buildings also have discrete access and often have further physical divisions such as fencing. In these type of cases it is valid to conclude that one conjoined half is not incorporated into the other and, therefore, that each is physically separate from the other.

237. Similarly, if, for example, premises apt for the conduct of a business are located in one part of a corner block and that part has its own entry and egress from the road and is blocked off from a separate private dwelling of the individual or personal services entity on the same block of land by a fence with no entry or egress between the two, then the business premises would be regarded as being physically separate from premises that are used for private purposes. In this

instance, the physical impression enables the land to be divided into two parts, the first being the dwelling with curtilage employed for private purposes and the second being the building premises and curtilage employed for business purposes. In these circumstances, the physical impression is that the business premises are not within the private premises of the individual or an associate, and are, therefore, physically separate.

238. An example of business premises that are not physically separate from the premises of the entity (or associate) to which the individual or entity provides personal services is covered in the Explanatory Memorandum (Example 15):

> "Rose provides personal services, through her personal services entity, to BOR Pty Ltd. Rose leases a room at BOR's premises from which to conduct her business. Rose does not meet the business premises test, as her business premises are not physically separate from the entity that she is providing services to."

239. The reference to 'premises' in paragraph 87-30(1)(d) is taken as a reference to premises at which the service acquirer or an associate of the service acquirer conducts their business activities. A narrow interpretation might otherwise have disqualified an individual or personal services entity from satisfying the business premises test merely because the service acquirer or an associate owned the commercial property.

240. The position where premises are within a high rise building follows along similar lines to the approach taken for private premises. For example, where an individual or personal services entity operates from a room within the premises of the service acquirer, the premises are incorporated both physically and functionally into the premises of the service acquirer and, therefore, the entire floor space has the physical impression of being that of the service acquirer's premises. The room of the individual or personal services entity is, therefore, not physically separate from the premises of the service acquirer.

241. Where an individual or personal services entity leases a discrete floor or part of a floor in a high rise building from the service acquirer, and another floor is occupied by the service acquirer, the question of physical separation needs to be looked at on an objective basis having regard to the extent to which the floors or parts of floors are functionally and physically integrated with each other, entry and egress facilities, and other indicators of physical separation such as signage and security arrangements. In addition, the occupancy rights are likely to be different and would provide for exclusive possession albeit that this is more relevant to the 'exclusive use' requirement.

Changing business premises

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

Personal Services Business Determination

243. Subsection 87-15(3) provides if 80% or more of the personal services income of an individual during the income year is from one source, [55] the individual's personal services income is not from conducting a personal services business unless, when the income is gained or produced, a personal services business determination is in force relating to the individual's personal services income.

244. The Commissioner may make a personal services business determination relating to an individual's personal services income if he is satisfied about a number of matters set out in section 87-60 (for individuals) or 87-65 (for personal services entities). If the Commissioner is satisfied that an individual or a personal services entity met or could reasonably be expected to meet either the employment test or the business premises test or both, a determination may be made.[56]

245. The Commissioner may also make a determination in those cases in which he is satisfied that, but for unusual circumstances applying to the individual or to the personal services entity, the individual or the entity would have met or could reasonably have been expected to meet at least one of the three personal services business tests set out in subsection 87-15(2).[57]

246. The use of the word 'may' often grants a power to a person which would otherwise not be available. Whether this is the case should be discerned from the purpose of the provision and the overall intent of the relevant Act: see *Finance Facilities Pty Ltd v. FC of T* (1971) 127 CLR 106, where Windeyer J cites from *Macdougall v.*

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[55] The Government has announced that even where 80% or more of the personal services income comes from the same entities taxpayers can self assess as a personal services business where they pass the 'results test' (i.e., "where they derive income from producing a result, where they supply their plant and equipment or tools of trade (if required), and where they are liable for rectification. These are traditional tests for independent contractors": Treasurer's Press Release No 51 of 9 July 2001

[56] Note that the 'unrelated clients test' is not able to be used for this purpose, but it may be relevant where there are unusual circumstances.

[57] The 3 personal services business tests are the unrelated clients; employment and business premises tests.

Paterson (1851) 11 CB 755 the proposition that the word 'may', when used of a person having an official position:

> "is a word of permission, an authority to do something which otherwise he could not lawfully do. The authority must be exercised, if the circumstances are as such to call for its exercise."

