Tax Summary

The guide to Australian Tax

2019-20
Acknowledgements

A Tax & Super Australia publication.

Brought to you by your trusted and experienced team at Tax & Super Australia.

External contributors:

Ken Mansell
Ken works part-time for the Australian and Solomon Island governments on tax policy and provides tax and super education for several organisations. He worked on the secretariat of the Henry Review and for the Assistant Treasurer as a tax advisor. Ken has also worked in the tax division for KPMG and Deloitte, as a tax trainer and specialist for the Institute of Chartered Accountants in Australia and as head of tax for the Seven Network Limited group and Raytheon Australia. He has worked as a legal researcher in commercial and academic roles.

Josh McMullen
Josh is a qualified lawyer who, for the past 15 years, has written nation-wide tax and bookkeeping publications for tax practitioners and business owners. He also provides subscribers of these publications with complex tax advice in response to specific tax questions they have. In this capacity, he has advised the High Court of Australia, and Woolworths Group Ltd among other high profile subscribers.

Kirk Wilson
Kirk Wilson has over 25 years of taxation experience in the ATO and the private sector. He specialises in capital gains tax (and is a registered tax agent for that purpose). He holds an Arts Law degree from Sydney University and is admitted as solicitor of the Supreme Court of NSW. He also passed the NSW Barristers Exams in 2013. He has been writing on CGT issues for many years and is a co-author of a specialist text on the subject.

Betty Wu
Betty is a qualified Chartered Accountant with 10 years’ experience within medium to mid-tiered sized chartered environment. She completed her Diploma of Financial Planning (RG 146 compliant) in 2016 and is an authorised representative of a limited Australian Financial Services (AFS) licensee. As a manager at BDO Sydney, Betty specialises in SMSF accounting, tax and compliance, and she is qualified to provide personal advice to SMSF members and trustees.

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About Tax & Super Australia

Our tax and super landscape is constantly changing.

**Tax & Super Australia** has the agility and expertise to provide you with accurate Australian tax guidance through all its ongoing complexities.

**Our mission is to educate and empower tax and superannuation professionals.**

Formerly known as Taxpayers Australia Ltd, **Tax & Super Australia** is a not-for-profit organisation that has been assisting tax and superannuation professionals for 100 years. It was established in 1919 by a group of Melbourne businessmen who believed in a simple, fairer tax system. Since then, we have evolved and remain at the forefront of supporting professionals.

With a long and proven track record, we provide relevant and easy-to-understand guidance on all areas of tax, empowering our members to better service their clients. Our highly skilled and credentialed team of experts ensure every piece of information is authoritative and accurate, so when you become a member, you have the peace of mind that your clients are fully compliant with all their obligations.

**Tax & Super Australia** represents its members’ views through the media, the Australian Taxation Office and the government. As an advocate for professionals, we support today’s practitioners so they can thrive tomorrow.

**Tax & Super Australia**
Level 13, 303 Collins Street, Melbourne, Victoria 3000
www.taxandsuperaustralia.com.au
info@taxandsuperaustralia.com.au
Phone: (03) 8851 4555
Preface to the 100th edition

It is with great pride Tax & Super Australia presents the 100th edition of the Tax Summary.

Being 100 years old, the Tax Summary is Australia’s oldest continuing tax publication. Born just after the First World War, the Tax Summary has informed the Australian public and tax professionals about the Australian Taxation System through its significant developments over the past century. Over its long life, the Tax Summary has been the “go to” publication for thousands of people seeking to understand the complexities of Australian taxation laws.

It is appropriate that Tax & Super Australia, at this time, thanks its thousands of members over the last century for their ongoing support. Tax & Super Australia is a member-based organisation, and without the support of our members, there would be no Tax Summary.

This publication provides a concise and practical summary, in plain English, of tax and superannuation laws operating within Australia. Filled with tips and examples, it covers most areas of taxation. It includes 2018-19 updates and also incorporates changes applying in the 2019-20 income year.

Members of Tax & Super Australia receive the Tax Summary and the SMSF Manual, in both print and digital format. These comprehensive manuals are complemented by our new bi-monthly journal “Outlook”, which provides interesting and in-depth articles on taxation and superannuation issues of relevance to our members.

Taxation laws and interpretation are constantly changing. In a publication of this size, it is impossible to refer to every change or possible change. The team at Tax & Super Australia seek to provide in this edition of the Tax Summary all of the important taxation changes and proposed changes as at 30 June 2019.

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The personal services income regime taxes individual contractors on a similar basis as employees where income is derived mainly from the individual's own skills, expertise or the provision of personal services. The measures also apply to companies, trusts and partnerships where income is derived by the entity primarily as a result of an individual's personal efforts or skills. These provisions are contained in Divisions 84 to 87 ITAA97.

All legislative references relate to the ITAA97 unless otherwise specified.

The Personal Services Income (PSI) rules restrict:

- the availability of tax deductions to affected individuals over and above deductions ordinarily available to employees providing the same or similar services, and
- the alienation of PSI through an interposed entity to utilise lower tax rates through entities or related parties, by treating the relevant income as income earned by the individual from the provision of their personal services. The individual is taxed on the attributed income at his or her marginal rates.

The provisions apply where the individual or interposed entity is deemed to be earning PSI. However, where the relevant individual or entity can meet one of a number of carve-out tests, the normal tax position of the taxpayer will be unaffected. That is, the PSI rules will have no adverse application.

Those caught by the PSI rules are specifically excluded from being treated as employees for any other purposes under Australian law (s84-10). However, PAYG withholding obligations are imposed on any interposed entity which is subject to the rules (see 16.500).

The flowchart following sets out in simple terms how the PSI rules operate.

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### Flowchart: Personal Services Income

1. **Personal services income**
   - Does the taxpayer receive income that is mainly a reward for personal efforts or skills of an individual? *(see 16.100)*

2. **Results test**
   - Does the taxpayer meet all of the conditions of the results test? *(see 16.205)*

3. **The 80% rule**
   - Does 80% or more of the individual’s personal services income in an income year come from one client? *(see 16.210)*

4. **Other tests**
   - Does the taxpayer satisfy one or more of the following tests?
     - the unrelated clients test (see 16.215), or
     - the employment test (see 16.225), or
     - the business premises test (see 16.230)

5. **The personal services income legislation applies**
   - to deny deductions or attribute income to the individual unless the taxpayer obtains a personal services business determination *(see 16.240)*.

6. **The taxpayer may apply**
   - to the Tax Office for a personal services business determination to confirm that the personal services income legislation does not apply to them *(see 16.240)*.

7. **The personal services income legislation does not apply**
   - to deny deductions or attribute income to the individual. The general anti-avoidance measures in Part IVA may still apply *(see 16.600)*.
Generally, the PSI rules will not affect those individuals or interposed entities that qualify as a personal services business (PSB) – see 16.200. PSBs comprise the following:

- individuals (or interposed entities) that contract on a results basis (see 16.205)
- individuals (or interposed entities) that derive less than 80% of their PSI from a single source and satisfy one of the following tests:
  - the unrelated clients test (see 16.215)
  - the employment test (see 16.225), or
  - the business premises test (see 16.230), or
- individuals or interposed entities that obtain a personal services business determination (PSB determination) from the ATO (see 16.240).

