

# ***TR 2001/7 - Income tax: the meaning of personal services income***

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## Taxation Ruling

### Income tax: the meaning of personal services income

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#### ***Preamble***

*The number, subject heading (the title), **Class of person/arrangement**, **Date of effect** and **Ruling** parts of this document are a ‘public ruling’ for the purposes of Part IVAAA of the **Taxation Administration Act 1953** and are legally binding on the Commissioner. The remainder of the document is administratively binding on the Commissioner. Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a public ruling and how it is binding on the Commissioner.*

#### **What this Ruling is about**

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1. This Ruling explains the meaning of personal services income contained in Division 84 of Part 2-42 of the *Income Tax Assessment Act 1997* (ITAA 1997) (the alienation measure).
2. This Ruling incorporates the proposed legislative amendments announced in Treasurer’s Press Release No. 47 of 29 June 2001 and Treasurer’s Press Release No. 51 of 9 July 2001. Those aspects of the ruling that relate to those announcements are not public rulings for the purposes of the *Tax Administration Act 1953* (TAA 1953).<sup>1</sup>

#### **Class of person/arrangement**

3. This ruling applies to:
  - individuals whose ordinary income or statutory income includes income that is mainly a reward for their personal efforts or skills; and
  - companies, partnerships or trusts whose ordinary or statutory income includes income that is mainly a reward for the personal efforts or skills of an individual (an individual’s personal services income). Such entities are called personal service entities.

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<sup>1</sup> After the enactment of the proposed amendments, the ruling will be reviewed and will be modified, if necessary.

**The Relevance of Personal Services Income**

4. The alienation measure only applies to income earned mainly from the provision of an individual's labour or skills (personal services income) rather than being generated by the use of assets, the sale of goods, the granting of a right to use property or by a business structure.<sup>2</sup>

5. By definition, income earned by an employee is personal services income. However, the measure does not apply to employees, except where an individual is an employee of an interposed entity.<sup>3</sup> The alienation measure will not apply where the income is earned in the course of conducting a personal services business. The meaning of personal services business is explained in Taxation Ruling TR 2001/8.

6. You will not be within the alienation measure and can self-assess accordingly if you come within ONE of the following four situations:

- You satisfy the 'results test', that is:
  - (a) You work to produce a result(s); and
  - (b) You provide the tools and equipment necessary (if any) to produce the result(s); and
  - (c) You are liable for the cost of rectifying any defective work.<sup>4</sup>

OR

- None of your clients pay you 80% or more of your personal services income in the year of income and you have two or more unrelated clients (who were obtained as a result of you making offers to the public at large or to a section of the public)<sup>5</sup>.

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<sup>2</sup> The note to section 86-10 makes it clear that the general anti-avoidance provisions of Part IVA of the *Income Tax Assessment Act 1936* (ITAA 1936) may still apply to cases of alienation of personal services income that fall outside the alienation measure. This may occur for example where the dominant purpose of an arrangement is income splitting.

<sup>3</sup> See section 85-35 which provides that Division 85, which relates to deductions for individuals who are not conducting personal services businesses, does not apply to the extent that an amount, payment or contribution relates to personal service income that is received as an employee.

<sup>4</sup> See Treasurer's Press Release No.51 of 9 July 2001.

<sup>5</sup> See Treasurer's Press Release No.47 of 29 June 2001. If an agent satisfies the four conditions set out in that Press Release, they will not be subject to the alienation measure. The four conditions are that an agent:

- Receives personal services income from providing services (on behalf of the principal) to customers, and less than 80 per cent of that income is from services provided to each customer;
- Receives at least 75 per cent of that income as commission or results-based payments, (as opposed to retainers or salary-like payments);

OR

- None of your clients pay you 80% or more of your personal services income in the year of income and
  - (d) You engage an individual(s) or an unrelated entity(ies) to perform 20% or more (by market value) of the principal work (ie the work that generates the personal services income) or
  - (e) You have an apprentice for at least half the year

OR

- None of your clients pay you 80% or more of your personal services income in the year of income, and you exclusively use business premises that are physically separate from your home, or from the premises of the person for whom you are working.

7. If you cannot satisfy any of the tests outlined in the previous paragraph (for example, because you do not meet one of the three personal services business tests, or the results test, and 80% or more of your personal services income is from one source), you may be able to obtain a Personal Services Business Determination (PSBD) from the Commissioner that you are conducting a personal services business.<sup>6</sup> You can also apply for a PSBD if you are not sure whether you satisfy any of the tests. If the Commissioner is satisfied that you are entitled to a PSBD, you will not be subject to the alienation measure.

### **The effect of the alienation measure**

8. If the alienation measure applies to an individual or a personal services entity, the amount of the personal services income is included in the assessable income of the individual whose personal efforts or skills generate the income.

9. If the alienation measure applies, the individual or personal services entity will not be able to claim certain deductions. For example, rent expenses, mortgage interest payments, rates and land tax paid in respect of the individual's private residence will not be allowable deductions to the extent that those expenses are incurred in gaining or producing the individual's personal services income. Also, payments made to the individual's spouse (or any other associate) will

- 
- Actively seeks customers for their principal; and
  - Does not provide services from the premises of their principal (or the principal's associate).

<sup>6</sup> For example, if an individual or personal services entity would have met, or could reasonably have been expected to meet the unrelated clients test, the employment test or the business premises test but for unusual circumstances: see subsections 87-60(3) and (4) and 87-65(3) and (4).

not be deductible when the payment relates to non-principal work, such as bookkeeping for an individual who is a builder.

10. If the alienation measure applies, a personal services entity may also have additional withholding obligations in relation to personal services income that is attributed to an individual under the alienation measure.

## **Background**

11. The *New Business Tax System (Alienation of Personal Services Income) Act 2000* (Alienation of Personal Services Income Act) amended the ITAA 1997 by inserting new Part 2-42 into that Act and amended the TAA 1953 by inserting new Division 13 in Schedule 1 to that Act.