247. Having regard to the specific criteria which the Commissioner must have regard to in considering an application for a PSBD, where an individual or personal services entity applies for a PSBD and the Commissioner is satisfied that the requirements for the making of a PSBD have been met, the Commissioner will make a determination.

248. A personal services business determination only remains in force for the period specified in the Notice of Personal Services Business Determination and for the period in which the conditions specified in the Notice remain satisfied. The Commissioner may also revoke or vary a PSBD where material facts relevant to the issue of the personal services business determination are varied or altered (see sections 87-60 and 87-65). This means a PSBD may come to an end in one of two ways and a formal revocation is not required in cases where the conditions specified in the Notice cease to be satisfied.

249. It is also important to note that a PSBD is limited in its consideration to the criteria specified in Part 2-42. Accordingly, it does not preclude the application of Part IVA in appropriate cases (see paragraphs 261 – 267 below).

Reasonable expectation

250. In *News Corporation Ltd v. National Companies and Securities Commission* (1984) 57 ALR 550; (1984) 5 FCR 88 at ALR 561; FCR 101, Woodward J said:

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

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

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

Unusual circumstances

253. The Macquarie Dictionary defines 'unusual' as 'not usual, common, or ordinary; uncommon in amount or degree; of an exceptional kind.' In *Re Beadle v. Director-General of Social Security* (1984) 6 ALD 1 the Tribunal said (at page 3):

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

254. Similarly in *Re Z* (1970) 15 FLR 420 at 421, Joske J commented that '"exceptional" and "unusual" have much the same meaning'. He then held, following *Martin v. Martin* [1941] NI 1 at 14, that 'exceptional' meant simply 'out of the ordinary' and thus concluded that "the legislation enables the judge to exercise his discretion in a case which appears to him to be 'out of the ordinary'"; and in *Re S.G.* (1968) 11 FLR 326 at 328, Blackburn J. held that:

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

255. Subsections 87-60(4) and 87-65(4) of the ITAA 1997 provide two examples of 'unusual circumstances' in the context of the unrelated clients test:

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

When unusual circumstances become usual circumstances

256. Subparagraph 87-60(3)(a)(ii) and subparagraph 87-65(3)(a)(ii) refer to unusual circumstances applying to the individual or to the personal services entity in the income year during which the determination first has effect. Situations may arise where circumstances that might be considered to be unusual in an income year become the normal or usual. An example may be where an individual, who normally enters into monthly contracts with clients, enters into a 12 month contract with one client. At the conclusion of

that contract, the contract is rolled over for a further period of 12 month with the possibility of further rollovers. It is considered that, whilst the first 12 months contract may give rise to unusual circumstances in the relevant income year, the subsequent rollover of that contract may result in the circumstances ceasing to be unusual.

257. The legislative benchmark requires the change in circumstances to be temporary and unusual, 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.

Further Grounds

258. Further grounds for determination set out in subsections 87-60(5) and 87-65(5) are referred to in this Ruling as the 'results test', which is explained in paragraphs 106-139 above.[58]

Applying the tests in Division 87

259. The tests in Division 87 (i.e., the 3 personal services business tests and the 'results test') operate to ascertain whether, during the income year, that individual's personal services income is income from conducting a personal services business. The tests can be applied at any stage throughout the income year based on activities that have already occurred or on the reasonable expectation that certain activities will occur or continue to occur. In these circumstances, where the relevant tests are satisfied, the individual or the personal services entity can be considered to be conducting a personal services business for the whole of the income year. The Commissioner may make a determination in these circumstances that takes effect as from 1 July in the relevant income year.

Example 12

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

[58] The Government has announced that it will amend the law so that paragraphs 87-60(5)(d) and 87-65(5)(d) can be disregarded: Treasurer's Press Release No 51 of 9 July 2001

Application of Part IVA to Independent Contractors

261. The application of a general anti-avoidance provision, such as Part IVA, is more likely where the income derived under the contract is predominantly from the provision of an individual's personal services. This is because the courts and tribunals have often disallowed arrangements which have as their dominant purpose the alienation of personal services income. Income Tax Rulings IT 2121, IT 2330 and IT 2639 explain the factors that are relevant to this issue.