**NOTE:** Where income is earned by an entity and one or more of the personal service business tests is passed, the general anti-avoidance provisions contained in Part IVA ITAA36 may still be applied to the use of the entity to derive the income (see 16.600).

### 16.100 Personal services income

Ordinary or statutory income will be treated as PSI if it is mainly a reward for a person’s personal efforts or skills. Where the income is derived by an entity other than a person, the test requires an examination of whether the income would mainly be a reward for that person’s personal efforts or skills had it been derived directly by the individual.

Subsection 84-5(1) states:

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

In TR 2001/7 the ATO at paragraph 25 provides its interpretation of “mainly”:

*Implicit in the use of the word “mainly” is that more than half of the relevant amount of the ordinary or statutory income is a reward for the personal efforts or skills of an individual.*

Whether an amount of income is mainly a reward for an individual’s personal efforts or skills is a question of fact.

Income derived from the use of an asset cannot be PSI. However, according to Taxation Ruling TR 2001/7, income derived from the provision of personal services involving the use of some equipment may nevertheless be PSI. Where the substance of an agreement is the provision by an individual of his or her personal efforts or the exercise of his or her skills, or the production of a result from those efforts or skills, income would be regarded as PSI.

Income that is derived mainly for the sale and supply of goods or for granting a right to use property is not PSI.

Income derived as a result of a business structure is also not PSI. TR 2001/7 states that when determining whether income is mainly a reward for the personal efforts or skills of an individual or from a business structure, consideration should be given to the relative values of the efforts or skills of the individual and other inputs, such as the efforts of other workers, and the use of plant and equipment, intellectual or other property and goodwill.

Factors relevant to making this determination include:

- the nature of the activities being conducted that generate the income
- the extent to which the amounts paid under an agreement (whether directly to an individual or to an interposed entity) is primarily for the personal efforts or skills of a particular individual
- the extent to which the contract price has been calculated having regard to the costs to be borne by an individual or entity in providing assets to use in the performance of contractual obligations
- the market price of using any equipment, plant or tools as compared with the market price of hiring the relevant labour or skills for the same period
- the nature, size and significance of the assets used by the individual or entity in relation to the activity
16.105 Personal services entity

- the value of the asset in relation to the total income generated under the agreement
- the uniqueness and degree to which an asset is specialised in the performance of a particular function
- the uniqueness, level of skill or degree of specialisation of an individual to provide the particular services contracted
- whether the payments made to an individual or a entity is for the transfer of the ownership or a right in respect of items produced by the individual or entity
- the existence of goodwill
- the existence of substantial income-producing assets
- the size of the business operation, and
- the contribution of other workers to the income-earning activities.

The Full Federal Court held in Russell v FCT (2011) 79 ATR 315 that the PSI rules applied to the personal services income of an Australian resident derived from a New Zealand company (a non-resident). The Court also held that no double taxation arose under the Australia-New Zealand double tax agreement as the PSI was effectively excluded from the New Zealand company’s taxable income because it was a deduction from assessable income.

The ATO holds the view that medical practices, which have at least as many non-principal practitioners as principal practitioners, are deriving income from the business structure (IT 2639). Principal practitioner here refers to a professional or non-professional staff member who derives material fees for the practice and owns or shares in the ownership of the practice, whether directly or indirectly.

A payment received by a personal services entity from a service acquirer during a period when the services are not actually provided until further called upon is personal services income (TD 2015/1).

**EXAMPLES**

A taxpayer owns one semi trailer and he is the only person who drives it. The income derived from driving the truck is not PSI because it is mainly produced by the use of the truck and not mainly as a reward for the personal services of the taxpayer.

A taxpayer provides a computer programming service but she does all of the work involved in providing those services and uses the client’s equipment and software to do the work. The income derived would be treated as PSI as it is a reward for her personal efforts or skills.

A taxpayer works as an accountant with a large accounting firm. None of the firm’s ordinary or statutory income is PSI because it is produced mainly by the firm’s structure and not mainly for his personal efforts or skills.

**16.105 Personal services entity**

A company, partnership or trust that derives PSI is a Personal Services Entity (PSE). Generally, a PSE would exist where the entity derives income from the end client or customer and the work is performed by an individual who, in turn, has a contract with the entity in relation to the performance of that work.
16.110 **Definition of “associate”**
The various tests contained in the PSI rules often include the “associate” of the test’s object. An associate is defined in s318 ITAA36 and comprises the following:

- **associates of an individual:**
  - a relative
  - a spouse
  - a partner of the individual in a partnership
  - a partnership of which the individual is a partner
  - the spouse or child of a partner that is an individual other than in the capacity of a trustee
  - a trustee of a trust under which the individual or another associate of the individual benefits
  - a company which is sufficiently influenced by one or more of:
    - the individual, another associate of the individual or another company that is an associate of the individual, and
    - a company in which a majority voting interest is held by one or more of:
      - the individual, and
      - other associates of the individual

- **associates of a company:**
  - a partner of the company in a partnership
  - a partnership of which the company is a partner
  - the spouse or child of a partner that is an individual other than in the capacity of a trustee
  - a trustee of a trust under which the company or another associate of the company benefits
  - an entity which controls the company, either alone or jointly with another entity or other entities (the other entities would also be associates)
  - an entity which holds a majority voting interest in the company and associates of that entity
  - a company that is sufficiently influenced by one or more of:
    - the company, or
    - another associate of the company, and
  - a company in which the majority voting interest is held by one or more of:
    - the company, or
    - another associate of the company

- **associates of a trustee of a trust:**
  - a beneficiary of the trust
  - any associate of a beneficiary that is an individual, and
  - any associate of a beneficiary that is a company, and

- **associates of a partnership:**
  - a partner in the partnership
  - any associate of a partner that is an individual, and
  - any associate of a partner that is a company

**Australian government agencies**
The PSI legislation specifically provides that an Australian government agency is treated as a separate entity from any other government agency. Government agencies generally have no legal identity separate from the government. Furthermore, each agency is not treated as an associate of any other agency. These provisions apply to Commonwealth, State and Territorial government agencies and only apply in relation to the 80% test (see 16.210) and the unrelated clients test (see 16.215).
16.200 Personal services business

Once it has been determined that an individual or a PSE has derived PSI, Divisions 85 and 86 may apply to deny deductions and/or attribute assessable income to the individual to be taxed at marginal rates unless the individual or the PSE is deemed to be carrying on a personal services business (PSB).

A taxpayer (whether an individual or a PSE) will be a PSB if one of four alternative tests is satisfied or if there is a PSB determination in place. The alternative tests are subject to self-assessment but a PSB determination may only be made by the Commissioner.

The four tests are:
- the results test
- the unrelated clients test
- the employment test, or
- the business premises test.

