

Personal Services Income



Personal Services Income (PSI) is income which is derived mainly as a reward for personal effort or skills. In determining whether you derive PSI, you should consider the following:

- PSI relates more to the supply of services rather than the supply of goods
- PSI tends to require greater dependence on skill and judgement
- PSI is more likely to arise if you have minimal assets and few employees.

Most computer consultants are generally taken to be deriving PSI even if they may be operating through an entity, such as a company. However, courier drivers do not usually derive PSI as the income derived by the courier driver is mainly as a result of the use of the vehicle to provide courier services rather than reward for personal efforts and/or skills.

The PSI legislation aims to prevent taxpayers splitting income from personal exertion with other entities or individuals, such as companies, trusts and spouses, to reduce their tax. If the PSI rules apply, the net PSI is taxed at the individual level. Deductions are also largely limited to those which can be claimed by employees.

The following are examples of PSI:

- Contracts wholly or principally for labour or services of a person
- Consultants who derive income from their skills eg. computer and engineering consultants
- Professional persons practising on their own account without professional assistance e.g. accountants, lawyers and doctors.

Examples of non-PSI are investment income, sale of goods and payments for the use of assets.

Personal Services - Business Tests

Even if a taxpayer does derive PSI, the specific PSI rules do not apply if the taxpayer carries on a Personal Services Business (PSB). A PSB is a business that satisfies the results test, **or** alternatively, meets the 80% test and one of the three other tests discussed below, **or** has a Determination from the Taxation Office.

Results Test

A taxpayer will satisfy the results test where **all** of the following three conditions are met in respect of **at least 75%** of the PSI:

- The taxpayer produces a result (e.g. delivering a completed software component, as contrasted with performing a week of programming work)
- The taxpayer is required to supply all the tools required to perform the work, and
- The taxpayer is liable for the cost of rectifying any defect in the work performed.

80% Test

This test is failed if more than 80% of your personal services income for the year is from the one source. If you pass the 80% test, you must **also** pass one of the following three tests to be classified as a personal services business.

Other Tests

1. Unrelated Clients Test

The unrelated clients test is passed where you earn your PSI from two or more entities that are not related to you or related to each other. However, you must obtain these clients through direct means such as advertising or tendering.

2. Employment Test

You meet the employment test if you satisfy one



of the following:

- You employ an apprentice for at least half of the year
- You employ other unrelated/non-associated persons to perform more than 20% of the total principal work (principal work excludes administration and support services)

3. Business Premises Test

The business premises test is passed if at all times during the income year you maintained business premises used exclusively by you for activities that earn PSI. The premises must be physically separate from you or your associate's private premises or a premise of your client.

Personal Services Business Determination

If you fail the 80% test, the PSI regime applies unless you obtain a Determination from the Taxation Office that you are conducting a personal services business. Completing an application for a Determination is time consuming and requires disclosure of substantial amount of information about the business and its operations. You must also satisfy certain tests before you can apply. If you think you may need a determination, please contact us for assistance.

Deduction Limitations

If you are receiving PSI and not conducting a personal services business, the PSI regime will apply to limit the deductions you can claim.

Individuals

- Deductions are largely limited to expenses that are deductible to employees. For example, you cannot claim home to office travel.
- Wages and superannuation paid to an associated person or entity for non-principal work are not deductible. Example: spouse's wages for bookkeeping.
- Deductions are not allowed for rent, mortgage interest, rates or land tax on your residence or an associate's residence.
- You can still claim deductions for expenses

that are specifically deductible under other legislation. These include income protection and public liability insurance, your superannuation contributions, wages, superannuation and Work Cover for non-associates or associates who perform principal work.

Entities

In addition to the above, expenses termed 'Entity maintenance costs' such as bank charges, accounting fees, ASIC fees and government registration fees are deductible but must first be offset against non-PSI income such as interest. Any excess is then an allowable deduction against PSI.

Further, the personal services entity **cannot** provide car fringe benefit for more than one car **per individual** whose personal services income is included in the entity's income.

Attribution

If the PSI is derived by an entity, such as a company, trust or partnership, and the entity is not carrying on a personal services business, the net PSI of the entity is "attributed" to the individual. This means the net PSI is included in the tax return of the individual rather than the entity.

Alternatively, the entity can pay out the PSI promptly (within 14 days after the end of the PAYG period) as salaries to the individual. The relevant PAYG withholding tax must be withheld from the salaries. If you do not pay out all PSI as salaries, you must still remit PAYG withholding each period on the remaining attributed income. Please contact us for advice on calculating the required quarterly tax.

General Anti-Avoidance Provisions

If a taxpayer is deriving PSI, but is conducting a personal services business (i.e. they meet the tests described above), the attribution rules will not apply. However, taxpayers are still subject to the general anti-avoidance provisions, known as

Part IVA. These provisions can apply if you enter into an arrangement where the dominant purpose is income splitting.

The Taxation Office has stated that the anti-avoidance provisions may apply if you split income with a relative or another entity and the income included in your tax return is not commensurate with the value of the services you provide and the responsibilities you undertake. You can remunerate an associate for services they provide in helping you derive your PSI but you should ensure the amount is commercially realistic.

Actions Required

1. If you are a contractor you should determine whether you are deriving PSI.
2. If you derive PSI, determine whether you are a personal services business, as follows:
 - a. Consider whether you satisfy the results test.
 - b. If not, do you meet the 80% test and at least one of the other three tests (unrelated clients, employment or business premises)?
 - c. If you fail the 80% test, determine whether you should apply for a Determination.
3. If you are caught by the rules, ensure that the correct amount of PAYG withholding is being remitted to the Taxation Office each quarter. This may mean reviewing salary packaging arrangements.
4. If you are a personal services business, but

derive PSI, ensure you comply with the general anti-avoidance provisions.

Further information

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Personal Services Income Flowchart