262. The question whether a particular situation is one where the income of an independent contractor, whether carried on as a sole trader or through an interposed entity, is in reality produced predominantly from the personal services of an individual or in reality from income producing assets of the entity or the entity's business structure is subject to the factual circumstances of the case. Taxation Ruling TR 2001/7 outlines the factors that are relevant.

263. Assessable income is generated from a very wide spectrum of activities, ranging from income derived solely as a result of the taxpayers personal skill and effort to income derived solely from the use or sale of assets, or from a business structure. The courts have not articulated a clear dividing line between personal service income and income from property (assets) or from a business structure, other than that the more substantial the assets (and investment) the more likely that they are to be the main generators of the income. Where only an asset exists (and there is no other indicator of a business structure), the contribution of the asset has to be balanced against the skills and effort of the relevant individual to determine the main source of the income.

264. The ATO will not seek to apply Part IVA to make adjustments in cases where the nature of the equipment and other factors, relative to the skills and efforts of the individual, do not clearly indicate that the income is generated predominantly from the personal activities of the independent contractor, rather than from the use or the sale of property or from a business structure. However, the ATO will seek to do so where other factors clearly indicate that the dominant purpose of the arrangement is income splitting.[59]

265. An example of a situation where there may be income splitting to which Part IVA could apply would be where an independent contractor, who conducts his or her business through an interposed entity, is paid substantially less than the market value for his or her work, and the profit made by the entity as a result of paying less than a market value salary is distributed to those of 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. Take for example a taxpayer

[59] See Income Tax Rulings IT 2121, IT 2330 and IT 2639.

who was deriving wages of $600 per week for driving a truck, and then enters into an arrangement through his personal company with his former employer under which he is paid $1000 per week, but has to provide his own truck. If the taxpayer's personal company paid the taxpayer less that the market value of his service (e.g., paid only $100 per week, rather than $600) then the arrangement could be subject to challenge. This would be particularly the case if the company distributed to the taxpayer's wife and children, by way of dividend, the profit made as a consequence of the low salary paid to the taxpayer, or if the profits were retained by the interposed company.

266. Relevant factors in determining whether Part IVA applies include the following.

(a) The interposed entity derives income from sources other than from the services provided by an individual who controls, or is associated with that entity, that is, the service provider. This may be the case for example where the interposed entity employs other individuals at arm's length to provide services or labour to the other contracting party (the service acquirer). Similarly, the interposed entity may have substantial assets, or a substantial business structure, which are used in the production of assessable income. However, equipment of a minor nature, for example, the drawing board of an architect, or the personal computer of a computer programmer, or the tool kit of a tradesperson will not usually be regarded as sufficient on its own to characterise the income as being other than mainly from the efforts or skills of an individual. Similarly, the extent to which the interposed entity deals with and provides its services to the public at large or is limited to contracting with one party is also a relevant consideration.

(b) The expenses claimed by the interposed entity may demonstrate the existence of a business operation or structure. For example, if the interposed entity operates from rented premises, employs others to provide services, and/or uses raw materials or stock as part of the income producing activity, then this points to there being a business structure in existence.

(c) The services provided may be unique to the taxpayer in that the services are of a type which cannot be provided by any other person, or alternatively, the contract with the interposed entity may stipulate who is to provide the services, such that the 'force of attraction' in generating the income is the individual providing the services

rather than the assets or goodwill of the interposed entity.[60]

(d) Whether the interposed entity is, at law, unable to provide the services to the service requirer (where, for example, the law prevents incorporation of particular types of practices).

267. As previously stated another possible relevant consideration, independent of the factors outlined above, is the extent, if any, of income splitting activities. In deciding whether there is income splitting some or all of the following considerations are relevant.

(a) Whether the salary or wages paid to the service provider is commensurate with the skills exercised or services provided and with the income received by the interposed entity for those services.

(b) The interposed entity distributes income only to the service provider and the arrangement has been implemented only for the purpose of providing additional superannuation benefits for the service provider (in these circumstances Part IVA will generally not apply, see IT 2503).

(c) The interposed entity distributes income to family members or an associated person of the service provider, and/or does not distribute any income to the employee who provided the actual services.

(d) In a "Friday night / Monday morning"[61] situation the profits of the interposed entity are accumulated.

(e) Whether there has been a substantial change in the activities which the individual performed prior to incorporation or any other significant external indicators that the arrangements have changed.