12. The alienation measure contained in Part 2-42 applies from the 2000-2001 income year. However, it does not apply until the 2002-2003 income year for those individuals or personal services entities who:

- were in the former prescribed payments system and were entitled to and had made a payee declaration to a payer; and
- the payee declaration was in force as of 13 April 2000; and
- the Commissioner had received the payee declaration for the payee from the payer on or before 13 April 2000.<sup>7</sup>

13. The measure was introduced following recommendations made in the report of the *Review of Business Taxation: A Tax System Redesigned* (commonly called the Ralph Report).<sup>8</sup> The relevant recommendations that relate to this measure are recommendations 7.2, 7.3 and 7.4. Those recommendations were aimed at improving the integrity and equity in the tax system. The recommendations arose out of concerns that substantial erosion of the income tax base had occurred as a consequence of the alienation of personal services income through the use of interposed companies, partnerships and trusts; and that there was a perception that “employee-like” individuals

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<sup>7</sup> The Commissioner's declaration in relation to this deferral was published on 30 August 2000 in the Commonwealth of Australia Gazette No. GN 34.

<sup>8</sup> See also Treasurer's Press Release No. 74 of 11 November 1999, and the Explanatory Memorandum which accompanied the New Business Tax System (Alienation of personal Services Income) Bill 2000, the New Business Tax System (Alienated Personal Services Income) (Tax Imposition) Bill (No.1) 2000, and the New Business Tax System (Alienated Personal Services Income) (Tax Imposition) Bill (No2) 2000, (the Explanatory Memorandum).

and interposed entities were able to claim a greater range of deductions than those available to employees.

14. Note that the general anti-avoidance provisions of Part IVA of the ITAA 1936 may still apply to cases of alienation of personal services income that fall outside the alienation measure: see section 86-10 of the ITAA 1997, paragraph 1.17 of the Explanatory Memorandum and page 292 of the Ralph Report. Further guidance on this matter is provided in Taxation Ruling TR 2001/8, and in Taxation Rulings IT 2121, IT 2330, IT 2503 and IT 2639.

## **Definitions**

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### **Personal services entity**

15. A company, partnership or trust whose ordinary or statutory income includes the personal services income of one of more individuals (subsection 86-15(2)).

### **Service acquirer(s)**

16. The entity or entities that acquire the personal services of an individual directly from the individual or through a personal services entity.

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graph TD
    Q1[Does an individual or a personal services entity have income that is mainly a reward for personal efforts or skills of an individual (an individual's personal services income) and not mainly a reward from the use of assets, the sale of goods, or a business structure? (Division 84)]
    Q2[Does the individual or personal services entity satisfy the 'results test'?]
    Q3[Is 80% or more of the individual's personal services income from one source? (Division 87)]
    Q4[Has the Commissioner of Taxation made a personal services business determination relating to the individual's personal services income? You will need to meet one of the following tests:  
• The 'results' test;  
• The employment test;  
• The business premises test; or  
• Unusual circumstances.]
    Q5[Does the individual or the personal services entity meet at least one of the following three personal service business tests:  
• The unrelated clients test;  
• The employment test;  
• The business premises test?]
    R1[The individual or the personal services entity is not conducting a personal services business. Divisions 85 and/or 86 applies.]
    R2[The individual or the personal services entity is conducting a personal services business. Divisions 85 & 86 do not apply. However, Part IVA of the ITAA 1936 may still apply if income splitting occurs.]
    R3[Part 2-42 of the ITAA 1997 does not apply.]
    R4[The individual or the personal services entity is not conducting a personal services business. Divisions 85 and/or 86 applies.]

    Q1 -- Yes --> Q2
    Q1 -- No --> R3
    Q2 -- Yes --> Q3
    Q2 -- No --> Q5
    Q3 -- Yes --> Q4
    Q3 -- No --> Q5
    Q4 -- Yes --> R2
    Q4 -- No --> R1
    Q5 -- Yes --> R2
    Q5 -- No --> R4
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Does an individual or a personal services entity have income that is mainly a reward for personal efforts or skills of an individual (an individual's personal services income) and not mainly a reward from the use of assets, the sale of goods, or a business structure? (Division 84)

If Yes: Does the individual or personal services entity satisfy the 'results test'?

If Yes to 'results test': Is 80% or more of the individual's personal services income from one source? (Division 87)

If Yes to 80% test: Has the Commissioner of Taxation made a personal services business determination relating to the individual's personal services income? You will need to meet one of the following tests:

- The 'results' test;
- The employment test;
- The business premises test; or
- Unusual circumstances.

If Yes to Commissioner's determination: The individual or the personal services entity is conducting a personal services business. Divisions 85 & 86 do not apply. However, Part IVA of the ITAA 1936 may still apply if income splitting occurs.

If No to Commissioner's determination: The individual or the personal services entity is not conducting a personal services business. Divisions 85 and/or 86 applies.

If No to 'results test': Does the individual or the personal services entity meet at least one of the following three personal service business tests:

- The unrelated clients test;
- The employment test;
- The business premises test?

If Yes to any test: The individual or the personal services entity is conducting a personal services business. Divisions 85 & 86 do not apply. However, Part IVA of the ITAA 1936 may still apply if income splitting occurs.

If No to all tests: The individual or the personal services entity is not conducting a personal services business. Divisions 85 and/or 86 applies.

If No to the initial question: Part 2-42 of the ITAA 1997 does not apply.

18. If:
  - (a) If you have personal services income; and
  - (b) you or the personal services entity do not satisfy the ‘results test’; and
  - (c) you or the personal services entity get 80% or more of the personal services income from one source,

<sup>9</sup> See Treasurer's Press Release No.47 of 20 June 2001 and Treasurer's Press Release No.51 of 9 July 2001.

you will be subject to the alienation measure, unless you have a PSBD.

