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Let's chat

A Tax Journey from Sole Trader to Company Director Webinar - Is It Business or PSI Chris' Early Test – November 2025

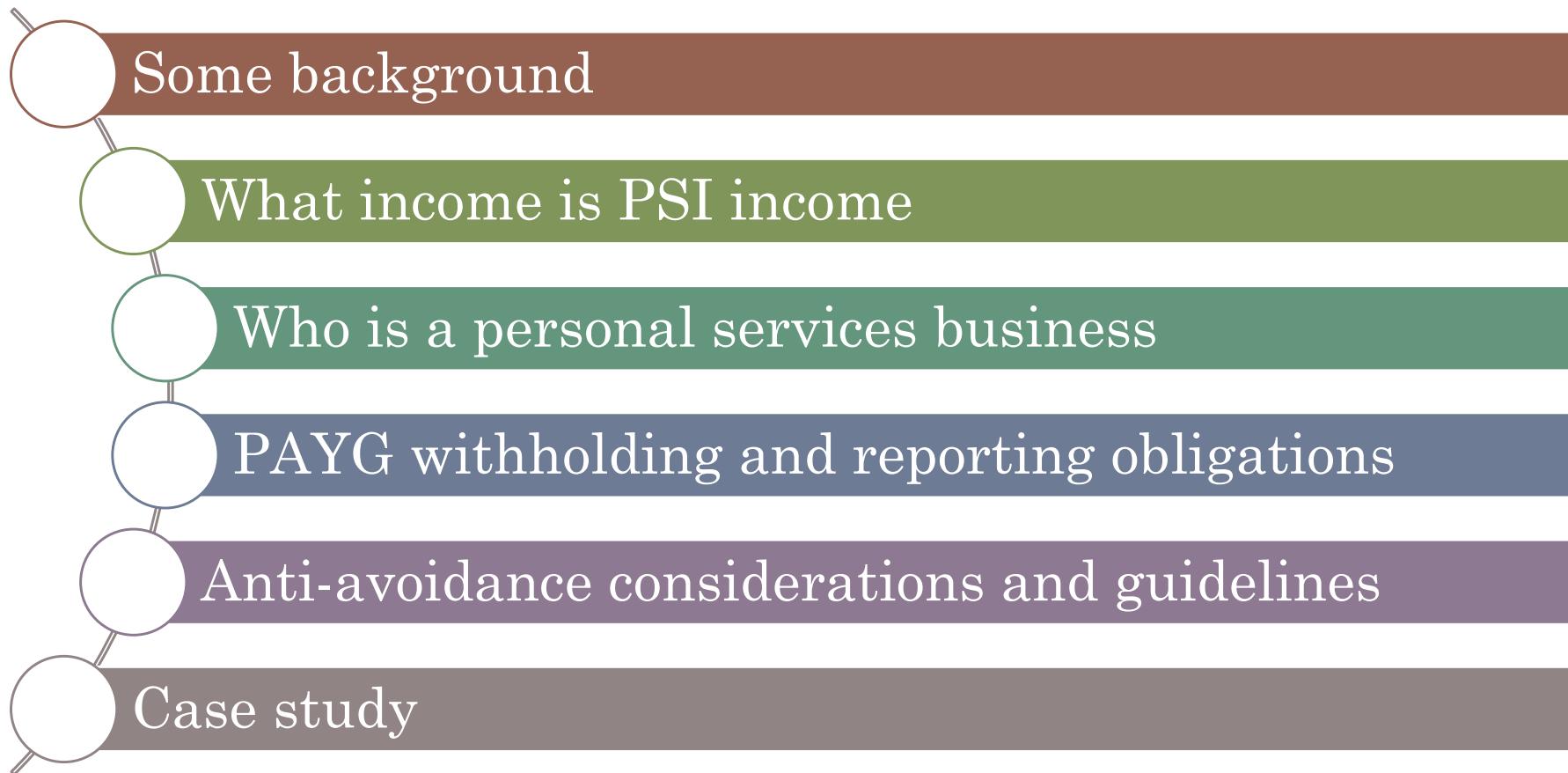
With:

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Information provided is general in nature; precise application depends on specific circumstances



Overview





The old days

Tupicoff v Commissioner of Taxation

- Taxpayer was a life assurance agent who restructured his activities to become an employee of a family trust
- Trust received the commissions formerly paid to the taxpayer who was paid a salary by the trustee
- Balance of income distributed to family members
- General anti-avoidance provisions applied

IT 2121

- Above facts and more
- Ceasing employment one day and coming back to do the same work the next day in the form of a contractor
- May include companies instead of family trusts



The old days

Commissioner of Taxation. v. Gulland, Watson v. FCT and Pincus v. FCT

- Medical practitioner conducting business alone or in partnership
- Unit trust established which family trust owns the units
- Unit trust acquires medical practice and employed practitioner on a base salary
- Excess income distributed to family trust unitholder
- General anti-avoidance provisions applied

IT 2330

- Above facts and more
- Outlines ATO position that income derived from personal services cannot be split from the individual performing the work
- Cases and Tax Ruling still referred to in modern ATO guidelines