**NOTE:** While the four tests are alternative tests in that only one has to be satisfied for the taxpayer to qualify as a PSB, they are to be applied sequentially in the order in which they are listed. Furthermore, where the results test is failed, the subsequent three “sub-tests” are available only if the taxpayer passes the “primary” 80% test (see 16.210).

**Where the results test and the 80% test are failed, the individual or PSE will not be treated as a PSB unless a PSB determination is obtained from the Commissioner of Taxation (see 16.240).**

**The ATO has an online Personal Service Income tool available on its website.**

Users of the tool will be provided with a report that gives:
- guidance on whether income is PSI and if the PSI rules apply to the taxpayer
- a summary of the responses provided
- information about what the result means for the taxpayer’s tax obligations.

The tool can be accessed at www.ato.gov.au using search code “QC 47696”.

16.205 The results test

The results test is satisfied if at least 75% of the PSI derived for the year meets the following criteria.

1. The contractor is paid for producing a result.

In TR 2001/8, the Commissioner states that 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 to achieve the contractually specified outcome. Payment is often made for a negotiated contract price as opposed to a fee for time (such as an hourly rate). Where payment is only made when contractual conditions have been fulfilled, generally that payment is considered to be for producing a given result. For example, a contract to build an earth dam for a set price would be a contract for a result. In contrast, the payment on an hourly basis to dig the hole is probably a contract for personal services and would not satisfy this criterion.

Satisfying the common law criteria for determining whether a person is an independent contractor does not by default mean that the statutory test has been met ([Confidential and Commissioner of Taxation (2011) AATA 682]).

**NOTE:** Re Taneja and Commissioner of Taxation [2009] AATA 87 and Park and Commissioner of Taxation [2011] AATA 567 espoused the principle that in determining whether the contractor is paid for producing a result, the relevant factor is not how the fee is calculated, but rather, what the contractor is paid for (ie his responsibilities to the clients and what he has to do to satisfy the obligations he has under the agreement and to justify payment).

The decisions also confirm the following propositions:
- in an industry where it is common to be paid for producing a result – such industry customs and practice may support an argument that a taxpayer was “paid for producing a result”, but
- in an industry where it is not common to be paid for producing a result – such industry customs and practice will not support the taxpayer’s argument where there is a written agreement which, in substance, suggests that the person is not paid for producing a result.
The results test

Also see the AAT decision in Prasad Business Centres Pty Ltd at 16.240.

2. The contractor is required to provide the tools, plant and equipment necessary (if any) to produce the result.

Where plant and equipment not needed by the individual or PSE to perform the agreed upon work is provided (eg where scaffolding is provided at a building site for a carpenter to access the particular work area), this will not cause the contractor to fail this condition. Further, the condition will be met where no tools or equipment is supplied by the contractor simply because none are required to do the work. In TR 2001/8, the ATO also provides that a substantive approach should be taken in assessing whether this requirement is satisfied. A “de minimis” usage of others’ equipment (eg borrowing a phone or stationery) or a temporary use of tools of trade (eg where the contractor’s own tools are not accessible at that time) would not, on their own, cause the test to be failed.

3. The contractor is (or would be) liable for the cost of rectifying any defective work.

This looks at whether the individual or entity is exposed to commercial risk for the cost of rectifying defective work. There is no requirement that the individual or entity actually performs the work to rectify defects provided they are exposed to the costs of doing so. This could include a rectification achieved by the acquirer of the services pursuing a legal remedy for damages where the defect is incapable of repair.

While a contractual clause to the effect that the contractor is liable for the cost of rectifying defective work would prima facie support a conclusion that the requisite commercial risk is borne by the contractor, the ATO in TR 2001/8 warns against including such a clause where it is merely “window dressing” and that all relevant circumstances should be taken into account in forming a conclusion in relation to whether the commercial risk and potential liability does exist.

NOTE: In determining whether the contractor satisfies the results test, the custom and practice in the particular industry will be taken into account. For example, if the custom is for the contractor to rectify their work, that will be sufficient for the contract to be treated as a contract for a result. If there is any doubt, it would be wise to set out in writing the terms and conditions.

- It is not essential that the terms and conditions of the “work” to be performed are specifically included in a written contract. The ATO and the legislation requires an examination of all relevant facts and circumstances. This also means that “legal form” compliance with the requirements by inserting relevant contractual clauses is insufficient.

- The Federal Court decided in the case of IRG Technical Services Pty Ltd v Deputy Commissioner of Taxation [2007] FCA 1867 that activities carried out by a taxpayer as part of a team did not satisfy the requirement that the taxpayer must be engaged to produce a result. If there was an engagement to produce a result, that result would be achieved by the team rather than the taxpayer. See also Confidential and Commissioner of Taxation (2011) AATA 682 in which the Tribunal arrived at a similar conclusion.

An individual and a PSE are subject to different results tests. The three elements relating to results, tools and commercial risk are the same for both. Where the taxpayer being tested is a PSE which has derived PSI in relation to one or more individuals, the 75% threshold test appears to be applied on an aggregate basis (where there is more than one individual) and not on an individual-by-individual basis (subs87-18(3)). Where the taxpayer being tested is an individual, the 75% requirement does not apply to any income received by the individual in their capacity as an employee or an office holder (eg a director of a company) nor income derived by religious practitioners in relation to religious activities (subs87-18(2)).

In TR 2008/1, the Commissioner at paragraph 138 considers when a taxpayer is, or would be, liable for the cost of rectifying any defect in the work performed:

- 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 contact.

- 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 PSE is or would be liable for the relevant component of damages awarded for the faulty or defective work.
The results test was failed in *Re Scimitar Systems Pty Ltd v DCT* (2004) 56 ATR 1162, where a company controlled by an IT consultant hired out the consultant's services to essentially only one client. The AAT held that the relevant contract was for the efforts and skill of the particular consultant and not for producing a result. The other legislative requirements (supplying equipment and being liable for the cost of rectifying defects) were also absent.

Similarly, in *Nguyen v FCT* (2005) 60 ATR 1178 where the services of an IT consultant were hired out by his family company. The AAT held that the contracts were for work and not for producing a result as the fees were payable at a specified hourly rate, the work performed was at the direction of the client, there was very limited discretion in the way the work was carried out and there was no scope for substitution or delegation.

In *Douglass and Commissioner of Taxation (Taxation) [2018] AATA 3729*, the AAT rejected the taxpayer's argument that the results test was passed as “all engineers, whether employed or independently contracted, worked “to achieve a result”. It rejected this argument as the question was not whether the taxpayer worked to a result, but rather whether the taxpayer was paid for a result. In this case the taxpayer was generally paid at an hourly rate for 9 hours a day. The taxpayer had amended contracts to make them appear to be for the provision of a result, but the AAT did not accept that this changed the nature of the arrangement.

In *Fortunatow and Commissioner of Taxation (Taxation) [2018] AATA 4621*, the taxpayer worked as a business analyst for a series of organisations. The work was done under a contract with a company owned by the taxpayer. The taxpayer would contract with a recruitment agency and the recruitment agency would contract with the organisations.

