

PERSONAL SERVICES INCOME



1. CASE STUDY



CASE STUDY

- Cornu Pty Ltd is the trustee for the Cornu Trust (**Trust**)
- The Trust carries on a management services business across Australia (the **Business**)
- The Business offers three service offerings namely traditional project/development management, commercial management and general management services
- Your client is the director and sole shareholder of Cornu Pty Ltd

CASE STUDY

- The Trust enters into contracts with each of its clients and is generally paid on a monthly basis during the course of the project, in accordance with the terms of the contract
- To assist with niche projects, the Trust may contract with a consultant from an unrelated business to assist in providing services that it doesn't have the necessary skills
- The Trust may also engage other independent contractors

CASE STUDY

- The Trust does not have any employees
- The Trust supplies all the necessary equipment to provide its services to customers
- The equipment generally needed is office equipment
- Where services are provided at a client's office, the client's printing services and wireless system is used by the Trust
- The Trust obtains an indemnity insurance in relation to its services provided

CASE STUDY

- The nature of the management services provided by the Trust is not one which attracts business risk as if the project runs over time, the Trust does not bear the costs of overrunning, rather the Trust would quote further in relation to the work to be done
- The nature of the services provided is that there are no situations where the Trust has to rectify a defect in work out of its own pocket

CASE STUDY

- During most income years, more than 80% of the Trust's income has come from two or three clients (as projects usually tend to run for a long time)
- The Trust sources its clients largely from reputation in the market as opposed to marketing and does not publicly advertise its services
- The Trust conducts the Business from a home office or the client's office

2.

THE LEGISLATION



OVERVIEW

- Personal services income (**PSI**) = reward for your personal efforts or skills
- Contrast with income derived from use of assets or the sale of goods
- IT 2639
- Nature of taxpayer's activities (personal services?), extent to which income depends on own skill and judgement, assets used to derive income or number of employees/others engaged

A WARNING WHEN RESTRUCTURING

- Part IV A
- *AAT Case 165* (1999) 41 ATR 1249
- *Re Egan and FCT* (2001) 47 ATR 1180

LEGISLATION

- Divisions 84 to 87 *Income Tax Assessment Act 1997*(Cth) (**ITAA 97**)
- ATO rulings: TR 2001/7 (personal services income), 2001/9 (personal service businesses), 2003/6 (attribution of PSI) and 2003/10 (deductions relating to PSI)
- PSI rules do not apply if carrying on a personal services business
- If PSI affects entity, it **does not** affect the legal status of the entity (just the income tax outcome) or status as an enterprise

WHAT IS PSI

- PSI is ordinary income or statutory income derived mainly as a reward for the personal efforts or skills of an individual (s 84-5(1) and (2)) and includes income derived by an entity
- *Mainly* suggests that more than half of the income must relate to an individual's personal effort or skills (TR 2001/7)
- Income that is not related to an individual's effort includes supply of goods, a business structure or use of assets
- PSI does not care if it relates to doing work or producing a result, it is how the income is coming about (i.e. from personal effort)

WHAT IS PSI

- PSI can even include gardening leave
- Section 84-10 ensures alienation of PSI rules do not imply that individuals affected by the rules are employees for any legal purposes (i.e. are not suddenly entitled to employee rights even if PSI links to you)

IMPACT OF PSI RULES

- If PSI applies – there is a limit to deductions that can be claimed (not considered today, but look at Div 85/86 ITAA 97 and TR 2003/10) but is overridden if there is a personal services business
- Broadly, amount is not deductible to the extent that it relates to gaining or producing PSI if the income is not payable to the individual as an employee and the amount would not be deductible if the income were payable to the individual as an employee
- Section 84-15 to 25 also lists other amounts that are not deductible

IMPACT OF PSI RULES

- Division 86 ITAA 197 looks at PSI derived through an entity
- Important to appreciate amounts that are not assessable income to the entity are not assessable income to the individual (think GST)
- Also consider that PSI will not attribute income by an Australian personal service entity to a foreign resident individual unless that income has an Australian source (just general income rules)

GETTING OUT OF THE PSI ISSUE

- Everything we just discussed won't apply if an individual or an entity is deriving that income in the course of carrying on a personal services business
- Division 87 ITAA and TR 2001/9

PERSONAL SERVICES BUSINESS

- Out of PSI if (Section 87-15):
 - Entity's PSI meets the results test; or
 - Not more than 80% of the entity's PSI comes from more than one client and either the unrelated clients test, employment test or business premises test is met; or
 - Obtaining a personal services business determination.

RESULTS TEST

- Easiest to satisfy as if can prove PSI for a result then PSI isn't an issue
- Satisfies test if at least 75% of the entity's PSI:
 - Is used for producing a result and not be paid until and unless the result is produced;
 - Entity is required to supply the plant, equipment or tools necessary to perform the work; **and**
 - Entity is liable for the cost of rectifying any defective work

RESULTS TEST

- Look at TR 2001/ in relation to the tool comment and also that the custom of the industry needs to be considered when analysing the previous factors
- Recall what a common law ‘independent contractor’ looks like, but the results test requires all three factors to be satisfied
- *IRG Technical Services Pty Ltd v DCT* (2007) 69 ATR 433 where team of engineers didn’t provide own tools and income derived for work as engineers rather than getting a result
- Can professionals time billing ever satisfy the results test?