## Related Rulings

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- Taxation Ruling TR 2001/8 deals with the meaning of personal services business (Division 87);
- Taxation Rulings IT 2121, IT 2330, IT 2503, IT 2639 and TR 2001/8 deal with the application of Part IVA to the alienation of income from rendering personal services.

## Ruling

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19. Personal services income is income that is mainly a reward for an individual's personal efforts or skills (or would be mainly such a reward if it was the income of the individual who did the work).

20. The definition of personal services income requires an analysis of the statutory or ordinary income of an individual or a personal services entity to determine those amounts or items that are mainly a reward for an individual's personal efforts and skills. It is only the income that has that character that may be subject to Part 2-42.

21. The reference to '*income of any other entity*' in the definition in subsection 84-5(1) is a reference to an amount or item that would be income of the other entity but for the operation of Division 86.

22. The phrase '*or would mainly be such a reward if it was your income*' in subsection 84-5(1) ensures that the character of the income as being mainly a reward for an individual's personal efforts or skills is not altered in those circumstances where it is legally derived by another entity. The phrase requires a determination as to whether the income, if it was derived by an individual, would be mainly a reward for that individual's personal efforts or skills rather than being generated by the use of assets, the sale of goods, or by a business structure<sup>10</sup>. If, as a practical matter, the income is mainly a reward for the individual's efforts or skills, then that amount or item of that

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<sup>10</sup> See Example 3 in s84-5. See also *Sun Newspapers Ltd v. FC of T* (1938) 61 CLR 337 and Taxation Ruling IT 2639 in relation to profit yielding structures; and *Hollis v. Vabu Pty Ltd* [2001] HCA 44, 9 August 2001, where the High Court held that bicycle couriers are employees and not independent contractors. In the course of their judgment, the majority of the High Court said: 'Viewed as a practical matter, the bicycle couriers were not running their own business or enterprise ... The notion that the couriers somehow were running their own enterprise is intuitively unsound, and denied by the facts disclosed in the record.'



entity's ordinary income or statutory income is an individual's personal services income.

23. Subsection 84-5(2) ensures that for tax purposes only individuals can have personal services income. The fact that income is payable under a contract does not prevent the income being mainly a reward for an individual's personal efforts or skills (subsection 84-5(4)).

24. The use of 'mainly' in the definition means that the income referred to needs to be 'chiefly', 'principally' or 'primarily' a reward for the provision of the personal efforts of, or for the exercise of the skills of, an individual. Therefore, the use of tools of trade or plant and equipment does not of itself preclude the income from being personal services income, if they are ancillary to the generation of the income.

25. Implicit in the word 'mainly' is that more than half of the relevant amount of the ordinary or statutory income is a reward for the personal efforts or skills of an individual.

26. In interpreting Division 84 it is relevant to ask whether the income is mainly a reward for an individual's personal efforts or skills. If it is, then it is personal services income. If it is not, then that particular amount of income is not personal services income, and not within the alienation measure.

27. Whether or not payments are mainly a reward for personal efforts or skills is determined having regard to the commercial substance of the arrangements between the parties. Where the commercial substance of the arrangement is that there is one set of obligations (different components of which are integral or common to each other) they are looked at together. For example, the sale and installation of an article would be looked at as one obligation rather than separate sources of income, where they are integral components of one transaction. Similarly, when you are providing plumbing services all the activities associated with these services are considered to be provided under a single contractual obligation giving rise to one amount of income. In these cases, there is, in substance, the primary obligation and the other components of the contract are ancillary to the primary obligation. Those obligations, looked at as a whole, are the source of the relevant amount of income and are to be considered as a whole to determine whether the income is mainly a reward for the individual's personal efforts or skills.<sup>11</sup>

28. This is contrasted with the situation where the contract deals with obligations which are completely separate and distinct, in which

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<sup>11</sup> It is arguable that each item in an itemised contract gives rise to a separate obligation. However, such a construction would produce different results depending on form rather than substance.

case each is, in substance, the source of the separate amounts of income. For example, where an individual derives income from plumbing activities and also from the sale of household cleaning products, the two activities are not related and give rise to separate amounts of income. Similarly, where, under a contract, different individuals do the work, the practical source of the income is the work of each individual.

29. The meaning of personal services income is wider than that which might otherwise be the case under the common law, but it does not include income that is mainly:

- from an entity supplying goods or granting a right to use property;
- generated by assets an entity holds; or
- generated by the business structure.

30. Where personal services are provided that are ancillary to:

- (a) the sale or supply of goods;
- (b) the granting of a right to use property;
- (c) the supply and use of assets that have a significant role in the generation of the income; or
- (d) the generation of the income by the business structure,

the income so generated is not personal services income.

31. The determination of whether income is mainly a reward for the personal efforts or skills of an individual or is income generated from the circumstances outlined in paragraph 30(a) to (d) above, requires the exercise of practical judgment as to whether the value contributed by the efforts or skills of the individual exceeds the value of the other inputs, such as the efforts of other workers, and the use of plant and equipment or machinery, or intellectual or other property or goodwill. In making that judgement, regard may be had to factors including:

- the nature of the activities being conducted that generate the income;
- the extent to which the amounts paid or payable or particular amounts paid or payable by a service acquirer to an individual or a personal services entity under an agreement is primarily for the personal efforts or skills of a particular individual;
- the extent to which the contract price has been calculated having regard to the costs to be borne by an individual or a personal services entity in providing and using assets or plant and equipment in the performance

of the obligations of the individual or the personal services entity to the service acquirer;

- the market price of using any equipment, plant or tools in comparison with the market price of hiring the relevant labour or skills for the same period;
- the nature, size and significance of the plant and equipment or other assets that are used by the individual or the personal services entity in relation to the income-producing activity;
- the value of the asset in relation to the total income generated in the performance of obligations under an agreement;
- the uniqueness and degree to which an asset is specialised in the performance of a particular function;
- the uniqueness, level of skill or degree of specialisation of an individual to provide the particular services contracted for by the service acquirer;<sup>12</sup>
- whether the contractual payments made to an individual or a personal services entity is for the transfer of the ownership or a right in respect of an item that is produced by the individual or personal services entity;
- the existence of goodwill;<sup>13</sup>
- the existence of substantial income-producing assets;
- the size of the business operation; and
- the contribution of other workers to the income-earning activities.