The income from the company was not paid to the taxpayer as the taxpayer claimed the company conducted a personal services business. The taxpayer argued that his company passed both the results test and the unrelated clients test (refer 16.215).

As the contracts provided for an hourly rate of pay to be paid on a weekly or fortnightly basis, the AAT rejected that the company passed the results test. There was no requirement for any project to be completed before payment was made.

**NOTE:** The ATO will generally consider a particular industry's customs and practices when applying the above criteria.

### 16.210 The 80% test

If the individual or PSE cannot satisfy the results test, they may be able to rely on one of the three other tests (the unrelated clients test, the business premises test or the employment test) if the 80% test (s87-15(3)) is satisfied.

The 80% test is passed if 80% or more of the PSI does not come from one source, including the associates of that source.

Where the 80% threshold is breached, the individual or entity cannot apply any of the other self-assessed tests and would have to apply to the ATO for a PSB determination in order to achieve PSB status (see 16.240).

Note that the following categories of income under s87-15(4) are not taken into account in determining whether the 80% threshold is exceeded (nor for the purposes of the results test):

- income the individual receives as an employee (ie salary and wages);
- income the individual receives as an office holder (ie payments to an office holder that are subject to the PAYG withholding arrangements), and
- income received by a religious practitioner that is subject to the PAYG withholding arrangements.

**NOTE:** Special rules apply to agents (see 16.220).

According to TR 2001/8, the source of the PSI is determined by reference to the contract under which the services are rendered. The source is not necessarily the entity that physically pays the income. For example, a doctor has contractual relations with each of his patients, even though he/she may actually be paid by a single medical fund.
16.215 The unrelated clients test

To satisfy the unrelated clients test (s87-20), the individual or PSE must derive income from providing services to two or more entities that are not associates of each other and are also not associates of the individual or the PSE (as appropriate). The test also requires that the services are provided as a direct result of the individual or PSE making offers or invitations (eg advertising) to the public at large or to a section of the public. The Commissioner's view is that making an offer to the public would include advertising, tendering for work, maintaining a website or word of mouth referrals. Services offered through labour hire companies and other such businesses that arrange to provide services directly for clients do not qualify as services which would satisfy this test.

In *Yalos Engineering Pty Ltd v FC of T* (2010) ATC 10-139, the Tribunal found that where the particular expertise is relevant only to a very small number of businesses, advertising in a general sense in newspapers, brochures or other such medium would be inappropriate and the small number of businesses would constitute the requisite section of the public. Further, regular personal contact with those companies to assess their needs and the opportunity to provide specialised services via word of mouth and personal recommendations constitute making offers or invitations to provide services. The Commissioner has issued a Decision Impact Statement in relation to the *Yalos Engineering* case.

The Federal Court in *Cameron v Commissioner of Taxation* (2012) FCA 1378 noted that an invitation or offer to a section of the public may or may not constitute an invitation or offer to the public at large. In this case, the Court observed that the manner of the communication cannot be the sole focus and that regard must also be had to the nature or character of the taxpayer's invitations or offers in determining whether the services were provided as a direct result of offers or invitations to a section of the public.

In *Fortunatow and Commissioner of Taxation (Taxation)* [2018] AATA 4621, the taxpayer worked as a business analyst for a series of organisations. The work was done under a contract with a company owned by the taxpayer. The taxpayer would contract with a recruitment agency and the recruitment agency would contract with the organisations.

The income from the company was not paid to the taxpayer as the taxpayer claimed the company conducted a personal services business. The taxpayer argued that his company passed both the results test (refer 16.205) and the unrelated clients test, arguing in relation to the results test that they advertised to the public through a LinkedIn profile, being a form of advertising.

The AAT rejected this argument, indicating that all of the work obtained and carried out by the applicant was through an intermediary and that, in effect, the applicant received referrals from intermediaries and allowed those intermediaries to take responsibility for obtaining and dealing with customers. This was not considered to be the conduct of a genuine business operating as an independent contractor.

The AAT also stated that the unrelated clients test is not satisfied if work is obtained through recruitment firms, labour hire firms or employment agencies where an individual has not made offers or invitations.

16.220 Special rules for agents

Special rules apply in relation to agents who bear entrepreneurial risk in the provision of the particular services. The rules, contained in s87-40, operate on a “look through” basis to treat income that the agent receives from the principal in respect of services that the agent provided to the principal's clients as though the income is earned directly from the clients. The rules do not apply to employees of the principal. The principal beneficiaries of this special rule include financial planners and insurance agents who derive their income from fees and commissions.

The special rules assist agents in passing the unrelated clients test (see 16.215) and the 80% test (see 16.210).

To be subject to the special rules the agent must satisfy the following criteria:

- the agent receives income (eg fees for service or commissions) from the principal for services the agent has provided to the principal's clients on the principal's behalf
- at least 75% of that income is commissions or fees based on the agent’s performance in providing those services, and
- the agent actively seeks new clients to whom the agent can provide services on behalf of the principal, and
• the agent does not provide the services to clients from premises that are either:
  - owned by the principal or an associate of the principal, or
  - in which the principal or an associate has a leasehold interest
unless the premises are used under an arrangement made at arm’s length on commercial terms.

An agent is permitted to have a fixed remuneration (such as a retainer or salary-like payment) of up to 25%. Any fixed remuneration in excess of this figure would cause the agent to breach the requirement that at least 75% of the agent’s income from the principal must be based on the agent’s performance in providing services to clients on the principal’s behalf. In other words, the agent’s income must be at risk.

The agent must also actively seek new clients to whom they can provide services on behalf of the principal. It will be incumbent on the agent to demonstrate that they are making an active effort (e.g., by advertising) to obtain clients. The active test is not satisfied by receiving referrals from the principal or allowing the principal to take the responsibility for obtaining clients. In determining whether an agent satisfies the 80% test (see 16.210), the income received from the principal for providing services to the client will be treated as income derived from the client if the above conditions are satisfied. The clients are in effect treated as clients of the agent. As a consequence, each client is treated as a separate “source” of PSI for the agent instead of the principal being treated as one single source in relation to the same income. So long as there is more than one end client and none of the clients are associates of each other or of any of the agent’s other PSI sources, these provisions may assist the agent in satisfying the 80% test.

In determining whether an agent satisfies the unrelated clients test (see 16.215), the legislation provides that any PSI-producing services that the agent provided to clients on the principal’s behalf is deemed to have been provided directly by the agent to the clients and not by the principal to the clients. As a consequence, where the agent has at least two unrelated clients (which may all be clients of the principal which are deemed to be clients of the agent under these rules) and can demonstrate that the services provided to their clients directly resulted from making offers or invitations to the public at large or to a section of the public, the conditions of the test will be satisfied and the agent will be treated as a PSB.