80% TEST

- Recall 80% of income cannot come from a single client
- And another test must be satisfied, being:
 - Unrelated clients test;
 - Employment test; or
 - Business premises test

UNRELATED CLIENT TEST

- Clients cannot be associated with each other
- Services are provided as a **direct result from advertising or offering the services to the public at large** (or a section of the public)
- Not limited to advertising and can include other forms of solicitation (except labour hire/employment agencies)
- Need to look at what's common in the industry in that in some industries, word of mouth is custom to get work
- Cold calling and responding to advertisements may fail the test

UNRELATED CLIENT TEST

- Need to look at what's common in the industry in that in some industries, word of mouth is custom to get work (*Re Yalos Engineering Pty Ltd and FCT*(2010) 79 ATR 282 where a there was a focussed group of the public in offshore petroleum exploration and mining)
- Cold calling and responding to advertisements may fail the test (*Re The Engineering Company and FCT*(2008) 74 ATR 272)

EMPLOYMENT TEST

- Employing one or more persons (need to be unrelated) to perform work of at least 20% of the market value of the PSI

BUSINESS PREMISES TEST

- Maintaining a business premises to conduct activities from which PSI is derived (does not have to be the same – s87-30(2))
- Entity has exclusive use of the premises
- Physically separate from any premises that the entity (or associates) use for private purposes
- Physically separate from client's location
- TR 2001/8 (i.e. shared offices do not disqualify)

AGENTS

- 80% and unrelated clients test modified if an individual/entity:
 - Is an agent of another entity
 - Receives income for services provided to customers on principal's behalf
 - Receives at least 75% of that income as commission
 - Actively seeks out other customers;
 - Supplies own business premises
- PSI of the agent treated as income from the customer for purpose of 80% threshold and unrelated clients test

3. BACK TO THE CASE STUDY



Any takers?

CASE STUDY

- True client example
- Earlier ones I did
- Client tried to look at the ATO flowchart and determined PSI did not apply to him

THE VERDICT

Results test failed

He billed on a time basis and beared no risk if projects did not run to time. He had also no commercial risk in his advice component

Employment test failed

He did not engage others to perform income producing work. He may have hired a secretary but they did not assist in generating any income

80% threshold was borderline

Fortunately the client had two income sources for the relevant year he sought advice, but the same could not be said for prior years

Business premises test failed

He used his client's premises to provide his services

Unrelated clients test failed

Although his clients were unrelated he did no advertising and purely relied heavily on word of mouth

4. MOVING FORWARD



REMINDER

- Be tough on your clients
- Just because it looks like PSI, doesn't mean you are out
- Consider the personal services business tests

5. BONUS SESSION CHANGE OF TRUSTEES



OVERVIEW

- Changing individual trustees of SMSFs to corporate trustees
- What do you need to consider
- Benefits include asset protection, continuous succession, able to adapt to changes in members, flexibility for estate planning and reduced penalty regime

READ THE DEED

- Read the document!
- Who can retire the trustee
- Who can appoint the trustee
- Is it the same person
- Is a principal employer needed
- Is the person still around

TRUE STORY

- Template change of trustee for a SMSF from an online platform
- Template stated that the *Trustee has the power to appoint a successor trustee*
- Not always suitable!
- Fixing up issues as it was the members who had the power to appoint a new trustee
- Other issues include getting the entities wrong
- Example of the principal employer being stated as the trustee instead of two individuals and the flow on effects

BUYER BEWARE

- Online solutions are convenient but one size **does not** fit all
- Only you can confirm if the template provided is suitable by reading the document
- Note companies can have a reduced fee if it is solely used as a trustee for a SMSF
- Note if certain States have requirements when changing the trustee (see QLD)

AFTER THE LEGAL DOCUMENT

- Stamping
- Notifying third parties
- Transferring assets out of the name of the old trustee to the new trustee
- Real property (normally best to get a lawyer to assist here due to government regulations)
- Shares, bank accounts can usually be done by the client

PERRY V NICHOLSON [2017] QSC 163

- The Colin Maurice Superannuation Fund (the Fund) established on 17 September 2009 with Colin Maurice as the sole member.
- Original trustees were Colin and his daughter (Sonia Perry).
- In October 2010, Colin stated to live with Jennifer Nicholson
- Purportedly on 23 April 2015 documents retiring Sonia as trustee and appointing Jennifer as trustee were signed.
- Clients do not recall signing the documents on 23 April 2015 but rather in February 2017 signed some deed.

PERRY V NICHOLSON [2017] QSC 163

- On 4 January 2017, binding death benefit nominations were signed giving 100% of the death benefits to Jennifer.
- In February 2017, a proper deed was prepared to change the trustee and signed but dated 23 April 2015.
- Recollection was the date was inserted after documents were signed.
- Issue, however, was the change of trustee documents were being attacked as invalid, and therefore the binding death benefit nomination documents were invalid as well

PERRY V NICHOLSON [2017] QSC 163

- This went to Court and in this case what was prepared was found to be acceptable, notwithstanding some deficiencies.
- Specific deficiency is that documents were required to be in writing, and they were not in this case done contemporaneously.
- This can be contrasted with Moss Super Pty Ltd v Hayne [2008] VSC 158 where a stricter approach was applied.
- If you want to avoid doubt, do it properly.

CREDITS

Special thanks to all the people who made and released these awesome resources for free:

- Presentation template by [SlidesCarnival](#)
- Photographs by [Unsplash](#)

THANKS!

ANY QUESTIONS?

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