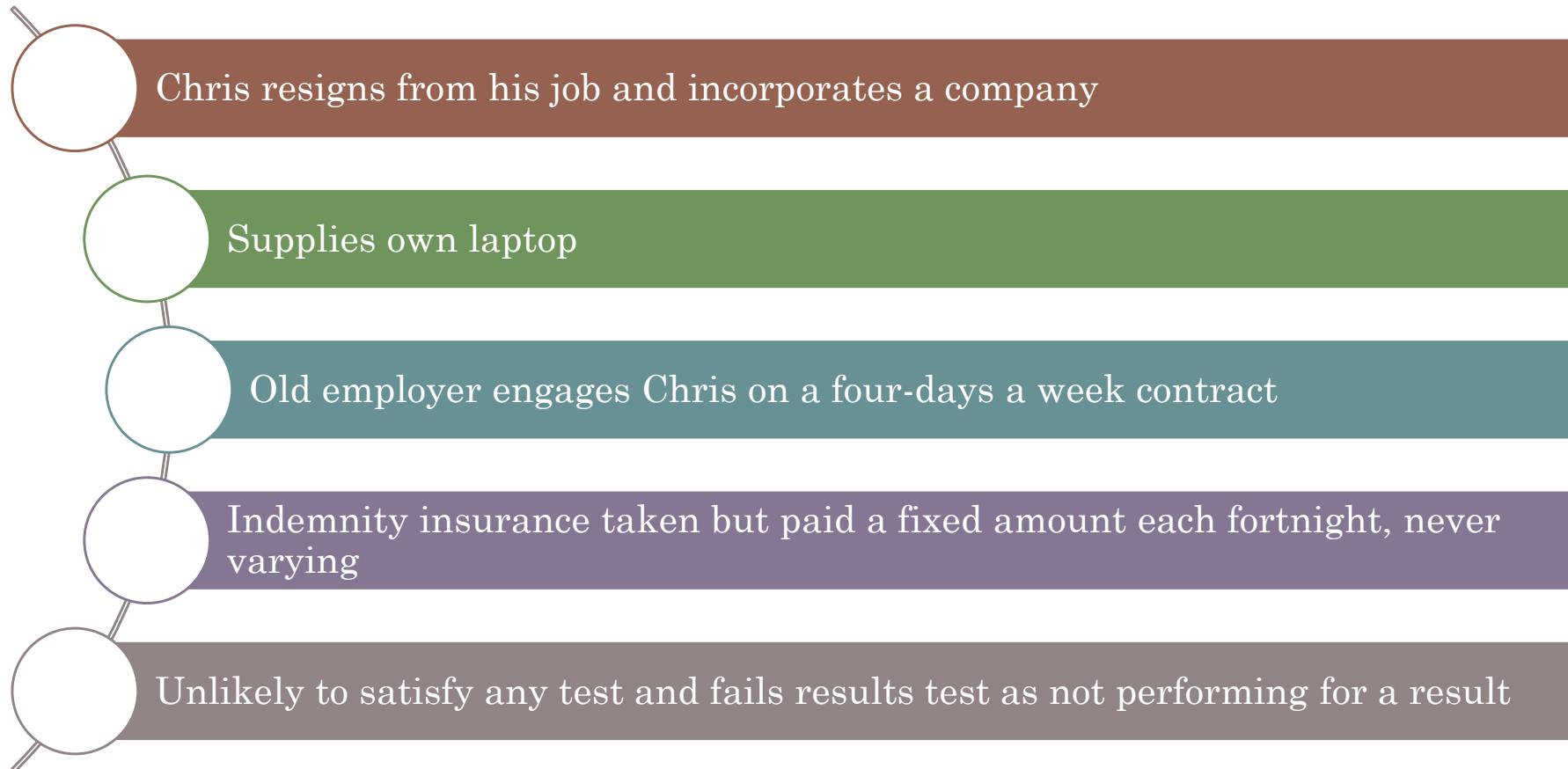


Need for new rules

- Introduced in 2000
- Provided clear rules to “*achieve a consistent taxation treatment for personal services income*”
- Reduce reliance on general anti-avoidance provisions which required case-by-case consideration
- Not intended to affect genuine business undertakings



Case study – Year 1





What is PSI?

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)

- Section 84-5 Tax Act 1997



A wide definition

Explanatory memorandum

- Salary or wages
- Income of a professional person practising on their own account without professional assistance
- Income payable under a contract which is wholly or principally for the labour or services of a person
- Income derived by a professional sports person or entertainer from the exercise of his or her professional skills. This does not include income from endorsement by the person of a sponsor's products
- Income derived by consultants from the exercise of personal expertise.

TR 2022/3

- *"The use of the word 'mainly' means that the income referred to needs to be 'chiefly', 'principally' or 'primarily' a reward for the provision of the personal efforts or for the exercise of the skills of an individual. That is, more than half (50%) of the ordinary or statutory income received is required to be a reward for the personal efforts and skills of an individual rather than being generated by the use of assets, the sale of goods or by a business structure"*



PSI or not?

TR 2022/3

- Comprehensive ATO guidance in relation to personal services income rules
- Various examples available and references to cases
- Highly recommended to review

Example 1

- *“Andre is a plumber who operates as a sole trader. He receives a contract to fix a blocked toilet and repair 3 leaking taps. He charges \$25 for materials and \$225 for his labour. The total of the invoice is \$250. This income is Andre's PSI as it is mainly a reward for his personal efforts and skills.”*
Note how a substantial portion of the invoice relates to his labour.

Example 2

- *Judy is an information technology (IT) consultant who provides systems analysis services through her company, J.I.T. Pty Ltd, which enters into a contract with Rich Computer Co to provide Judy's consultancy services. The income J.I.T. Pty Ltd receives from Rich Computer Co is PSI as it is income generated from Judy's labour where more than 50% of the payment is a reward for her labour.”* Note how such services does not involve the supply or sale of goods as part of Judy's services.



PSI or not?

Example 4

- *“Jack is an experienced backhoe operator. His family company, Jack & Jill Pty Ltd, owns a 10-tonne truck and a backhoe. Jack & Jill Pty Ltd enters into a contract with the Main Roads Department to dig trenches for laying sewerage pipes. The contract specifies that Jack & Jill Pty Ltd supplies a tractor with a backhoe and other special attachments, together with a licensed backhoe operator to work at specific locations.*
- *Jack transports the backhoe on the truck to various construction sites at the request of the Main Roads Department. He then uses the backhoe to dig the trenches. The contract requires Jack & Jill Pty Ltd to provide specific plant and equipment to do the work. Without the backhoe and the truck, Jack & Jill Pty Ltd would not be able to gain or produce income.*
- *Taking into account the significant size, value and uniqueness of the asset required to be supplied and the relative contribution of the asset compared to the personal service in generating the relevant income, the amount that is invoiced to the Main Roads Department is mainly for the cost of supplying the truck and the backhoe, and is not mainly for the efforts and skills of Jack. The income is therefore considered to be for the supply and use of income-producing assets and is not PSI.”*
- In contrast with Example 1, a significant value of the income is derived through the use of substantial equipment (as opposed to plumbing taps).



PSI or not?