**EXAMPLE (adapted from the Explanatory Memorandum)**

Gordon is a financial planner who holds a proper authority under the Corporations Law to act as agent for Champagne Financial Services (Champagne), a licensed securities dealer. Gordon receives 85% of his income from Champagne as commissions, dependent on the level of services Gordon provides to clients of Champagne. Gordon advertises his services once a month in financial papers and in professional associations. Champagne operates from five floors of an office block which they lease, and one of those floors is dedicated for Champagne proper authority holders. Gordon uses an office and has access to other facilities under an arm’s length commercial agreement.

Gordon satisfies the requirements in s87-40(1) and is consequently entitled to use the special test for agents. He would also be treated as having derived less than 80% of his PSI from one source.

Gordon satisfies the unrelated clients test as he advertises to the public and does not receive referrals from Champagne. Gordon would be entitled to self-assess as a PSB.

### 16.225 The employment test

The employment test (s87-25) will be satisfied if the individual or the PSE engages one or more entities during the income year, and that entity performs or those entities together perform at least 20% of the market value of the principal work for the year.

Some entities which are engaged by the individual or the PSE are not included in this test. These entities are:

- **if the taxpayer being tested is an individual** – associates of the individual that are themselves not individuals, and

- **if the taxpayer being tested is a PSE** – associates of the individual that are themselves not individuals and any individuals whose PSI is included in the PSE’s assessable income (disregarding any application of the PSI rules).

Where the PSE is a partnership, work performed by a partner is deemed to be work which the PSE has engaged another entity to perform.
The employment test does not require the hiring of labour on an employee basis. Hiring staff on a contractor basis to perform the work will suffice.

The employment test can be passed where relatives are engaged to perform principal work. However, where an associated entity (for example, the spouse’s company) is engaged to perform principal work, that work is not counted toward the 20% threshold test.

There are deduction restrictions that apply to payments to associates (see 16.305). Only amounts that specifically relate to principal work that associates have undertaken are deductible to an entity that is not a PSB. Principal work is the work essential to generating PSI (eg a bricklayer’s principal work would be bricklaying services). Principal work does not include the individual or PSE’s own administrative work.

As an alternative to the 20% market value of principal work test, the employment test may also be satisfied if the individual or the PSE has one or more apprentices for at least 50% of the income year.

16.230 The business premises test

The business premises test (s87-30) will be satisfied by either an individual or a PSE if at all times during the income year they maintain and use business premises:

• at which the individual or the PSE mainly conducts activities from which PSI is gained or produced
• which are used exclusively by the individual or PSE
• which are physically separate from any other premises that is used for private purposes by the individual or PSE or any of their associates, and
• which are physically separate from the premises of any of their clients (or associates of those clients) to which they provide services.

The test must be satisfied over the entire income year. The test is failed if any of the criteria is not satisfied during any part of the year. However, the test does not require the same business premises to be maintained and used throughout the year – the individual or PSE may change premises during the year.

In C of T v Dixon Consulting Pty Ltd [2006] FCA 1748, the Federal Court emphasised that it is important to consider whether the premises are subject to private use, unless the private use is “minimal”. For example, private parking on the premises may indicate private use. Use for family purposes, such as private storage, may also be relevant. Physical separation from private premises is also necessary (eg street address, a shared entrance etc. although these factors may not always be decisive).

In Cameron and Commissioner of Taxation [2012] FCA 1378, the Federal Court held that the business premises test requires consideration and comparison of both of the following aspects:

• the physical aspect – the area of the premises used for providing each type of service, and
• the temporal aspect – the time that the taxpayer had used the premises for providing each type of service.

The Commissioner provides further guidelines in TR 2001/8 in relation to the business premises test, which includes:

• the individual or personal services entity is required to have business premises on each day during the income year in which activities producing the individual’s PSI are conducted
• the exclusive use requirement does not disqualify the shared use of common areas if they are the subject of separate arrangements;
• an individual or entity does not have exclusive use of premises if they are occupied under licence or mere possession, and
• if the business premises are within a larger building, in certain circumstances they may be regarded as physically separate from the rest of the building (the ruling lists various factors to be taken into account).

The Commissioner states in TR 2001/8 that a car of a travelling salesperson does not qualify as business premises.
16.240 Personal services business determinations

The Commissioner is empowered to issue a written personal services business determination (PSB determination) in certain circumstances. The Commissioner also has the power to vary a PSB determination that has already been made.

The effect of a PSB determination is that the relevant individual or PSE will be regarded as conducting a PSB during the period the determination is in force. Where an individual or an entity seeks to avoid application of the PSI rules by achieving PSB status, a PSB determination will be required in the following circumstances:

- where the results test and the 80% test have both been failed
- the results test, employment test or business premises test was failed for the year due to unusual circumstances in that year
- the unrelated clients test was met but the 80% test was failed due to unusual circumstances in that year
- the unrelated clients test was failed for the year due to unusual circumstances in that year; if the 80% test was also failed, it was also due to unusual circumstances in that year; or
- the individual or PSE is uncertain whether any of the relevant tests can be passed or is seeking confirmation that one of the PSB tests is passed if the results test, employment test or business premises test can reasonably be expected to be met.

An application for a PSB determination must be made on the approved form (NAT 72465) and the ATO has 60 days to respond to the application. If a decision is not made within that time, the applicant can request the ATO to treat the application as having been refused. Any application for a PSB determination that is refused by the ATO is a reviewable decision and the applicant has the right to object against that decision.

This process also applies in relation to a request for a variation of a PSB determination. The ATO has the right to request further specified information to decide the application.

An application for a PSB determination can be made prior to, during or after the relevant income year. The PSB determination (or variation of it) has effect from the day specified in the notice (or if no date is specified, the date of the notice). It ceases to have effect at the earliest of when:

- any condition of the notice is not met
- the ATO revokes the PSB determination, or
- the period for which the PSB determination has effect has come to an end.

The ATO must revoke the determination by written notice if the Commissioner is no longer satisfied that there are grounds on which the determination could be made.

When can the Commissioner issue a PSB determination?

Before issuing a PSB determination, the Commissioner must be satisfied that:

- the individual or entity does meet, or could reasonably be expected to meet, the results test, the employment test, or the business premises test
- the individual or entity could reasonably have been expected to meet or would have met the results test, the employment test or the business premises test but for unusual circumstances applying in that year
- the individual or entity does meet the unrelated clients test but unusual circumstances prevent the 80% rule from being met, or
- the individual or entity could reasonably have been expected to meet or would have met the unrelated clients test but for unusual circumstances applying in that year; and if the 80% test is also failed, that is also due to unusual circumstances applying in that year.

In Prasad Business Centres Pty Ltd and Commissioner of Taxation [2015] AATA 411, the AAT held that income derived by the taxpayer, an IT consultant, did not satisfy the “results test” for the purposes of obtaining a PSB determination. The taxpayer in this case was only remunerated for the time spent and not for producing a result; there were no contractual requirements to attain specific milestones or deliberate deliverables in order to qualify for that remuneration.
Note that where both the results test and the 80% test are failed, and the 80% test is failed due to unusual circumstances, the Commissioner may make a PSB determination only in relation to the unrelated clients test. If the unrelated client test is not deemed to have been failed due to the requisite unusual circumstances, there is no recourse to rely upon a PSB determination in respect of the employment test or the business premises test where the 80% test has not been met.