32. Whilst the above is a list of factors that are relevant, no one factor may be decisive, nor is the list exhaustive. Their individual weighting will depend on the circumstances of each case.

33. Even if an amount of income is personal services income, the alienation measure will not apply where that personal services income is earned in the course of conducting a personal services business (i.e., where you meet one of the tests in paragraph 6 or you have a PSBD).

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<sup>12</sup> For the purposes of drawing a distinction between independent contractors and employees, the High Court in *Hollis v Vabu Pty Ltd* said that there is nothing contrary to a relationship of employment in the fact that employees have to supply their own tools and equipment, particularly where the capital outlay is relatively small and the tools and equipment are not inherently capable of use only for the particular work being done. However, a different conclusion might be appropriate where the investment in capital equipment is more significant.

<sup>13</sup> See *Hollis v. Vabu Pty Ltd* [2001] HCA 44, 9 August 2001, where the High Court said that a bicycle courier is unable to generate any goodwill as a bicycle courier.

**Individuals affected are not employees**

34. Section 84-10 ensures that the application of the alienation measure (Part 2-42) to an individual does not make the individual an employee. The application of the alienation measure does not result in a change in the nature of contractual relationships between parties to an arrangement involving the rendering of personal services. Nor does the operation of Part 2-42 affect an individual's or a personal services entity's entitlement to an Australian Business Number, or entitlement to be registered for the purposes of the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act).

**Date of effect**

35. This Ruling first applies to the 2000-2001 income year. The Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

**Explanations****Meaning of Personal Services Income**

36. Division 84 of Part 2-42 of the ITAA 1997 sets out the meaning of personal services income.

37. Section 84-5 provides:

- “(1) 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).

**Example 1:** NewIT Pty. Ltd. Provides computer programming services, but Ron does all the work involved in providing those services. Ron uses the clients' equipment and software to do the work. NewIT's ordinary income from providing the services is Ron's personal services income because it is a reward for his personal efforts or skills.

**Example 2:** Trux Pty. Ltd. Owns one semi-trailer, and Tom is the only person who drives it. Trux's ordinary income from transporting goods is not Tom's personal services income because it is produced mainly by use

of the semi-trailer, and not mainly as a reward for Tom's personal efforts or skills.

**Example 3:** Jim works as an accountant for a large accounting firm that employs many accountants. None of the firm's ordinary income or statutory income is Jim's personal services income because it is produced mainly by the firm's business structure, and not mainly as a reward for Jim's personal efforts or skills.

- (2) Only individuals can have personal services income.
- (3) This section applies whether the income is for doing work or is for producing a result.
- (4) The fact that the income is payable under a contract does not stop the income being mainly a reward for your personal efforts or skills."

***Does the statutory definition widen the common law meaning of personal services income?***

38. The scheme of the alienation measure is to draw a wide net as to what constitutes personal services income but then to exclude from the measure situations where the individual or personal services entity conducts a personal services business.

39. As section 84-1 explains, under the alienation measure, personal services income that is being diverted to other entities is attributed to the individual providing the labour or skill, except where one of the tests outlined at paragraph 6 above is satisfied or a PSBD is obtained.<sup>14</sup> The Examples in subsection 84-5(1) reflect this view. This view also underlies subsection 84-5(1) which specifically includes income of any other entity as personal services income even where it may not legally be the income of the individual.

40. Similarly, subsections 84-5(2), (3) and (4) make it clear that a wide concept of personal services income is intended. For example, while the alienation measure is predicated on the view that personal services income can be the income of an individual or of a personal services entity, subsection 84-5(2) ensures that for tax purposes only an individual can have personal services income. Similarly, subsection 84-5(3) provides that it is personal services income even if the income is for producing a result, which has been considered to be the mark of an independent contractor at common law (see *World Book (Australia) Pty Ltd v. FC of T* 92 ATC 4327 at 4334; (1992) 23 ATR 412 at 419-420). The wording of paragraphs 87-60(5)(a) and 87-65(5)(a) also support this conclusion.

<sup>14</sup> The Explanatory Memorandum notes that there is no equivalent specific rule in the existing law (paragraph 1.17).

41. According to paragraph 1.25 of the Explanatory Memorandum subsection 84-5(4) is intended to “overcome any argument that particular income does not fall within the definition of personal services income because it results from a contractual right”.

42. Division 87 provides that Divisions 85 and 86 do not apply to personal services income that is income from conducting a personal services business. Division 87 then sets out a number of tests for determining if the income is from the conduct of a personal services business, including the ‘results test’ in subsections 87-60(5) and 87-65(5). The personal services business tests and the ‘results test’ are based on the traditional tests of who is an independent contractor and in business on their own: see for example *Stevens v. Brodribb Sawmilling Co. Pty Ltd* (1985-86) 160 CLR 16, *Queensland Stations Pty Ltd v. FC of T* (1945) 70 CLR 539 and *Hollis v. Vabu Pty Ltd* [2001] HCA 44, 9 August 2001.

43. The ‘results test’ in subsections 87-60(5) and 87-65(5) also reflects the legislative scheme outlined above, and would be otiose if personal services income was given a construction in line with the dicta in the cases referred to at paragraph 51 below.