Example 5

- *“Grace is a carpenter who operates a partnership with her spouse, Chris. Grace designs and constructs bespoke furniture and sells it through the partnership via the internet and at trade fairs. The payments made to the partnership are for the sale of the furniture rather than Grace's personal efforts or skills. The income derived by the partnership is not PSI.”*

Example 7

- *“Clare is an IT consultant who operates through a partnership with her spouse, Ralph, to provide IT services. Ralph does not engage in any of the principal work of the partnership (that is, IT activities), although he provides minor administrative assistance. The partnership has no significant assets, no employees or other workers and has not generated any significant goodwill. The income is not derived from the business structure of the partnership. As Clare is performing all the principal work of the partnership, the income derived by the partnership is Clare's PSI as it is mainly a reward for her personal efforts and skills.”*



Case study – Is Chris' income PSI

- Chris' work as an IT consultant will likely be PSI
- Chris isn't generating income via a product or business structure
- Consider the Example 7 on the prior slide for Claire the IT consultant
- Chris' income is derived from his personal skills and knowledge



So it is PSI





PSI not apply

Divisions 85 and 86 do not apply to personal services income that is income from conducting a personal services business.

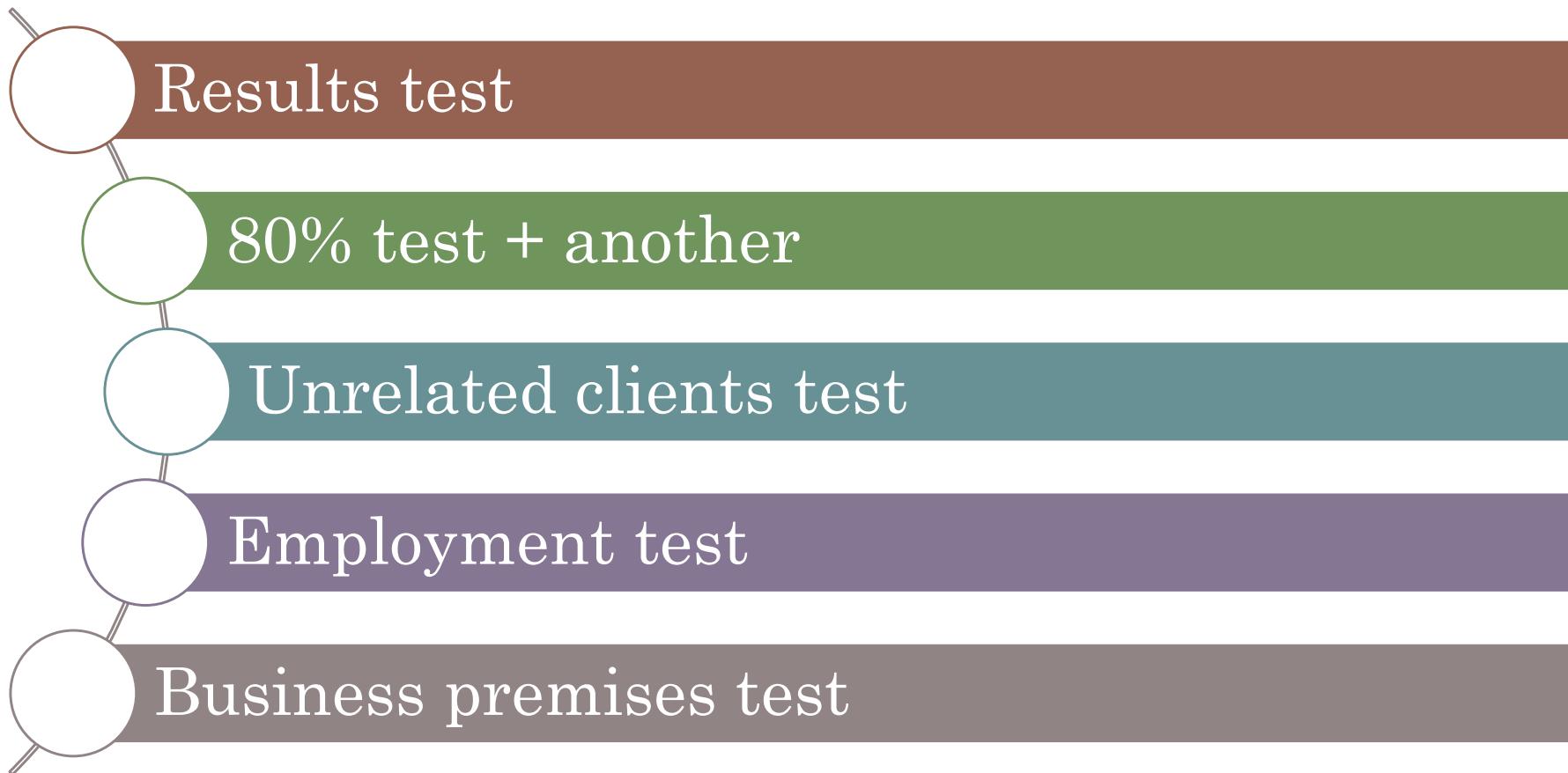
It is not intended that the Divisions apply to independent contractors.

A personal services business exists if there is a personal services business determination or if one or more of the 4 tests for what is a personal services business are met

- Section 85-1 Tax Act 1997



Exceptions to the rule





Results test

Requirements

- At least 75% of personal services income satisfies following 3 conditions
- Income is for producing a result
- Individual is required to supply the plant and equipment, or tools of trade, needed to perform the work from which the individual produces the result
- Individual is, or would be, liable for the cost of rectifying any defect in the work performed

Cases and takeaways

- Douglass – leading a team to produce a result does not satisfy results test
- IR Technical Services – paid by the hour to produce results as part of a team designing and constructing a plant does not satisfy results test
- Skiba – paid by the hours and was provided with equipment and not required to remedy defects
- Raj Taneja – paid by the hour under four different contracts and **not** for a specific result