**Unusual circumstances**

The Commissioner states in TR 2001/8 that the term “unusual circumstances” refers to circumstances that are exceptional and temporary, with the likelihood that usual circumstances will resume in the short term. Unusual circumstances may include:

- securing a one-off large contract for a temporary period only, and
- loss of business premises part way through a year due to circumstances outside of the taxpayer’s control, or loss of an employee and inability to find a replacement despite best efforts.

In *Creaton Pty Ltd v FCT* (2002) 51 ATR 1047, the AAT specifically rejected the Commissioner’s contention that unusual circumstances cannot last for more than one income year.

Moreover, the prevailing economic conditions, either in the industry in question or the place where the taxpayer is located, were held not to amount to unusual circumstances in *Scimitar Systems Pty Ltd v DCT* (2004) 56 ATR 1162. Whereas, in *The Engineering Company v FCT* (2008) 74 ATR 272, a long-term client indicating that it had no plans to engage the taxpayer’s services for the foreseeable future and the resignation of a key employee who took another client with him were considered to be unusual circumstances.

### 16.300 Effect of the PSI rules

Where an individual or PSE which has derived PSI cannot meet any of the self-assessment PSB tests and does not have a PSB determination in force, the PSI rules affect the income tax treatment of the PSI. If the PSI is derived by a company, trust or partnership, that PSI is treated as having been derived by the individual whose personal efforts gave rise to the PSI (s86-15). The income is then taxed in the hands of the relevant individual at marginal rates (see 16.400). This attribution of the entity's income to the individual only applies to amounts which would be assessable to the PSE but for the PSI rules. Amounts which have been paid by the PSE to the individual as salary or wages within statutory timeframes are not attributed (see 16.400) as such amounts are already treated as employment income derived by the individual.

**NOTE:** In ATO ID 2010/214, the Commissioner concludes that where an Australian resident PSE derives foreign sourced income that is the PSI of a non-resident individual, the income is NOT included in the individual’s assessable income under subs6-10(5) ITAA97 on the basis that:

(a) the PSI is not Australian sourced, and

(b) the Commissioner does not consider subs86-15(1) to be a provision that includes amounts in assessable income on a basis other than having an Australian source. The ID concludes that if the contrary view was accepted, foreign sourced income of a foreign resident would be assessable income in Australia and this would not be an appropriate alternative to the ordinary source rule.

The foreign employment income exemption in s23AG ITAA36 (refer 22.010) cannot apply to income attributed to a person under the PSI rules (*Clark v FC of T* (2010) AATA 392 and *Lopez v Deputy Commissioner of Taxation* (2004) FCA 756).

The individual will not be treated as an employee for any purpose outside the PSI rules. Further, the PSI rules do not have any GST effect, and do not affect any legal, contractual or workplace arrangements.

### 16.305 Rules limiting deductions

Where an individual earns the PSI directly, or is treated as having earned PSI, Division 85 limits the type and amount of income tax deductions to which they will be entitled. Broadly, the deductions available to persons earning PSI will be limited to those that would have been allowable if that person was an employee.
Rules limiting deductions

**EXAMPLE**

A person who works as an independent architect for one firm and who fails the PSB tests would not be conducting a PSB and as such would not be entitled to claim a deduction for the cost of travelling from home to the client’s business premises. The cost of a home office would be allowed, but the claim would be limited to running costs such as heat, light and power plus consumables and depreciation on plant and equipment.

No claim would be allowed for interest or any other occupancy expenses. The extent of the claims for expenses incurred in gaining the PSI would be limited to those claims allowed to an employee undertaking similar work.

The deduction rules contained in Division 85 affects individuals deriving PSI directly and individuals who have been attributed PSI amounts from a PSE.

**Summary of PSI deduction rules**

The table following is reproduced from the ATO fact sheet *Alienation of personal services income – deductions*. It provides a summary of the deductibility or non-deductibility of particular items of expenditure in relation to those whose tax outcomes are affected by the PSI rules (PSI rules apply) and to those whose tax outcomes are not affected by the PSI rules, such as PSBs and those outside the PSI regime (PSI rules do not apply).

<table>
<thead>
<tr>
<th>Deduction</th>
<th>PSI rules apply</th>
<th>PSI rules do not apply</th>
</tr>
</thead>
<tbody>
<tr>
<td>Premiums for workers compensation, public liability and professional indemnity insurance</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Bank and other account-keeping fees and charges</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Tax-related expenses, eg the cost of preparing and lodging tax returns or activity statements</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Registration or licensing fees</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Expenses for advertising, tendering and quoting for work</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Depreciation</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Running expenses for your home office (not including rent, mortgage interest, rates or land taxes, see next page)</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Rent, mortgage interest, rates or land tax for your home that is a place of business</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>If you are a personal services entity, expenses or fringe benefits tax for more than one car that is used partly or solely for private purposes</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Salary and wages for an arm’s length employee (not an associate)</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Salary and wages paid to the principal worker within 14 days of the end of each PAYG withholding payment period</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Contributions to a super fund on behalf of the principal worker or an arm’s length employee (not an associate)</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Reasonable amounts paid to an associate for principal work</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Contributions up to the super guarantee amount for an associate doing up to, but less than, 20% of the principal work</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Reasonable amounts paid to an associate for non-principal work</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Reasonable contributions to a super fund for an associate doing solely non-principal work</td>
<td>No</td>
<td>Yes</td>
</tr>
</tbody>
</table>

**General rules – individuals**

The general rule under Division 85 is that an individual taxpayer who must include an amount of PSI in their assessable income cannot deduct expenditure relating to earning that PSI if he or she would not have been able to deduct the amount had he or she derived the same income as an employee. There are some exceptions to this general rule. Claims continue to be deductible for the cost of (s85-10):
• gaining work (eg advertising, tendering, and quoting for work)
• insuring against loss of income or earning capacity (eg sickness, accident and disability insurance)
• liability insurance (eg public liability and professional indemnity insurance)
• engaging an entity that is not an associate to perform work
• engaging an associate to perform work that forms part of the principal work in relation to which the PSI is derived (warning: there are limitations on the amount that can be claimed)
• superannuation contributions for the individual (or their dependants in the event of death)
• workers compensation premiums and similar payments required under the law or payments made to an employee in respect of compensable work-related trauma, and
• meeting obligations, or exercising rights, under GST law.

Payments to associates
Allowable deductions for payments made to associates are limited under s85-20. As a general rule, payments to an associate are only deductible to the extent that they relate to engaging an associate to perform work that forms part of the principal work for which the PSI is gained.

Non-principal work is incidental or subsidiary work that is not central to meeting the obligations under the contract (that is, not the main work for which the business gets paid). Examples of non-principal work include bookkeeping for the business, issuing invoices, secretarial duties and running a home office.