***Does the definition refer to all the income or to specific items or amounts of income?***

44. The definition of personal services income in subsection 84-5(1) requires an analysis of the ordinary or statutory income of an individual or a personal services entity to work out which amounts are mainly a reward for the rendering or provision by that individual, or an individual, of his or her personal efforts or skills. This is because the assessable income rules in Division 6 (e.g., subsection 6-5(4)) operate on particular **amounts** of income. In addition, Division 86, and in particular subsection 86-15 which refers to “an amount” of ordinary income or statutory income, reinforces this conclusion. The Commissioner does not agree with the alternative construction which reads the definition as applying to all the income of the individual or personal services entity, because such a construction would attribute to an individual income that is not personal services income, which is clearly not intended (see for example, subsection 86-30).

45. To decide whether an entity’s income is your personal services income, assume that it is your income, and ask yourself whether it would mainly be a reward for your personal efforts or skills. If the character of the income is mainly a reward for your personal efforts or skills and is not mainly from the use of assets, sale of goods, or a business structure, it will be personal services income within the meaning of subsection 84-5(1), although it may legally have been derived by the personal services entity.

46. The reference to the income that is ‘mainly’ a reward for an individual’s personal efforts or skills requires a conclusion as to the substance of the arrangements between the relevant parties and whether, as a practical matter, the income is mainly generated by the efforts or skills of an individual.

47. The Macquarie Dictionary defines ‘mainly’ as ‘*chiefly; principally; for the most part.*’ In *Fawcett Properties Ltd v. Buckingham County Council* [1961] AC 636 the term mainly was discussed, by Lord Morton of Henryton who stated (AC at 669):

‘The word ‘mainly’ at once gives rise to difficulties. Probably it means ‘more than half’ and this was the meaning which this House gave to the phrase in *Bromley v. Tryon* [1952] AC 265.’

48. The use of the word ‘mainly’ in this context does not preclude the use of some materials, tools or plant and equipment in the rendering or provision of personal services. For example, the use of:

- a personal computer by a computer consultant to perform work under a contract that is essentially for his or her personal skills;
- hand or electrical tools by a tradesperson;
- off-the-shelf computer software packages used by individuals; or
- the drawing board of a draftsman,

will not alter the character of the income as personal services income if as a practical matter the income is mainly generated by the personal efforts or skills of an individual.

49. Implicit in the word ‘mainly’ is that more than half of the relevant amount of the ordinary or statutory income is a reward for the personal efforts or skills of an individual.

50. Paragraph 1.27 of the Explanatory Memorandum provides the following examples of personal services income:

- salary or wages;
- income of a professional person practising on his or her own account without professional assistance - for example, a medical practitioner in a sole practice;
- 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; and

- income derived by consultants, for example, computer consultants or engineers from the exercise of personal expertise.

### **Alternative view**

51. It could be argued that a reward mainly for personal efforts or skills covers similar ground as a payment that is wholly or principally for labour which is the definition used in section 221A of the ITAA 1936. This is not considered to be the case. However, if this were the case, it might be arguable that income derived by an independent contractor (see *Neale v. Atlas Products Ltd* (1955) 94 CLR 419 at 425 and *World Book (Australia) Pty Ltd v. FC of T* 92 ATC 4327 at 4333-4335; (1992) 23 ATR 412 at 418-421) is not personal services income. A further argument based on comments in *Liedig v. FC of T* 94 ATC 4269 at 4279; (1994) 28 ATR 141 at 153-154 might be that income derived by a personal services entity is not personal services income. However, both arguments are at odds with the purpose and statutory context of the alienation measure.

### ***Contracts for labour and skills where some materials are used***

52. The issue of contracts that are for the work and labour of an individual, where the supply of some materials occurs, was discussed by Slesser LJ in *Robinson v. Graves* [1935] 1 KB 579. At page 591 Slesser LJ expressed the view, in the context of the facts of that case, that

‘... it is here shown that the material, the paint and the canvas, were merely ancillary to the technical work of producing the work of art and that therefore this is a contract for work and labour’.

53. It is important, therefore, to distinguish between cases where the supply of materials is ancillary to the work to produce a result and those where the supply of materials is the principal obligation under the contract and where the use of labour to do some work in connection with that supply is ancillary.

54. If the supply of materials is ancillary to the doing of work, then the contract would be for work and labour and income under that contract would be regarded as being mainly a reward for personal efforts or skills. If the supply of labour or the doing of work is ancillary to the supply of materials, then any income under a contract where the principal obligation is the supply of materials would not be personal services income within the meaning of subsection 84-5(1).

55. ‘Ancillary’ in various contexts, has been held to mean ‘not necessary thereto or a primary part thereof’ (*Pearce v. London &*



*South Western Railway* [1900] 2 QB 100), or ‘auxiliary or appurtenant to the purpose for which the business is carried on’ (*Green v. Britten* [1904] 1 KB 350). So skill and effort can be a significant component, just as long as it is not the main component of the obligations under a contract.

56. Some instances where the supply of materials may be regarded as ancillary to the rendering of personal services are:

- the supply of art supplies by a graphic designer in doing design work for a service acquirer;
- the supply of nails and glue by a carpenter in carrying out repairs on behalf of a building company;
- the supply of paint by a painter in carrying out his work for a painting company;
- the supply of wiring by an electrician in connection with the installation of wiring into a building; and
- the supply of paints, canvas and other consumables by an artist who has been commissioned to paint a portrait.

### ***What is not personal services income***

57. While the meaning of personal services income may be wider than might otherwise have been the case under the common law, the definition of personal services income in section 84-5 includes examples which indicate that distinctions still need to be made.

58. Paragraph 1.23 of the Explanatory Memorandum explains that income which is:

- ancillary to an entity supplying goods or granting a right to use property; or
- principally generated by assets an entity holds,

is not personal services income as it is not paid mainly as a reward for the individual’s personal effort.