Further Examples

Example 13

268. The Jones Trucking Company (the 'Company') enters into contracts, not being contracts of employment, with a single arm's length third party to transport goods within the Sydney metropolitan area. The third party insists on contracting with a company, rather than a sole trader. The main assets of the company are a truck and the contract with the third party. Mr Jones is the only employee of the

[60] See for example *Egan v. F C of T* (2000) 47 ATR 1180.
[61] See for example *Tupicoff v. F C of T* 84 ATC 4851.

company, and drives the truck. The Company's name is prominently displayed on the truck.[62]

269. On balance it would be reasonable to conclude that the income of the company is predominantly derived from the use of the truck in the company's freight business.

270. Mr Jones is paid a market value salary by the Company. The payment of a market value salary is one indication that income splitting is not the purpose of the arrangement. The small amount of profit remaining after paying all the operating expenses of the company, including Mr Jones' salary and income tax, is retained in the company for the purpose of replacing the truck when it wears out. Mr and Mrs Jones each own half the shares in the Company and are the two directors.

271. Having regard to all the circumstance of the case the most reasonable expectation is that in the absence of the scheme the trucking business would still have been conducted by a corporate entity, as this was a requirement of the arm's length third party. Given that Mr Jones is already paid a market value salary it also seems reasonable to expect that the company, but for the scheme, would have continued to retain the small profit for re-investment. Consequently, Part IVA would not apply.

Example 14

272. JB, a computer systems analyst, was employed by XYZ Pty Ltd until the end of the 2001 financial year at a remuneration of $80,000. Due to reorganisation and cost-cutting, XYZ Pty Ltd changes its management and employee arrangements.

273. As part of the changes, JB is told that he will cease as an employee. Instead the company would be prepared to use his services from 1 July 2001 through a company structure.

274. JB seeks advice from a solicitor and sets up a family trust; JB Pty Ltd, as trustee, and his wife and three children as beneficiaries. JB Pty Ltd enters into an agreement with XYZ Pty Ltd to provide computing services, which are substantially the same as JB had previously performed as an employee. The understanding is that JB will personally provide these services.

275. XYZ Pty Ltd pays JB Pty Ltd a total fee of $100,000 for computer services provided to it by JB. JB Pty Ltd pays JB a salary of $38,000 and claims deductions amounting to $24,000. Just before 30 June 2002, JB Pty Ltd distributes the remaining $38,000 - $36,000 to JB's wife and $400 to each child. No income is distributed to JB.

[62] Similarly see *Humberstone v. Northern Timber Mills* (1949) 79 CLR 389.

276. In this case, the Commissioner would regard the distribution made to the wife and children, as being part of an income splitting arrangement to which Part IVA applies.

Example 15

277. A general practitioner incorporates her practice to enable her to access improved superannuation benefits. She sets up a company, which employs her.

278. All income received by the company is paid to the doctor in salary, except a superannuation contribution and management fees to a service trust (which meets the requirements of *Federal Commissioner of Taxation v. Phillips 78 ATC 4361* and Income Tax Ruling IT 25).

279. The Commissioner has accepted this type of arrangement in Income Tax Ruling IT 2503.

Example 16: Courier Drivers[63]

280. Courier Co engages individuals under written agreements to collect and deliver goods and other items. Courier Co receives orders at a central location. CC then arranges for one of its individual couriers to collect the goods or items and deliver them to their intended destination. The couriers engaged by CC are required to use their own vans (to a specified level in terms of size, type, age and fit-out). A courier is paid a prescribed rate for each successful delivery. A term of the contract between CC and each individual courier requires the individual to indemnify CC for any damage or loss for which CC is liable as a result of the failure by the individual to deliver the goods or items by a specified time or any loss or damage to the goods or items as a result of the negligence of the individual. If goods are delivered to the wrong address, the courier own/driver is required at their own cost to correct the mistake, by collecting the parcel and delivering it to the correct address. While there is no requirement that the van has to be driven by a particular driver, each of the individual couriers is engaged exclusively by CC and, therefore,

[63] It is recognised that the form of legal entity used by couriers may vary; that there is flexibility in relation to the basis of payment (including the payment of a minimum hourly rate for idle time, or the use of incentive rates), the ability of a courier to delegate the work to be performed, and in determining the hours worked. It is also recognised that payment for performance-based contracts can be calculated by reference to hourly rates, piece rates, award rates, or on the basis of deliveries made. In concluding that bicycle couriers are employees the High Court in *Hollis v. Vabu Pty Ltd* said that 'a different conclusion might be appropriate where the investment in capital equipment was more significant.' The High Court in *Hollis v. Vabu Pty Ltd* did not overturn the Full Federal Court decision in *Vabu Pty Ltd v. FCT* regarding the independent contractor status of owner/driver couriers.

receives 80% or more of their personal services income from the same entity.