Deductions are also allowed in relation to superannuation contributions made in respect of an associate to the extent that the associate’s work forms part of the principal work which gives rise to the PSI (s85-25(2)). The deduction available is limited to the amount necessary to avoid paying the superannuation guarantee charge (ie 9.50% – see 19.500 and 19.530), calculated as though Division 85 did not operate to deny deductions for any of the salary or wages paid to the associate.

Deductions are specifically denied for all other payments to associates and for any amount incurred arising from an obligation to associates.

Any payment to an associate which is non-deductible under Division 85 is non-assessable non-exempt income in the hands of the associate.

Residential expenses
Deductions are disallowed in relation to rent, mortgage interest, rates and land tax in respect of the individual’s residence or the residence of an associate to the extent that the expenditure relates to gaining or producing the individual’s PSI.

For individuals the disclosure in an individual’s income tax return is via Item P1 and Item 14 of the individual tax return.

General rule – PSEs
Section 86-60 provides that a PSE cannot deduct an amount relating to the derivation of an individual’s PSI unless:
• the amount would have been deductible to the individual had the circumstances giving rise to the deduction applied to the individual instead of the PSE, and
• the PSE receives the individual’s PSI in the course of conducting a PSB. In Russell v FC of T (2009) ATC 20-143, the PSE made payments to a partnership that was an associate of the individual who derived the PSI. The primary judge held that the PSE could not deduct the amount as neither limb of s86-20 was satisfied.

Car expenses
Division 86 does not limit the deduction which would be allowable under the tax law for car expenses in relation to a car for which there is no private use.

Where the car is not used solely for business purposes, car expenses and fringe benefits tax payable for a car fringe benefit are deductible to the extent allowable under the tax law but the deductions are restricted to one car for each individual whose work gives rise to PSI. Where there is more than one car in relation to an individual, the car in respect of which the deductions are taken is the taxpayer’s choice.

Note that the car expense deduction rules only apply in relation to PSEs (and not to individuals directly deriving PSI).
16.400 PSI derived through PSEs: Attribution rules

Unless the PSE is carrying on a PSB, the income of the entity derived as a result of an individual providing personal services (excluding any GST component) will be treated as the relevant individual's PSI unless it is promptly paid as salary and wages to that individual.

The Federal Court decided in the case of Fowler v Commissioner of Taxation [2008] FCA 528 that there was no requirement within the ITAA97 that income must be beneficially derived before it could be included in an individual's assessable income. The income of the entity derived, which were ordinary income should be included in the individuals assessable income as "statutory income".

The PSE has until the 14th day after the end of the PAYG payment period in which to pay the income (excluding any GST component) as salary to the individual, otherwise it is treated as the PSI of the individual.

Where an entity makes a payment of salary or wages to an individual by 14 July following the year of income and that amount would otherwise have been treated as PSI, then that payment is treated as having been received by the individual in the previous income year. The individual must include that amount in their assessable income for that preceding income year. However, where the personal services deduction amount exceed the gross PSI, the provisions allow for a deduction of the excess in the hands of the individual (s86-27).

It is possible for an entity to derive both PSI and non-PSI (e.g. interest, rent, dividends). The PSI rules do not affect any non-PSI. Also, any GST that has been collected by the entity is excluded from the calculation of a person's PSI. GST is neither assessable income nor exempt income.

In calculating the amount of income derived by a PSE that must be treated as the PSI of an individual, the gross PSI is reduced by the amount of certain deductions which are deductible in the hands of PSE. The method statement contained in s86-20 ensures that the extent of those deductions can never be greater than the amount of the income. However, where the personal services deduction amount exceed the gross PSI, the provisions allow for a deduction of the excess in the hands of the individual (s86-27).

Listed below are the steps to work out the deductions that can be claimed to reduce the amount of PSI to be attributed to the relevant individual:

Step 1: Work out the amount of deductions allowed (other than entity maintenance deductions and salary or wages paid to the individual) against the PSI. As a general rule a PSE can only claim deductions for expenses that relate to the earning of the individual's PSI. In broad terms this means that only those expenses that would be deductible to an individual are also deductible to the entity. For a summary of the deduction rules, see 16.305.

Step 2: Work out the total entity maintenance deductions to which the PSE is entitled. These are (s86-65):
- any fee or charge payable for opening, operating or closing an account with a financial institution
- any tax-related expenses (allowed under s25-5)
- losses or outgoings incurred in preparing or lodging any document as required under the Corporations Act 2001, and
- any fee payable to an Australian government agency for any licence, permission, approval, certification etc granted or given under an Australian law.

Step 3: Work out the PSE's assessable income for the income year that does not constitute PSI.

Step 4: Subtract Step 3 from Step 2. (NOTE: This step is designed to ensure that entity maintenance deductions are first deducted from non-PSI income.)

Step 5: If the amount in Step 4 is greater than nil, the amount of the reduction is the aggregate of Steps 1 & 4.

Step 6: If the amount in Step 4 is nil or less, the amount of the reduction is limited to the amount in Step 1.
Where multiple individuals derive PSI through an entity, the reduction allowed under Step 4 must be apportioned in accordance with the amount of PSI income earned in relation to each person relative to the PSE's total PSI.

If the above calculation results in a loss (ie the individual’s PSI is less than the deductions allowed) then that loss is an allowable deduction to the relevant individual in that income year. Any unused loss is able to be carried forward (s86-27).

An individual is able to deduct a net PSI loss from other income (the loss is calculated according to s86-27 and s86-87).

**EXAMPLES**

The taxpayer’s company has derived $120,000 of income that has been directly derived through the personal services of the taxpayer.

The company is entitled to claim $50,000 of deductions (ie superannuation contributions paid to a complying superannuation fund) (Step 1). The company is entitled to entity maintenance deductions (ie lodgement fees and tax agent fees) of $3,000 (Step 2). The company has also separately derived investment income of $20,000 (Step 3). As Step 4 (ie Step 2 less Step 3) is less than nil, Step 5 is not applicable.

The company is entitled to a reduction of only $50,000 (ie the Step 1 amount). Consequently, the taxpayer’s PSI is $70,000 (ie $120,000 less $50,000).

In the above example, if the amount of other income (ie Step 3) was $2,000, the company would have been entitled to a reduction of $51,000 (being the amount in Step 1 (ie $50,000) plus the difference between Step 3 and Step 2 (ie $3,000 less $2,000). In that case, the taxpayer’s PSI would have been $69,000 (ie $120,000 less $51,000).

In the above example, if another person also derived $180,000 PSI in the company, the entitlement to a reduction for each person would need to be calculated in accordance with each person’s PSI.

In the case of the taxpayer in the first example, the reduction would be 40% (ie $120,000/$300,000) of the Step 4 amount of $1,000 (being that taxpayer’s share of total PSI). The balance would be allowed as a reduction for the second individual.

Once an entity has calculated the amount of income to be included as PSI of an individual, that amount is non-assessable non-exempt income of the PSE. In that way the entity is neither taxed on that income (which is taxed in the individual’s hands) nor is it required to take it into account when claiming losses. Furthermore, the income is not a capital gain (s118-20(4)).