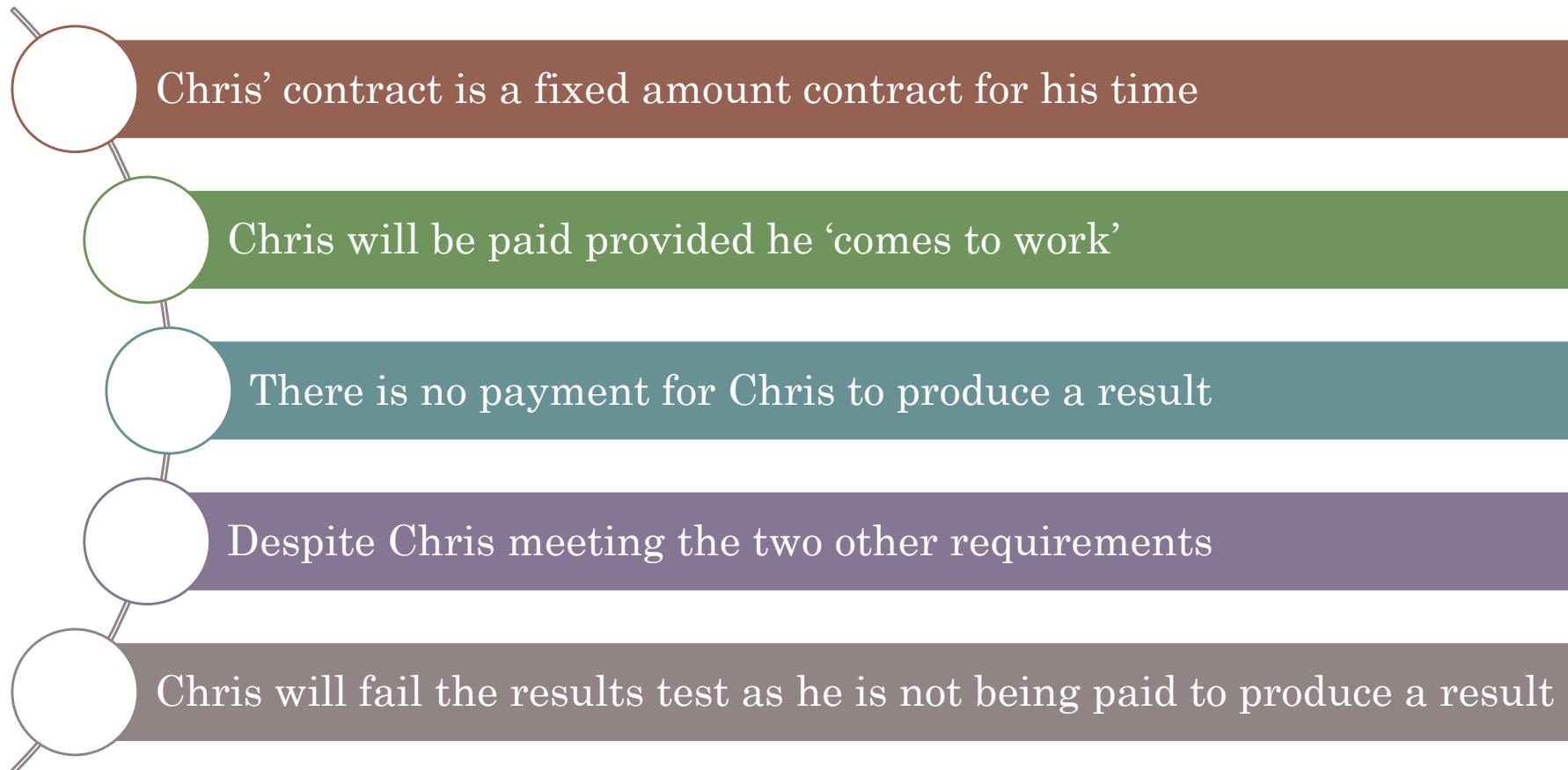
Results test

TR 2022/3 comments

- “*In contracts that are for producing a result, payment is usually made for a negotiated contract price to achieve a specified outcome... payment is made when the contractually specified results have been fulfilled. A contract price for achieving a specified result may be calculated by reference to an estimated number of hours applied to an hourly rate... What needs to be considered is whether the contract price is for achieving a specified result and not merely payment for the hours worked.*” – paragraph 84.
- “*The essence of the contract must be to achieve a result and not to do work. The fact that a sole trader or PSE is required to complete identifiable tasks is not the same as achieving a contractually specified result if those tasks merely form part of the work being paid for on an ongoing basis.*” – paragraph 85

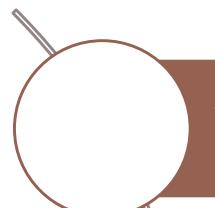


Case study – Year 1 – results test





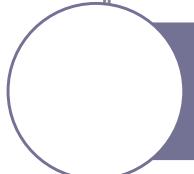
80% test



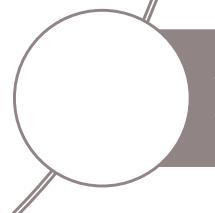
Where results test not satisfied



80% of the personal service entity's PSI cannot come from 1 client



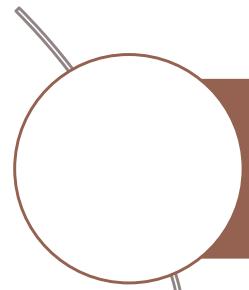
Failure of 80% test means no other test can be met



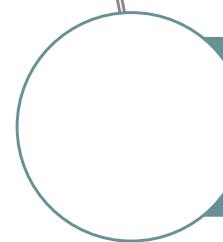
Must meet one of the other tests as well



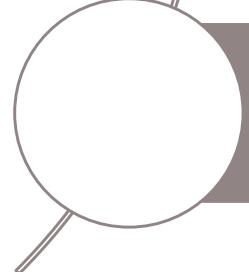
Case study – Year 1 – other tests



Chris is unable to meet the requirements for any other PSB test



Chris only has one client for his first year out



Chris needs to have at least two clients **and** no more than 80% of his income can come from one client

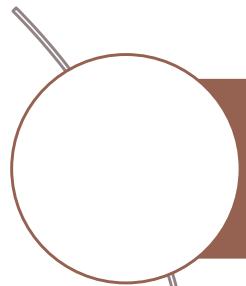


Case study – Year 2

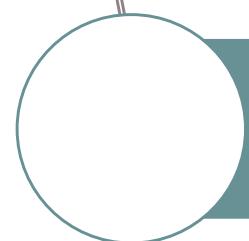




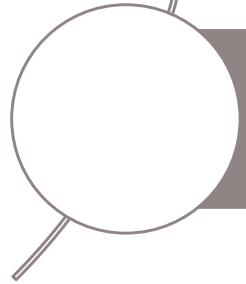
Case study – Year 2 – PSB tests



Chris still fails the results test – his payment structure has remained the same



Chris now has multiple clients and it appears that no client generates him more than 50% of his income



Chris meets the 80% rule that enables him to consider one of the other three PSB tests



Unrelated clients test

Requirements

- Income gained or produced 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
- Services are provided as a direct resolute 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

