

### ***personal services income (PSI)***

Some consultants arrange for the consultant's family trust/ company to contract with (and receive income from) the consultant's customers, in order to reduce tax by splitting income with family members, e.g. the consultant's spouse. But the Tax Office is awake to this arrangement and (some years ago) introduced a series of PSI tests — one of which (see below) must be satisfied if business net income is to be validly distributed to other family members.

background info

- employers used to encourage employees to become “independent” contractors, as a basis for reducing the employer's pay-roll tax and employee entitlements — with the incentive for the former employee being that the new arrangement would enable income-splitting
- to counter the loss of revenue, the Tax Office developed the *personal services* concept to apply to those contractors and consultants who were in “labour only” arrangements, with all (or almost all) of the contract payments coming from a single customer
- a contractor/ consultant needs to satisfy at least one test (or a combination of tests) for the PSI provisions to not apply — otherwise, all *personal services* income would be **assessable to the individual professional (rather than to the associated company or trust)** and must be declared in his or her personal tax return, and **tax deductions would be denied** for
  - home office expenses
  - any wages (or super) paid to a spouse for non-principal work, including secretarial support (even if the spouse's pay is at a commercial rate)
  - private car expenses.

### **OUTLINE OF TESTS**

#### **- ONE OF WHICH MUST BE SATISFIED FOR *PSI* PROVISIONS TO NOT APPLY**

#### **results test**

- you will meet this test if at least 75% of your income during the financial year was earned on the basis of achieving specified **results or outcomes** and you provided your own tools and equipment (if any required) and you are liable for remedying any defects in your work

if you don't meet the results test, the next test to consider is the **80% rule**

- you will meet this test if **no single customer** is the source or **80% or more of your income** during the financial year
- if you don't meet the results test nor the 80% rule, there are no further tests for you to self-assess and PSI applies
- if you don't meet the results test but do meet the 80% rule, there are three further tests you may consider

if you meet the 80% rule, a further test to consider is the **unrelated clients test**

- you will meet this test if, as a direct result of advertising, your family trust has **two or more unrelated clients (neither of whom is the source of 80% or more of your income** during the financial year) [The ATO accepts a business website as adequate advertising for the purpose of the ‘unrelated clients test’.]

if you meet the 80% rule, a further test to consider is the **employment test**

- you will meet this test if your family trust *either* has **employees** (apart from yourself and relatives) **or sub-contractors**, *or* has unrelated **apprentices** for at least half the financial year

if you meet the 80% rule, a further test to consider is the **business premises test**

- you will meet this test if the family trust uses **dedicated business premises**, either as owner or tenant, that are used exclusively by your business and are physically separate from your private residence and from the business address of your clients

**warning:** Just because a taxpayer's arrangements pass the PSI tests does not mean that the arrangements are exempt from challenge by the Tax Office. Where personal services income is involved (particularly where family members are not doing “principal” work), the ATO view is that income-splitting (including spouse super contributions from the employer entity) may be challenged under Part IVA.