Under s86-35, a payment by the PSE or (an associate of the taxpayer) to the taxpayer (or an associate of the taxpayer) of PSI that is assessable income or any other amount attributable to that PSI is non-assessable non-exempt income to the recipient and is not deductible to the payer. In Russell v FC of T [2009] ATC 20-143, it was held that since a partnership was an associate of the taxpayer who derived PSI, the PSE could not deduct amounts paid to that partnership where the payments were attributable to the PSI.
16.500 PAYG withholding obligations

Where a PSE is caught by the PSI provisions, the entity will have additional PAYG withholding obligations in relation to any PSI amounts attributable to individuals. However, where the PSE is promptly paying PSI amounts to the relevant individual as salary or wages, these additional PAYG withholding obligations will not apply. Instead, the entity will have the usual PAYG withholding obligations that apply to salary or wages.

The PSE must calculate the amount of PSI on which the PAYG withholding liability applies using one of three methods:

- calculating the attributable amount of PSI each reporting period (the legislative approach)
- using a PSI amount of 70% of the gross PSI of the period, or
- applying a percentage based on the entity’s net PSI for the prior year to the gross PSI for the period.

The PAYG withholding amount in respect of attributed PSI should be reported on the PSE’s BAS or IAS for the relevant period. The entity should issue the relevant individual with a PAYG payment summary – business and personal services income (NAT 72545) (unless the entity has elected to report these amounts via Single Touch Payroll, in which case no Payment Summary is required to be completed).

NOTE: If the PSE has already lodged some of its activity statements and has not been withholding as required, this must be corrected by lodging a revised activity statement. It cannot simply correct the withholding understatement on a future activity statement.

Where an individual derives “attributed” PSI through a PSE the individual income tax return disclosure is via Item 9 of the individual tax return.

16.600 Application of the general anti-avoidance provisions to PSBs

Where a taxpayer is treated as conducting a PSB and is therefore excluded from the PSI rules, the ATO has indicated that it may apply its anti-avoidance powers (under Part IVA ITAA36) to prevent the splitting of income through the use of the taxpayer’s entity (including the retention of personal services income in a company beyond the end of the income year) or with other members of the family, especially through trusts and companies.

Entities with minimal business infrastructure or plant and equipment used to derive the income of the entity will be at risk as will entities which focus on diverting income away from the primary individual (income splitting using a trust) or retaining profits in a company to attract the lower corporate rate of tax.

ATO publications which provide insight into the Commissioners approach to the use of Part IVA in these circumstances include:

- Part IVA: the general anti-avoidance rule for income tax, and
- General anti-avoidance rules and how they apply to a personal services business.

Taxation Rulings that were issued prior to the enactment of the PSI regime dealing with the alienation of income and the application of anti-avoidance rules under Part IVA (eg IT 2639, IT 2503, IT 2121, IT 2330 and IT 2501) remain in force.

Professional service firms deriving non-personal services income can still be subject to the general anti-avoidance provisions.

The ATO up until recently was assessing the Part IVA risk with respect to the allocation of profits from a professional firm carried on through a partnership, trust or company. It had issued guidelines outlining how it assesses such risk. In reviewing the guidelines, however, the ATO became aware that they were being misinterpreted in relation to arrangements that went beyond the scope of the guidelines. In light of these concerns, the guidelines were suspended in December 2017. Individual practitioners contemplating entering into new arrangements from that date are encouraged to engage directly with the ATO via email: Professionals@ato.gov.au as the anti-avoidance provisions may yet application irrespective of the withdrawing of the guidelines.
Labour hire arrangements

Taxpayer Alert TA 2011/2 outlines the ATO’s focus on certain labour hire arrangements which involve the use of a discretionary trust to split income.

The TA covers arrangements with broadly the following features:

- a labour hire firm offers remuneration structures for an individual (the service provider) who provides services or performs work
- the service provider becomes a beneficiary of a discretionary trust which is associated with the labour hire firm
- the discretionary trust agreement identifies additional beneficiaries, such as the service provider’s spouse, and the basis on which the trustee will allocate distributions
- the service provider or the labour hire firm contracts for services with a client (the end user) or a recruitment agency used by the end user
- the labour hire firm may enter into such contracts either in its own capacity or in its capacity as trustee of the discretionary trust
- the labour hire firm invoices either the end user or the recruitment agency
- payment for work performed or services provided are paid by the labour hire firm via the discretionary trust
- the discretionary trust makes payments to the service provider and/or an associate of the service provider, typically the spouse
- trust distributions are purportedly discretionary; however, in reality, the total amount of distributions are consistent with the service provider’s set rate of remuneration less management fees of the labour hire firm, and
- there is limited economic rationale for the arrangement other than the avoidance of taxation or superannuation guarantee obligations.

The ATO considers that such arrangements may give rise to PSI and Part IVA issues. In addition, the TA identifies other areas of potential concern, including the following:

- issues relating to the correct identification of the relationship as an employee/employer relationship or a contractor/principal relationship
- the PAYG withholding provisions
- the superannuation guarantee charge regime, and
- the promoter of tax exploitation scheme provisions.

Diverting personal services income to Self-Managed Superannuation Funds (SMSFs)

In Taxpayer Alert TA 2016/6, the ATO outlines that it is concerned with arrangements where individuals purport to divert income earned from their personal services to a SMSF to minimise or avoid tax on that income. The individuals involved are typically SMSF members at or approaching retirement age.

Some relevant characteristics or variations include:

- the entity that receives the consideration for the services provided is a company, trust or other non-individual entity
- the income may be distributed from the entity to the SMSF as either:
  - a return on the SMSF’s investment in the entity; or
  - by way of an agreement between the entity and the SMSF
- the SMSF may receive the income from more than one entity, or through a chain of entities; and
- the entity may distribute to income to more than one SMSF of which the individual and/or their associates (eg their spouse) are members.

The TA lists the following concerns based on the ATO’s review of these arrangements to date:

- the income may remain the assessable income of the individual under s6-5 ITAA97
- the income may be assessable to the individual as PSI
- the amounts received by the SMSF may constitute non-arm’s length income under s295-550
ITAA97 – such income is not eligible to be concessionally taxed and is not exempt current pension income
- the general anti-avoidance provisions contain in Part IVA ITAA36 may apply to cancel tax benefits obtained by the individual
- the amounts received by the SMSF may be a contribution to the fund and therefore subject to the contributions caps, and
- superannuation regulatory issues – in particular, whether the SMSF is maintained for purposes other than those set out in s62 SISA.

Diverting personal services income to self-managed superannuation funds

Step 1: Individual provides services

Step 2: Client pays income for services provided

Step 3: Entity distributes or pays income

Step 4: SMSF treats income as concessionally taxed or tax exempt
The Tax Summary is essential reading for everyone in need of a guide to navigate the complexities of the Australian taxation system. It is written in plain English with explanations and easy-to-follow examples on taxation and superannuation without the jargon.

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- Overview of superannuation and retirement planning
- Manage FBT obligations for employers
- Comply with state taxes including payroll tax, stamp duty and land taxes

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Hydon & Mody, Certified Practising Accountants