Cases and takeaway

- Fortunatow – LinkedIn profile but contracts obtained through a separate intermediary (some of whom identified the taxpayer through LinkedIn but not all). Causal connection required between making offers and obtaining the services
- Yalos Engineering – Okay to make offers to small number of large corporations if usually the case in the industry
- Cameron – word of mouth not enough to make offers to sections of public



Employment test

Requirements

- One or more entities (other than associates) to perform work
- Performs at least 20% (by market value) of the principal work

TR 2022/3

- Accepts a calculation $\% = (\text{market value amount} / \text{contract price}) \times 100$
- Where not clear, additional analysis required to separate out value of work of the employee



Business premises test

Requirements

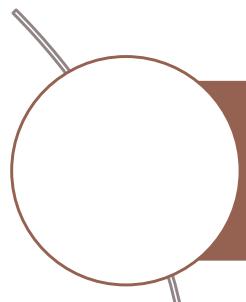
- Premises maintained and used to conduct activities from which personal services income gained or produced
- Exclusive use
- Physically separate from any premises used for private purposes of the taxpayer
- Physically separate from the premises of an associate entity of the taxpayer who provides services to

Case and takeaway

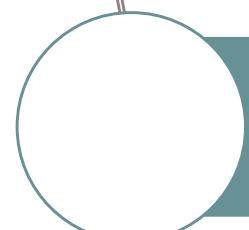
- Dixon and Consulting – premises not physically separate from location used for private purposes
- TR 2022/3 – licence arrangement not sufficient



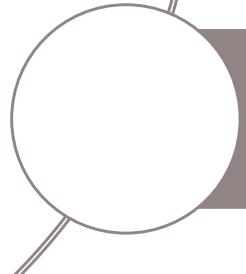
Case study – Year 2 – PSB tests



Chris will not meet the unrelated clients test as he does not meet the marketing requirements



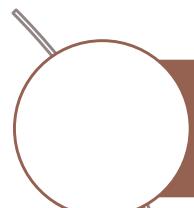
Chris will not meet the employment test as does not engage other persons to perform the work



Chris will not meet the business premises test as he does not operate from a separate business premises



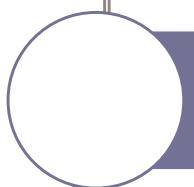
Case study – Year 3



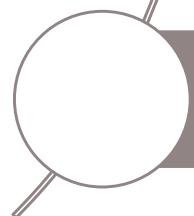
Various clients (5) now contacting Chris through marketing (websites and tenders within specialised industries)



Same payment terms



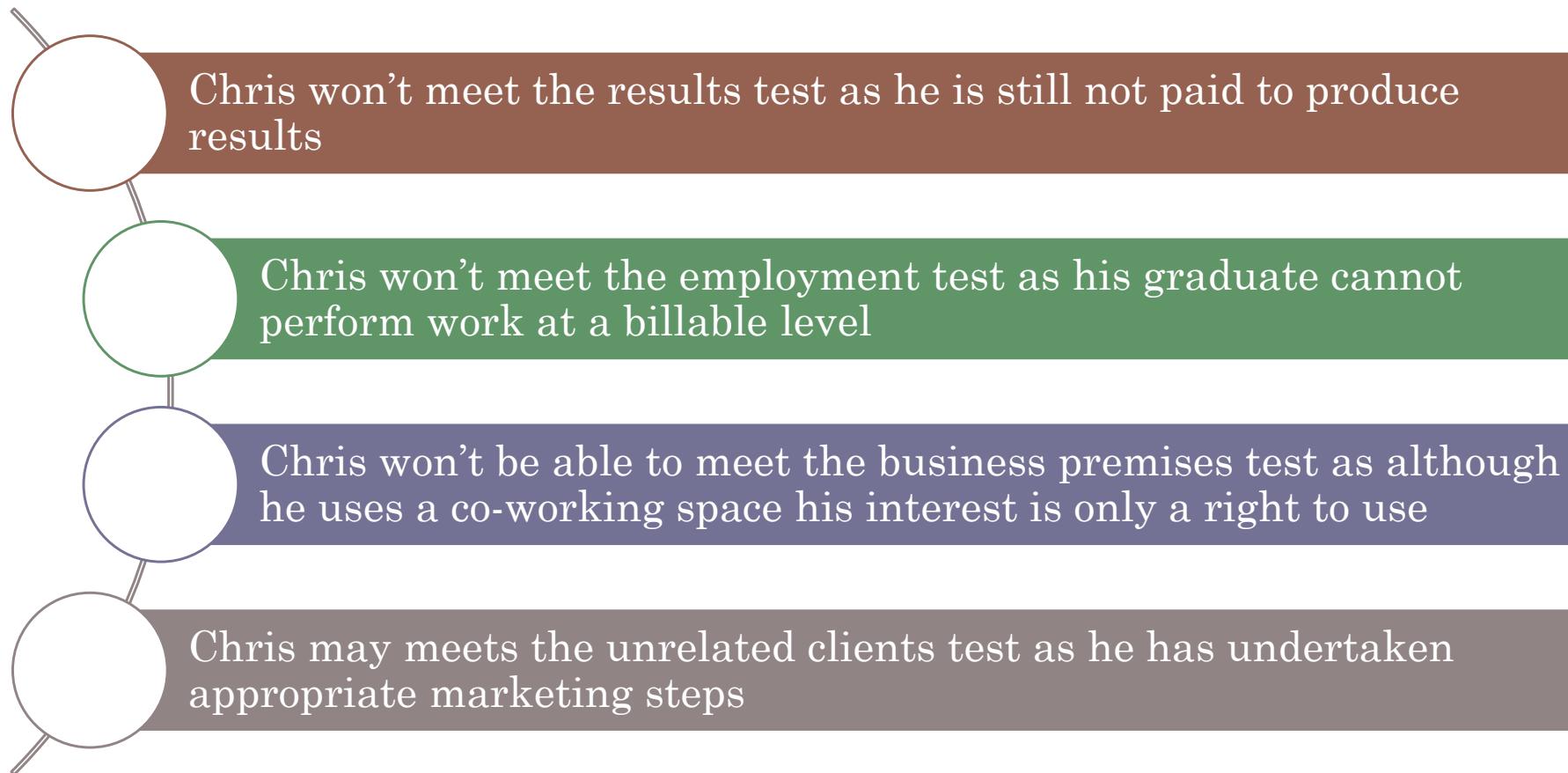
Graduate assistance, but not performing at the same level as Chris



