

What is Personal Services Income?

“Personal services income” is defined as any income resulting mainly from an individual’s personal efforts or skills. Examples of such income include salary and wages, amounts received under labour hire contracts and consulting income derived from applying expertise. Personal services income does not include income resulting mainly from sale of goods or use of assets.

What is the Personal Services Income regime?

The personal services income (PSI) regime is the means by which the ATO prevents individuals earning personal services income from reducing their income tax liability by:

- Channelling “personal services income” away from themselves to another entity, be it an associated individual, partnership, company or trust, and
- Claiming inappropriate business deductions

The regime is basically intended to level the playing field between employees and contractors.

Personal Services Entities

You are operating a “personal services entity” (PSE) if:

- You operate a business via a partnership, company or trust structure, and
- Your business’ income includes personal service income derived by one or more individuals

Personal service entities are required to attribute personal services income net of allowable deductions to the individuals generating the income, unless they meet the definition of a

“personal services business” (refer below). The net amount attributed is included as a deduction in the income tax return of the personal services entity. This has the effect of stripping out net personal services income from the entity and re-locating it with the individuals performing the work.

The relevant individuals declare the attributed personal services income in their assessable income. If the individuals have been paid a salary, the salary is included as such in assessable income and the net personal services income attributed is adjusted accordingly. The net personal services income amount attributed to an individual cannot be below nil, that is, you cannot attribute a loss.

There are restrictions on the types of expenses that can be claimed by personal services entities. Allowable deductions can be broadly categorised as follows:

- Deductions that relate directly to the personal services income. These deductions are generally limited to those that could be claimed if you were an employee earning salary and wages. For instance, you can claim the likes of home office expenses, however you cannot claim the likes of rent or mortgage interest
- “Entity maintenance” deductions”. These are costs associated with running the personal service entity, such as bank charges on bank accounts held by the PSE and tax agent fees incurred by the PSE

The following table contains examples of both permitted and disallowed deductions in the context of personal services entities:

Examples of Permitted Deductions	Examples of Disallowed Deductions
Salary, wages and superannuation paid to persons (including associates) performing principal work ¹	Salary, wages and superannuation paid to persons (including associates) who do not perform principal work
Home office running expenses	Rent or mortgage interest
Car expenses for business use of car used by individual performing principal work	Car expenses for subsequent cars used by an individual performing principal work

Personal Services Businesses

You or your personal service entity is exempted from the personal services income regime in the event the "personal services business" (PSB) criteria are met. Either of the following sets of tests must be met to qualify as a personal services business:

- "Results test" – the following conditions must be met in relation to at least 75% of the personal services income derived:
 - Income is received for producing a result rather than for time spent working (eg: delivery of software versus time spent programming)
 - You are required to supply any tools of trade or plant and equipment needed to perform the work
 - You are liable for the cost of rectifying any defect in the work performed, or damages
- "80% test" and additional tests – your largest client represents less than 80% of your total personal services income, and:
 - At least two of your clients are unrelated and your services are available to the public at large, or
 - At least 20% of the principal work is performed by an employee or contractor who is not captured in the PSI regime, or

- You employ one or more apprentices for at least half the income year
- You conduct your business activities at independent business premises

If you do not satisfy either of the above sets of tests but believe you are operating a personal services business, you can apply for a personal services business determination from the ATO. This is a particularly relevant option for start-up personal services businesses, or businesses experiencing sudden but temporary business downturn. That is, businesses that would satisfy the personal services business criteria over the long term.

What Next?

Visit our flash sheet on personal services businesses for a quick reference to the abovementioned tests.

If you are thinking about starting a new services business, or would otherwise like to know more about this legislation, please contact your manager or partner at Isaacs & Cole to discuss how the personal services income regime potentially impacts you.

Disclaimer: The information contained in this fact sheet is not intended as specific advice. Please contact Isaacs & Cole to discuss your individual situation.