281. Is an individual receiving personal services income for producing a result?

282. The courier enters into a contract for a specific series of tasks (i.e., delivery of the packages). The contract provides that the courier is entitled to be paid a fixed amount for each particular delivery. The individual does not receive any payment if the goods or items are not in fact successfully delivered to their intended destination. The courier works to achieve the result (collection and delivery of goods etc.) in terms of the contract and is working on his/her own account. This aspect of the test would be satisfied in this case.

283. Is the individual required to supply the plant and equipment or tools of trade needed to perform the work from which the individual produces the result?

284. In this case, each individual courier is required to provide their own van (as specified). The courier is providing the plant and equipment necessary to do the work, as would be expected from an independent contractor doing this kind of work. This aspect of the test would be satisfied in this case.

285. Is the individual liable, or would the individual be liable, for the cost of rectifying any defect in the work performed?

286. The individual courier is liable to indemnify CC for any damage or loss sustained by CC as a result of delay or negligence attributable to the individual courier, and/or has to rectify mistakes at their own costs. This aspect of the test would be satisfied in this case.

287. In this example, the individual courier bears the commercial and entrepreneurial risk - he/she supplies substantial assets that are required and are essential and apt to perform the work, takes the chance of making a profit and takes the risk of making a loss in the carriage of goods or items for the principal contractor, Courier Co, and is liable for the cost of defective work. An individual owner/driver courier in these circumstances is not subject to the alienation measure.

Example 17: IT Worker

288. 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 works for a maximum number of hours per day (e.g., 8 hours). The contract specifies an hourly or daily rate payable in respect of the work undertaken by the individual. Tasks performed by the individual are at the request of and the manner of performance of the work is subject to the direction of departmental officers. The

individual uses the plant and equipment provided by the department for carrying out the tasks required. 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.

289. Consultant Co is a personal services entity because its income includes the personal services income of the individual who does the work.

290. Is the income of a personal services entity that is the personal services income of an individual income for producing a result?

291. The contract specifies an hourly or daily rate for the performance of work required. The department is required to pay that rate to the entity for each hour or day worked by the individual, irrespective of the work being performed by the individual. The entity is not contracted to produce a specific outcome or result. This aspect of the test would not be satisfied in this case.

292. Is the personal services entity required to supply the plant and equipment or tools of trade needed to perform the work from which the entity produces the result?

293. The custom and practice for independent contractors in relation to undertaking work under this type of arrangement is that the department provides the equipment needed to perform the work, including access to office facilities. If the entity is not required to provide the assets and equipment needed to perform the work, having regard to custom and practice when work of that kind is performed by an entity other than an employee, then this aspect of the test would be satisfied.

294. Is the personal services entity liable, or would the entity be liable, for the cost of rectifying any defect in the work performed?

295. The department is entitled to terminate the contract if the performance of the individual is unsatisfactory, but the personal services entity does not have any responsibility or liability to rectify any faulty work done by the individual. If the individual is requested to remedy defects in the work performed, the time taken to complete that rectification would be subject to payment at the hourly or daily rate specified in the contract. This aspect of the test would not be satisfied in this case.

296. In this example, the personal services entity is not contracted to produce a result, nor is there exposure to any commercial risk - the entity is entitled to payment for each hour or day the individual works for the department, with no risk of making a loss as a result of undertaking the work. Nor is the worker liable for the cost of defective work, such as the cost of rectifying that work. An entity

engaged in these circumstances is not an independent contractor for the purposes of the personal services income legislation.

Example 18: IT Independent Contractor

297. 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. The individual maintains a high level of discretion and flexibility as to how the work is to be performed. 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 his/her business premises. If the final product does not satisfy the functional specifications, the contract requires the work to be rectified.

298. Consultant Co is a personal services entity because its income includes the personal services income of the individual who does the work.

299. Is the income of a personal services entity that is the personal services income of an individual income for producing a result?