Co-working space via a hot desk at the office



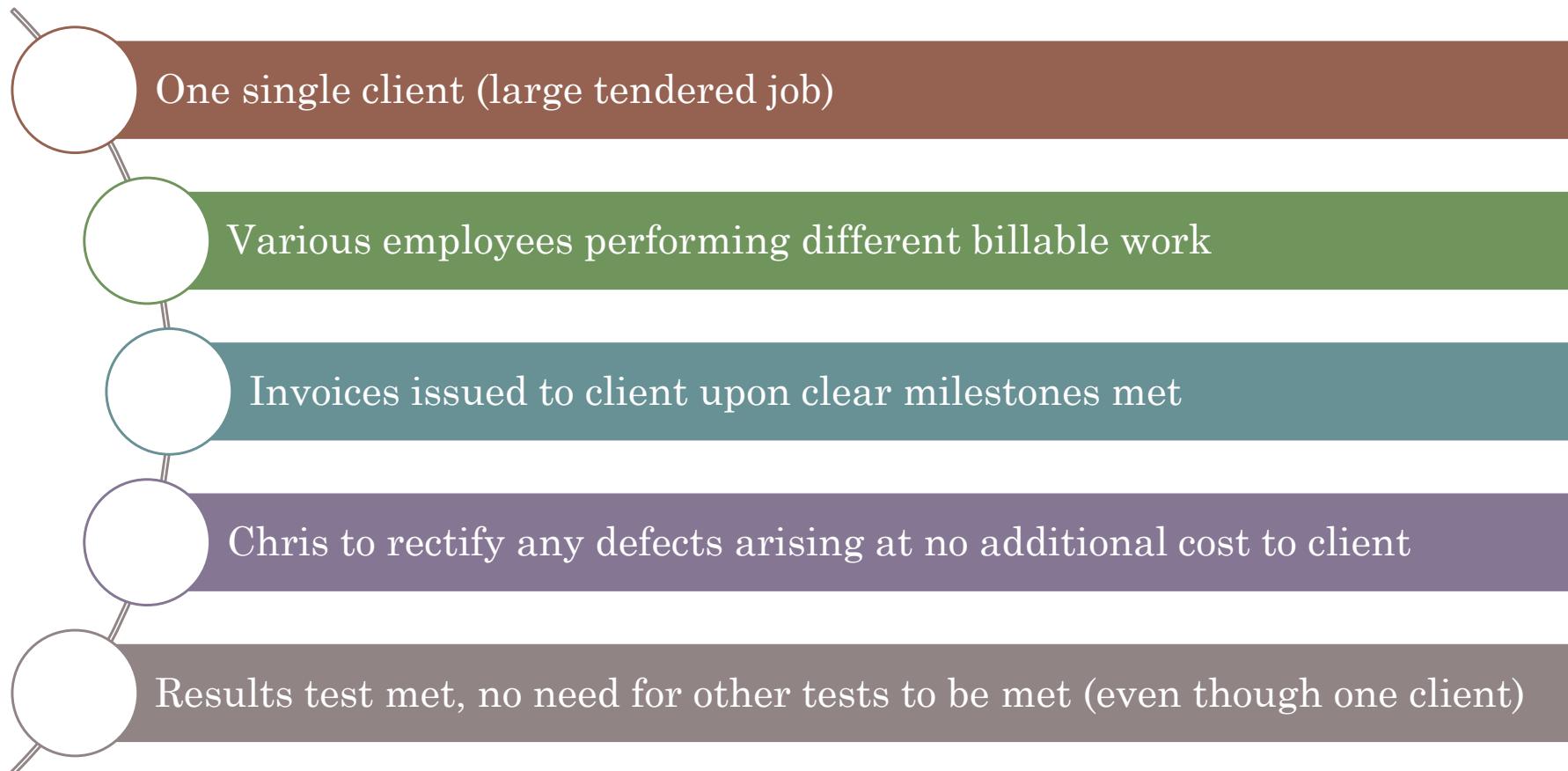
Case study – Year 3



- Chris won't meet the results test as he is still not paid to produce results
- Chris won't meet the employment test as his graduate cannot perform work at a billable level
- Chris won't be able to meet the business premises test as although he uses a co-working space his interest is only a right to use
- Chris may meet the unrelated clients test as he has undertaken appropriate marketing steps