59. Example 2 in section 84-5(1) provides an example of income from the use of an asset (i.e., a semi-trailer). The underlying assumption for this example was that the main component of the contract was the use of the semi-trailer rather than the personal services that were also provided.<sup>15</sup>

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<sup>15</sup> The issue in question is *Humberstone v. Northern Timber Mills* (1949) 79 CLR 389 which involved a truck which bore the applicant’s own name with the description ‘carrier’; and *Wright v. Attorney-General for the State of Tasmania and Others* (1954) 94 CLR 400 which involved a ‘four to five ton’ truck that could be

60. In addition, Example 3 in subsection 84-5(1) indicates that income produced mainly by an entity's business structure is not mainly a reward for an individual's personal efforts or skills. The income is generated from the business structure and not the personal services of an individual.<sup>16</sup>

61. There is some overlap between the distinctions drawn out in the Examples in subsection 84-5(1) and the personal services business and 'results' tests available in Division 87. On the basis of the legislative structure, a logical reconciliation is that the Examples in subsection 84-5(1) are intended to illustrate what is or what is not personal services income, and alleviate the need to go further and consider the tests in Division 87. The reference to the use of income-producing assets in Example 2 in subsection 84-5(1) is also explicable in these terms.

62. In any event, genuine business undertakings that are in receipt of personal services income would be excluded from the alienation measure under Division 87 by satisfying one of the tests outlined in paragraph 6, or by obtaining a PSBD from the Commissioner.

***Income mainly from the supply or sale of goods is not personal services income***

63. Even where personal efforts or skills are used in the production of something that is to be sold, then any later contract for the sale of that item or property would be for the sale or supply of goods. The payments made to the individual or personal services entity would not be in respect of an individual's personal efforts or skills in relation to the sale of goods but, rather, to acquire ownership (legal and beneficial) of the item produced.<sup>17</sup>

64. Where, however, the substance of a contract or related contracts is for the personal labour or efforts, or the exercise of the skills of an individual for a service acquirer, the fact that ownership of materials that are used passes to the service acquirer does not alter the substance of the contract, which is mainly for the efforts and skills of the individual.

***Income mainly from the supply and use of income-producing assets is not personal services income***

65. Distinctions will need to be drawn between those cases where plant and equipment or tools of trade are used by an individual or a

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driven by the owner or drivers supplied by the owner was whether the owner/driver was an employee or independent contractor.

<sup>16</sup> Contrast *Egan v. FC of T* (2001) 47 ATR 1180.

<sup>17</sup> See also paragraphs 1.29 and 1.30 of the Explanatory Memorandum.

personal services entity under an agreement that is for the personal efforts or skills of an individual, and those where the supply and use of the plant or equipment or other assets is the main source of the income of the individual or the entity. This will be relatively simple where there are separate contracts dealing with the supply or use of the assets and the provision of personal services, such that these are separate and distinct obligations that give rise to separate amounts of income.

66. Where components of a contractual obligation are integral to the performance of that obligation, judgment is required to determine whether the income is mainly the result of the use or supply of assets, or the provision of personal efforts or skill.

67. In determining if income is from the supply and use of income-producing assets in these circumstances, the following factors are relevant considerations:

- the market value of the supply and use of the asset, compared with the market value of the personal services;<sup>18</sup>
- The basis on which the contract price has been calculated and the extent to which the contract price relates to the costs borne by the individual or personal services entity in supplying and using the plant and equipment or other assets in the income-producing activity;
- the significance or uniqueness of the assets in the income-producing activity;
- the gross value of the asset in relation to the income of the individual or personal services entity from the particular activity; and
- the role the asset plays in generating the income.

68. The alternative view that there is no personal services income where the supply and use of an asset is a pre-condition for generating income is not accepted, because it is inconsistent with the examples provided in the Explanatory Memorandum. For example, the use of equipment such as a personal computer or the general programming software of a computer programmer does not suffice to alter the character of income from being mainly a reward for personal efforts or skills into one for the supply and the use of income-producing assets.<sup>19</sup> Rather it is considered that the statutory provisions require an analysis of the relative contribution of the personal services and of the assets used, to the generation of the income.

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<sup>18</sup> This is consistent with the market value approach taken in the employment test (s87-25) in relation to principal work.

<sup>19</sup> See also paragraph 1.34 of the Explanatory Memorandum.

***Income from a business structure is not personal services income***

69. The alienation measure does not apply to businesses that have a substantial profit-yielding structure. The distinction between income that is mainly a reward for personal efforts or skills and income from a business structure will need to be made having regard to factors such as the number of arm's length employees or others engaged to perform work, the presence of goodwill, the extent to which income-producing assets are used to derive the income, the nature of the activities carried out, the size of the operation and the extent to which the income is dependent upon a particular individual's own personal skills, efforts or expertise.

70. Example 3 in subsection 84-5(1) provides an illustration of a situation where income is considered to be from a business structure. Examples in this ruling provide other illustrations of when income is or is not generated by a business structure.

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**Examples**

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71. It is important to note that even if there is personal services income, the alienation measure will not apply if the individual or personal services entity satisfies one of the tests outlined in paragraph 6 or has a PSBD, so that the relevant personal services income is income from conducting a personal services business.

**What is personal services income?*****Example 1***

72. Chris is a computer consultant who provides his personal services through a family company, ChrisCom Pty Ltd. The company has a contract with Megabite Computer Ltd to provide the services of Chris. Chris provides those services at the premises of Megabite. The contract requires Chris to be at the premises of Megabite between 9.00am and 5.00pm Monday to Friday and the company is paid at an hourly rate of \$75.00.

73. ChrisCom Pty Ltd also operates a computer spare parts business that sells both computer hardware and software. Chris provides his personal services to install software for clients of that business. He provides these services in the evening. The cost of installation is usually built into the price for the hardware, and represents a relatively small proportion of the price.