300. The contract is for the performance of a specific task that produces an outcome or result, with the individual maintaining a high level of discretion and flexibility as to how the work is to be performed. A fixed amount is to be paid upon completion of the work. Payment is not made until the work is performed, although instalments are payable upon the achievement of particular milestones. The contract requires the product to be prepared in accordance with functional specifications. If the product delivered by the individual does not meet the specifications, the individual is required to undertake further work without additional payment. This aspect of the test would be satisfied in this case.

301. Is the personal services entity required to supply the plant and equipment or tools of trade needed to perform the work from which the entity produces the result?

302. In this case, relevant assets and equipment required to perform the work are provided by the entity. The need to access the department's IT system by using their equipment is incidental to the development of the product and does not cause the entity to fail this

requirement. Even if the task requires a result to be produced (e.g., development of a software program, or devising a fix for a software problem) that could only be done using the department's equipment and/or mainframe, if there is no requirement under the contract for the entity to provide the assets and equipment needed to perform the work, or there is no expectation, having regard to custom and practice when work of that kind is performed by an entity other than an employee, this aspect of the test would be satisfied.

303. Is the personal services entity liable, or would the entity be liable, for the cost of rectifying any defect in the work performed?

304. The contract requires the entity to produce a product that complies with the functional specifications of the department. The department would also be able to seek a remedy in damages if the entity fails to deliver the product in accordance with those specifications. The department would not be liable to pay for any additional work required by the entity to rectify any defects in the product. This aspect of the test would be satisfied in this case.

305. In this example, the personal services entity is contracted to produce a result and is exposed to the commercial risk – where necessary, the entity provides the assets to enable the individual to perform the work, takes the chance of making a profit and takes the risk of making a loss in the performance of the contract, including liability for the cost of rectifying defective work. An entity engaged in these circumstances is not subject to the alienation measure.

Example 19: Civil Engineer

306. Mick is a civil engineer and operates through his company, Mick Smith Pty Ltd. In June 1997, 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 1998 and June 2000. The contract stipulates that Mick is to perform the work and Mick actually performs all the principal work under the contract. During the course of each contract, Mick is assigned responsibility for overseeing various projects. 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.

307. The fee specified in the contract is a fixed fee of $210,000. The fee is calculated on a time basis of 2800 hours (40 hours per week for 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.

308. 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, that is performed 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.

309. Is the income of a personal services entity that is the personal services income of an individual for producing a result?

310. Although payment is fixed prior to the contract being undertaken, the payment of the amount is not contingent on a result being produced. Mick is paid fortnightly for hours worked and Mick must work on projects that are assigned to him by the department. Mick may cease working on a project before the project is completed to start work on another project. This aspect of the results test would not be satisfied.

311. Is the personal services entity required to supply the plant and equipment or tools of trade need to perform the work from which the entity produces the result?

312. It is the custom or practice that the department (and other departments who engage engineers) provide the necessary equipment, including access to office facilities, needed by non-employee engineers contracted to perform this sort of work. As a result this aspect of the test is satisfied.

313. Is the personal services entity liable, or would be liable, for the cost of rectifying any defect in the work performed?

314. Mick Smith Pty Ltd is not liable for the cost of rectifying any defect in the work performed by Mick and thus this aspect of the test is not met.

Example 20: Building Industry - Independent Contractor

315. Joe installs air conditioning ducts. Joe offers his services to the public. Joe 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. Joe is not subject to the control of the person who engages him (over and above the degree of control specified in the contract) and Joe has the say as to how the work is to be performed. Joe assumes the risk of not being able to complete the work to specification or for defective work, (e.g., Joe has to rectify any defective work at his own cost). Joe brings the tools required to do the work (e.g., hammer, tin-snips, dolly, hacksaw, electric drill, pop-rivet gun, ladder etc). Joe sets his own hours of work. The

contract does not provide for annual leave, long service leave, sick leave and other benefits or allowances. Joe incurs his own expenses for duct tape, glue, pop-rivets, nuts and bolts, drill bits etc. Joe satisfied the results test because he is contracted to produce a result, i.e., he is paid upon installation of ducts, he brings his own tools to do the work, and he is liable for rectifying defects.