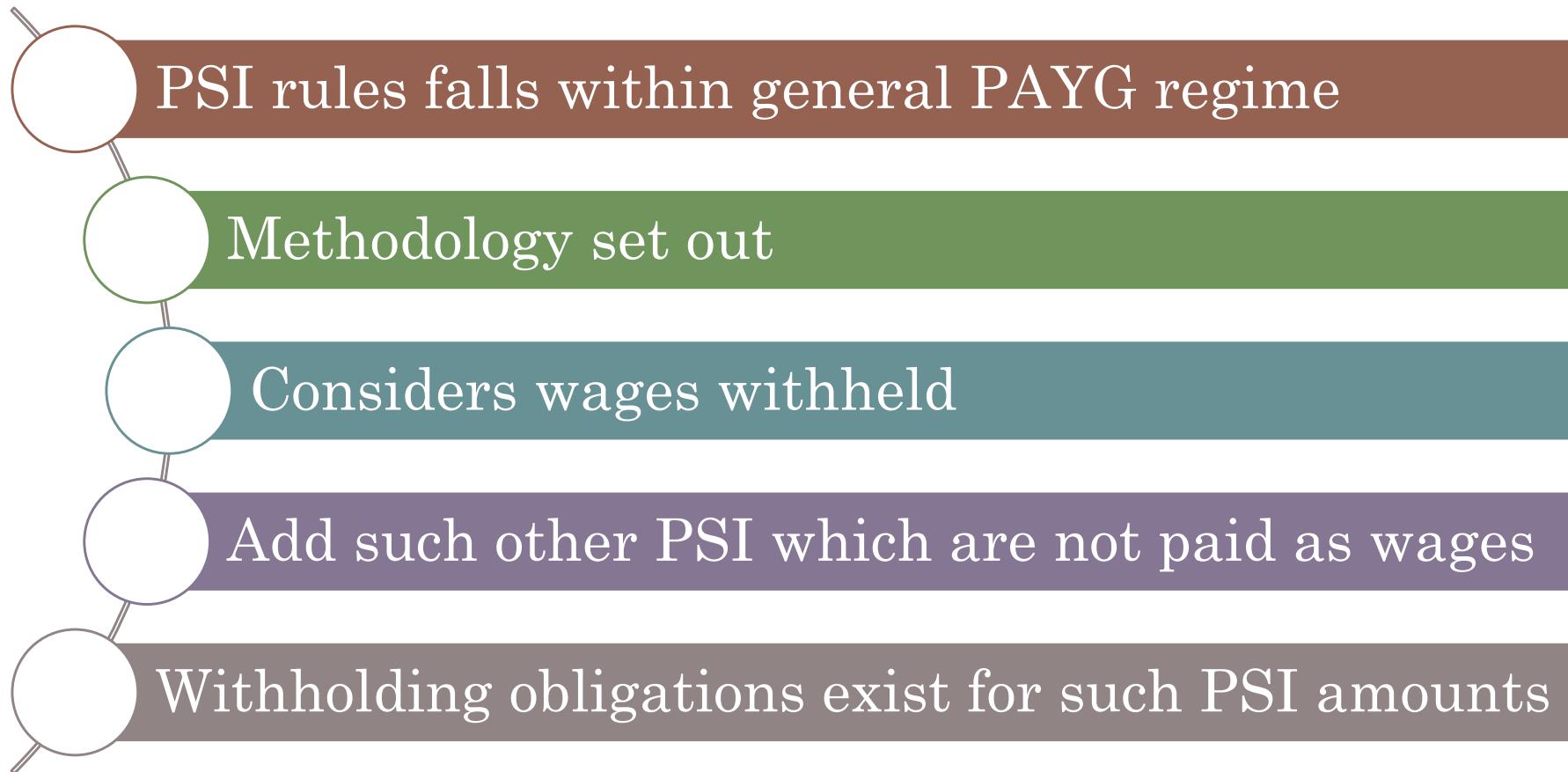


Case study – Year 4



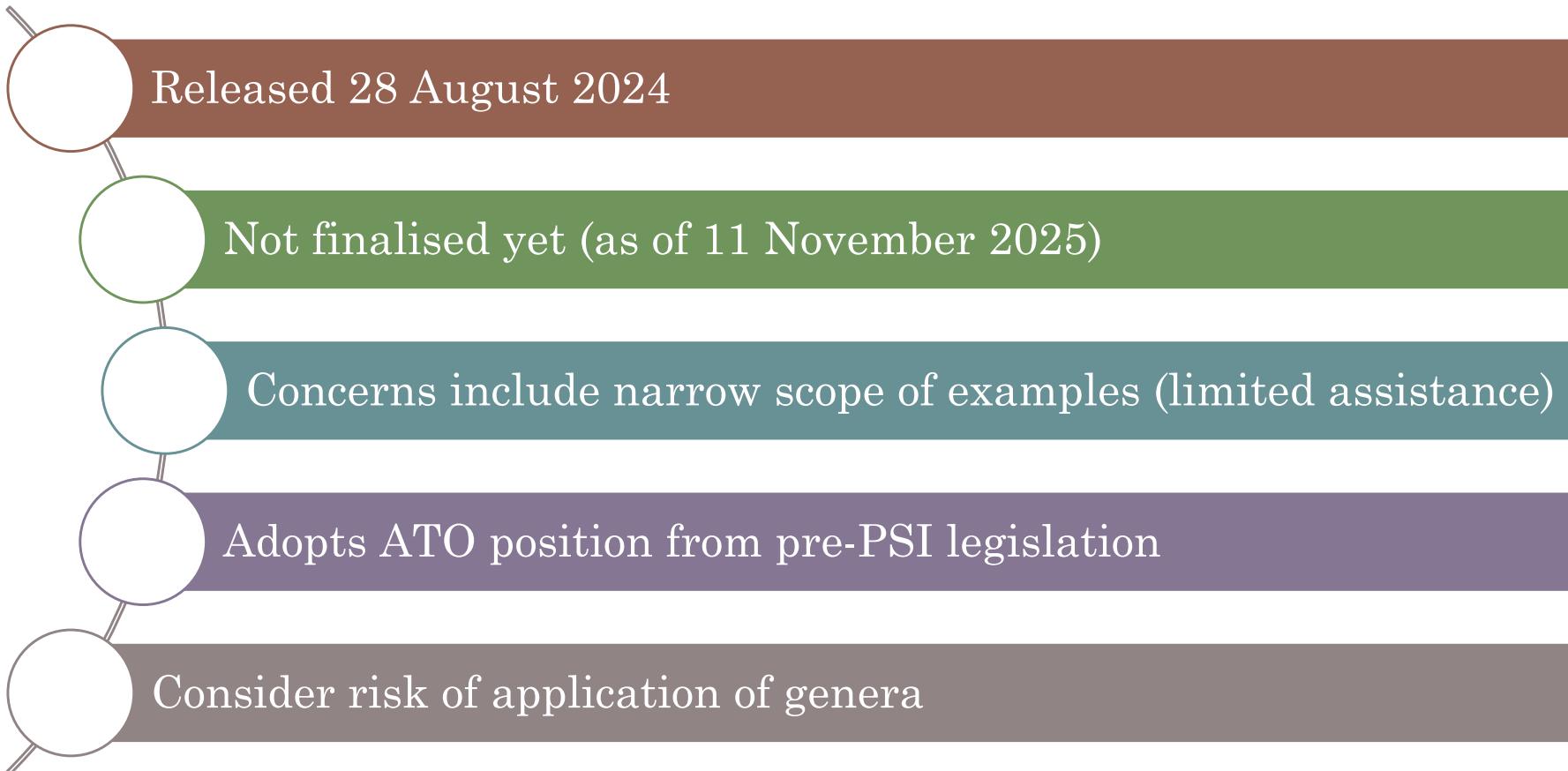


PAYG withholding and reporting





PCG 2024/D2





PCG 2024/D2

Guideline does not establish an acceptable level of income splitting, the degree to which PSI has been diverted away from the individual is a relevant factor in consideration the application of Part IVA, and whether the dominant purpose of the taxpayer is entering into the arrangement is to obtain a tax benefit'

- PCG 2024/D2 at paragraph 36



Low risk arrangements

Where net PSI is distributed to the individual whose personal efforts or skills generated the income and taxed at their marginal rate.