74. In this situation, income of the company that is from the contract with Megabite Computer Ltd is the personal services income

of Chris. This is personal services income because it is mainly a reward for Chris's personal skills and efforts in providing computer consulting services to Megabite. The income is not from a business structure or mainly a reward for:

- the sale or supply of goods;
- the granting of a right to use property;
- the supply and use of assets; or
- other inputs, such as the efforts of other workers,

as the income is generated mainly from the labour and skill required to fulfil the contract.

75. The income is, therefore, personal services income as defined in subsection 84-5(1).

76. However, the income that the company gets from the provision of Chris's services to install software is ancillary to the sale of hardware and software. Therefore, income from those services would mainly be for the sale and supply of goods. It would not be personal services income of Chris, but would properly be regarded as income of the company.

### ***Example 2***

77. Norm is a carpenter who operates in partnership with his wife. He is a qualified tradesman. The partnership contracts with Major Works Pty Ltd, a large building contractor, to do maintenance work on various sites for Major Works. The partnership supplies the tools of trade and provides some materials e.g., nails, glue and occasionally buys timber to do the work that it is contracted to do. The majority of materials are supplied by the building contractors. The partnership invoices the building contractor at the completion of each job (which usually takes about a week). The invoices are calculated on an hourly basis for the labour component of the work, plus the cost of materials supplied by the partnership. Norm's efforts and skills represent approximately 90% of the amount charged on each invoice.

78. In this instance, although some materials are supplied in doing the work, the substance of the contract is for Norm's personal labour, and it is Norm's personal skills and effort which predominantly generate the relevant income. This conclusion has been reached by having regard to the factors listed in paragraph 31 of this ruling. In particular, the value of the labour contributed by Norm exceeds the value of other inputs, being the use of the tools of trade and the supply of materials. Therefore, the income is mainly a reward for Norm's personal efforts or skills or for producing a result from Norm doing the

work. The income, therefore, is Norm's personal services income as defined in subsection 84-5(1).

**Distinction between personal services income and income from a business structure or from the use of assets**

***Example 3***

***Example 1.3: Explanatory Memorandum***

79. Michelle is a draftsman who operates through a family trust of which Mich Pty Ltd is the trustee. Michelle is the sole shareholder in Mich Pty Ltd. An agreement is entered into between Big Drafting Co. Ltd and Mich Pty Ltd to supply Michelle's services for a period of 18 months starting on 1 July 2000. The agreement does not specify what assets are to be used by Michelle or Mich Pty Ltd in doing the work. Mich Pty Ltd has an AUTOCAD machine and computer equipment that is used by Michelle in doing the work.

80. As the contract is only for the provision by Mich Pty Ltd of the services of Michelle, the use of the AUTOCAD machine and the computer equipment would be regarded as ancillary to the provision of the personal efforts and skills of Michelle. The use of that equipment is common to that professional environment, but, nevertheless, the income is being generated mainly as a result of Michelle's personal skill. Income received by Mich Pty Ltd under the agreement with Big Drafting Co. Ltd is Michelle's personal services income.

***Example 4:***

81. Russell is a courier driver who operates through a company, Russell Pty Ltd. The company has a contract with a large courier company to collect and deliver parcels and goods from one place to another. Under the terms of the contract with the courier company, Russell Pty Ltd is specifically required to provide a vehicle with a carrying capacity of one tonne. Russell Pty Ltd is responsible for the payment of all statutory costs and fees payable in respect of the vehicle (e.g., registration and comprehensive motor vehicle insurance) and to keep the vehicle in a mechanically sound, roadworthy and clean condition. The courier company supplies and fits the vehicle with a mobile radio and arranges to paint and/or signwrite the vehicle with the colours of the courier company (both at the courier company's expense).

82. Russell Pty Ltd is paid a specified rate per kilometre for each task allocated to Russell during the day (subject to a minimum safety net payment rate per hour from the time Russell commences to travel in order to pick up the first job of the day until the time he makes his final delivery on the same day). Russell Pty Ltd is permitted to engage

the services of another driver for the vehicle, subject to the approval of the courier company. Nevertheless, Russell is the only person engaged by Russell Pty Ltd to drive the vehicle.

83. For the purposes of undertaking its contractual obligations, Russell Pty Ltd purchases a commercial vehicle (e.g., a one tonne courier van) that is suitable for what is known as 'taxi truck work'. The vehicle is generally not suitable and is not normally used for domestic purposes (e.g., it does not have rear passenger seats and only has limited safety features).

84. Importantly, the vehicle represents a sizeable asset, it is purpose built for the relevant work, and it is not generally suitable for domestic purposes. This factor points to the income being generated mainly from the use of the vehicle. In addition, based on the NSW Courier and Taxi Truck Contract Determination 2000, the remuneration paid by the courier company varies depending on the carrying capacity of the vehicle. The larger the carrying capacity, the higher the remuneration paid. This is indicative of the greater costs borne by an individual or personal services entity in supplying and maintaining a commercial vehicle for the income-producing activity. It also reflects what the service acquirer is paying for under the contract and the importance of the commercial vehicle to the derivation of income. These factors also point to the income being generated mainly from the use of the vehicle. Even though for all practical purposes Russell is the only driver, he does not have specialised skills above being well presented and a holder of an appropriate driver's licence. Accordingly this factor is neutral in this case. Another factor is that the market value of the supply and use of the one tonne commercial vehicle is, according to the transport industry, higher than the value of the personal services of the driver of the vehicle, but the differential between the market value of the use of such a vehicle and the cost of hiring a driver for the period of its use is not substantial. This factor points to the income being mainly generated by the personal services business, but the narrow differential between the relevant contributions reduces the persuasive weight of this factor.