Example 21: Unrelated Clients Test

316. Kevin is an engineer. He was an employee of Mud Mining Pty Ltd until last year when his employment contract was terminated and at the instigation of Mud Mining he entered into a contract for the provision of his engineering services. Kevin also produces income from providing services to his brother's company, Lost Exploration Pty Ltd (an associate of Mud Mining Pty Ltd). Kevin regularly places an advertisement in a mining industry periodical. As a result of his advertising activities Kevin provides services to two unrelated entities, Pebbles Pty Ltd and GemCo Pty Ltd, neither of which is an associate of Kevin, or of each other, or either Mud Mining or Lost Exploration Pty Ltd. Less than 80% of Kevin's income is from each source.

317. Kevin's contract with Mud Mining was not as a direct result of making an offer or invitation to the public, but rather a result of Mud Mining changing the working arrangements (paragraph 87-20(1)(b) is not satisfied in this regard). Gaining income from providing services to Lost Exploration Pty Ltd does not satisfy paragraph 87-20(1)(a) because Lost Exploration would be considered an associate of Kevin.

318. Kevin meets the requirements of the unrelated clients test because Pebbles Pty Ltd and GemCo Pty Ltd are unrelated clients obtained as a direct result of Kevin making offers to the public. Therefore, the alienation measure does not apply to Kevin.

Example 22: Labour Hire Arrangements

319. Ian is a geologist who derives 70% of his personal services income from Rock Pty Ltd. Ian entered into a contract with Rock Pty Ltd as the result of advertising to the public at large. 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.

320. Due to the operation of subsection 87-20(2), Ian's registration with the labour hire firm is not treated as making an offer or invitation to provide services and therefore paragraph 87-20(1)(b) is not satisfied. Ian does not meet the requirements of the unrelated clients test 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 23: Principal Work

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

Example 24: Market Value

322. Jack is a contract engineer who contracts with Big Mining Co. to provide his services. He is paid a daily rate of $480.00 for his services. He occasionally hires Tom, who is not his associate, to assist him in his engineering work and pays Tom a daily rate of $160.00. The arm's length rate Jack would charge Big Mining Co for the work performed by Tom is $180.00 a day. Tom works a total of 200 days for Jack during the year of income. Jack's contract lasts for the whole year. He worked for 250 days during the year. The market value of Jack's work for Big Mining Co. for the whole year is $120,000 (250 days x $480) of which $36,000 (200 days x $180.00) is gained or produced from the work that Tom does.

323. The market value of Tom's work for Jack is $36,000 (200 days x $180). This represents 30% of the total value of the principal work required to fulfil Jack's contract. As this is more than 20% (by market value) of the principal work, Jack meets the employment test.

Example 25: Market Value

324. Jodie is a draftsperson who contracts with Big House Pty Ltd for the provision of drafting services. Jodie engages her spouse Ian, who is also a draftsperson, to correct errors and make any variations to plans that are required by the clients. Ian performs principal work that is to be performed under the contract for a total of 5 hours per week.

Ian performs a total 240 hours work for Jodie. Jodie derives $70,000 from the performance of principal work that is the object of the contract. Jodie's hourly rate is approximately $40 per hour and this is the same rate Jodie would charge Big House Pty Ltd on an arm's length basis for Ian's labour. Jodie pays Ian $32,000 per year. The market value of the work performed by Ian is $9,600 calculated as follows: 240 hours x $40.

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

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

325. Jodie does not meet the requirements of the employment test as Ian performs less than 20%, by market value, of Jodie's principal work.

Detailed contents list

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Related Rulings/Determinations:

TR 92/1; TR 92/20; TR 97/16; TR 2000/14; IT 2121; IT 2330; IT 2503; IT 2639

Subject references:

- alienation of personal services income
- apprentice
- associate
- business of arranging for persons to provide services
- business premises
- business premises test
- direct result
- employment test
- engages
- exclusive use
- market value
- offers or invitations to the public
- partnerships
- personal services business
- personal services entity
- personal services income
- physically separate
- principal work
- PSBD 80% test
- PSBD criteria
- PSBD normal circumstances business premises test
- PSBD normal circumstances employment test
- PSBD normal circumstances unrelated clients test
- PSBD unusual circumstances business premises test
- PSBD unusual circumstances employment test
- PSBD unusual circumstances unrelated clients test
- public or a section of the public
- reasonable expectation
- service acquirer
- test individual
- unrelated clients test
- unusual circumstances

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