The remuneration received by the individual is substantially commensurate with the value of their personal services.

Remuneration is paid to an associate for bona fide services related to the earning of the PSI if that amount is reasonable for the services provided by them.

Difference between the earning of the PSI and the distribution of net PSI to the individual explained by reasons outside control or where the delay can be explained by circumstances not attributable to tax.

The PSB makes a superannuation contribution on behalf of the individual, who is an employee of the PSB, for the purposes of providing a superannuation benefit.

There is a temporary retention of profits to acquire an asset for a clear commercial purpose.



Higher risk arrangements

The net PSI is distributed to another entity so that it is taxed at an overall lower rate than if the individual had received the income directly.

The remuneration received by the individual is less than commensurate with the value of their personal services.

The PSB does not distribute any income to the individual who provided the actual services.

The net PSI (or a part thereof) is split with an associate of the individual, thereby reducing the overall income tax liability.

Remuneration is paid to an associate (or a service trust) that is not commensurate with the skills exercised or services provided by the associate.

The net PSI is retained in the PSB. In most cases, the retained funds are subsequently made available to the individual for their personal use, however, the mere fact that PSI is retained is a sufficiently higher-risk indicator.



PCG 2024/D2 examples

Example 1

- Accountant (Eddy) operates through a family trust
- Accountant pays his entire net PSI received as assessable income in his name through a salary and trust distribution

Example 2

- Engineering consultant (Ellen) operates through a trading company
- After valid deductions and paying a fixed salary, the net PSI is paid to the consultant as a director fee or superannuation payment

Example 4

- Solicitor (Tran) who operates through a trading company knows he will undergo a serious medical procedure
- Solicitor proceeds to retain certain funds to cover the period which he will be recovering in the July following the end of financial year



PCG 2024/D2 examples

Example 5

- Audio engineer (Maxine) operates through a company
- Trading company makes superannuation contributions on behalf of engineer with the balance paid to the engineer

Example 6

- Medical practitioner (Hayley) requires funds to be retained to acquire CRM platform
- CRM platform estimated to cost \$7,000 and practitioner retained \$7,000 to pay for CRM
- CRM ends up costing \$5,000 and practitioner pays a \$2,000 bonus within one week of purchasing the CRM



PCG 2024/D2 examples

Example 8

- Corporate consultant (Chester) receives income of approximately \$400,000
- Trading company pays consultant \$20,000 and the remainder is retained and taxed at the company tax rate
- *“....had CC paid Chester an amount that represented a significant part of the PSI derived...then although Part IVA could still apply, we would be less likely to have cause to apply compliance resources...”*

Example 9

- IT Consultant (Diana) who operates through a company pays out between 20% and 25% of income generated, whilst retaining the remainder for IT upgrades
- Considered high risk as amounts retained excessive for maintenance of equipment



PCG 2024/D2 examples

Example 10

- Environmental engineer (Terry) who operates through a discretionary trust
- Discretionary trust seeks to distribute PSI income to entity with carried forward losses

Example 11

- IT Specialist (Adam) who was previously a sole trader, incorporates and engages persons on a disproportionate salary
- Where value not commensurate, then arrangements considered higher risk; particularly where overall, less tax was being paid



PCG 2025/5

Finalised 28 November 2025

Some changes made from the draft

Regarding previous references on earlier slides:

- PCG 2024/D2 at paragraph 36 → PCG 2025/5 at paragraph 41
- PCG 2024/D2 Example 8 → PCG 2025/ Example 12
- PCG 2024/D2 Example 9 → PCG 2025/ Example 13
- PCG 2024/D2 Example 10 → PCG 2025/ Example 14
- PCG 2024/D2 Example 11 → PCG 2025/ Example 15



PCG 2025/5

Mostly unchanged, however acknowledges some practical real life scenarios

Paragraph 11:

- *“While Part IVA can apply to any higher-risk arrangement, the materiality of the PSI diverted will always be a relevant factor we consider when deciding whether to review an arrangement or pursue Part IVA. We are more likely to target arrangements where there are substantial distributions or payments made to associated lower-tax persons or entities. Further tax payers should not be concerned that we will apply compliance resources to pursue Part IVA where they have made a genuine attempt to move into a low-risk arrangement by 30 June 2027”*



PCG 2025/5

Low risk indicators updated to include:

- *“There is a timing difference between the earning of the PSI and the distribution of net PSI to the individual, either for reasons outside the control of the individual and PSE or where the delay is explained by circumstances not attributable to tax. This creates only a temporary deferral of tax to a following income year.”*
- *“There is an intention to temporarily retain the profits for working capital purposes such as to fund business operations or acquire an asset for a clear commercial purpose, and that intention is carried out”*

Higher risk indicator updated to include following circumstance

- *“There is an intention to temporarily retain the profits for working capital purposes such as to fund business operations or acquire an asset but the intention is not carried out, and there are no sound commercial reasons for not carrying that intention out”*



PCG 2025/5 new examples

Example 7

- Where a web designer retained \$15,000 out of \$75,000 PSI income in order to ensure interest costs and wages in the following financial year could be paid amidst a downturn in her industry. The business had originally obtained a \$50,000 business loan to acquire initial assets on commencement of the business.

Example 8

- Where an IT specialist retains \$11,000 out of \$76,000 PSI income in order to cover start-up costs due to the uncertainty of the new business obtaining new clients in the following financial year.
- Example 8 also includes an alternative position where the retained profit continues to be retained for no sound reason, thereby attracting a higher risk consideration of whether Part IVA should apply.



PCG 2025/5 new examples

Example 9

- Where a landscaper operates a business through a company with his father as an equal shareholder. As the father originally provided an initial investment in the landscaper's business, the retention of a portion of the net profit may be considered as a return on investment (depending on whether the amount of net profit distributed is considered disproportionate to the investment risk undertaken). The business had originally obtained a \$50,000 business loan to acquire initial assets on

Example 11

- Whereby an electrician operating a PSB pays himself wages of \$189,000 during the 2024-25 income year out of a total of \$215,000 of eligible income to be paid to him. The example acknowledges a variation (albeit unhelpfully) where the electrician is paid an amount commensurate with the work performed equating to a salary of \$200,000 whilst paying the remaining amount as a bonus at the end-of-year

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