85. Weighing up the above factors, particularly the nature of the vehicle and the consideration paid by the courier company, it would be reasonable to conclude that the amounts payable to Russell Pty Ltd for the taxi truck work are not mainly for the personal efforts or skills of Russell and, therefore, are not the personal services income of Russell within the meaning of subsection 85-4(1). The conclusion that the income is not mainly personal services income would be reinforced where Russell Pty Ltd had other indicators of a business structure

(e.g., other vans, drivers, business premises, goodwill<sup>20</sup> or other clients).

***Example 5:***

86. Francis is a courier driver who operates through a company, Francis Pty Ltd. The company has a contract with a large courier company to collect and deliver parcels and goods from one place to another. Under the terms of the contract with the courier company, Francis Pty Ltd is specifically required to provide a vehicle with a carrying capacity of up to 750 kilograms. Francis Pty Ltd is responsible for the payment of all statutory costs and fees payable in respect of the vehicle (e.g., registration and comprehensive motor vehicle insurance) and to keep the vehicle in a mechanically sound, roadworthy and clean condition. The courier company supplies and fits the vehicle with a mobile radio and arranges to paint and/or signwrite the vehicle with the colours of the courier company (both at the courier company's expense). Francis Pty Ltd is paid a specified rate per kilometre for each task allocated to Francis during the day (subject to a minimum safety net payment rate per hour from the time Francis commences to travel in order to pick up the first job of the day until the time he makes his final delivery on the same day). Francis Pty Ltd is permitted to engage the services of another driver for the vehicle, subject to the approval of the courier company. Nevertheless, Francis is the only person engaged by Francis Pty Ltd to drive the vehicle.

87. For the purposes of undertaking its contractual obligations, Francis Pty Ltd purchases an ordinary passenger motor vehicle (e.g., a hatchback, sedan or station wagon) that is suitable for what is known as 'courier work'. The vehicle is also suitable and is used for domestic purposes.

88. Importantly, the motor vehicle, although a substantial asset, is not a commercial vehicle and is not considered to be specifically adapted or purpose built for the relevant work. Nor is it exclusively used for business purposes. In addition, based on the NSW Courier and Taxi Truck Contract Determination 2000, the remuneration paid by the courier company varies depending on the carrying capacity of the vehicle. For smaller vehicles, the remuneration paid is significantly less than for larger commercial vehicles. This is indicative of the lower costs borne by an individual or personal services entity in supplying and maintaining a passenger motor vehicle for the income-producing activity. Another relevant factor is that, according to the transport industry, the market value of the supply and

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<sup>20</sup> For example, goodwill may have been generated if Russell Pty Ltd had previously conducted courier work for other principals (although this is not the case here).



use of an ordinary passenger motor vehicle may be less than the value of the personal services of the driver of the vehicle. This will vary depending on the size and nature of the vehicle. It may also vary because the costs of hiring a vehicle are related to the kilometres travelled, fuel and other running costs and the profit margin associated with the particular vehicle and the nature of the work. These factors point to the income being mainly from the personal services of Francis, even though Francis does not possess special skills other than being well presented and holding an appropriate driver's licence.

89. While the vehicle is a necessary requirement for fulfilling the contractual obligations, the statutory provisions require an analysis of the relative contribution of the personal services and of the assets used, to the generation of the income. Having regard to the nature of the vehicle, the consideration paid by the courier company and the market value of the components of the activity (where this points to the personal services as providing the greater value), it is reasonable to conclude that the amounts payable to Francis Pty Ltd for the courier work are mainly for the personal efforts or skills of Francis and, therefore, are the personal services income of Francis within the meaning of subsection 85-4(1). If Francis Pty Ltd had a business structure (e.g., other vans and drivers, business premises and/or goodwill or other clients) and the vehicle was an asset of that business, then the income would not be characterised as personal services income.

90. Even where it is personal services income, the alienation measure will not apply if Francis is able to satisfy the results test, the unrelated clients test, the employment test, or the business premises test. As Example 16 in Taxation Ruling TR 2001/8 shows, an individual or personal services entity that provides courier services would usually be able to satisfy the results test.

#### ***Example 6: Income from a business structure***

91. Bob owns an earthmoving company, Bob's Earthworks Pty Ltd, with assets including two trucks, a backhoe tractor and small grader. The company has six employees, five of whom are plant operators. Bob is employed by Bob's Earthworks Pty Ltd as the managing director and he also performs some of the principal work that generates the income of his company. The assets that are operated by the other employees are the means by which the company generates its income even though the plant operators use their personal skills to contribute to income production. The income of the company is not reliant on the skills of any one individual; it can derive income as long as it owns or has access to the necessary equipment.

92. In this example, the income of the company is derived from a business structure. A business structure is determined by a number of

collective factors including the extent to which the income depends upon the efforts, expertise or skills of an individual; the number of employees or contractors engaged to perform work; the nature of the activities being conducted that generate the income; the existence of goodwill or substantial income-producing assets; and the size of the business operation.

93. Therefore, as the company has income-producing assets and a number of employees who are employed to perform the services, the income is generated from the operations of a business structure. The income of the company is not personal services income of any individual within the meaning of section 84-5 of the ITAA 1997.

***Example 7: Income from a business structure***

94. John is a partner in a large accounting partnership which has 20 partners and 200 employees.

95. As a partner, John's income from the partnership flows from property, namely, his proprietary interest in the partnership. That interest is an interest in, among other things, the profit derived by the partnership as a whole, i.e., in the profits generated by the other partners and employees from custom attracted by the goodwill of the partnership, and use of the partnership assets. When a partner participates in profits generated not merely in law, but as a commercial reality, from the efforts of the entire firm, it is properly attributed to the taxpayer's interest in the business structure or organisation of the partnership (which is his capital).

96. Accordingly, as a partner in the partnership, John's income is income of a business structure rather than his own personal services income. The partnership has numerous employees and business assets and the income of the partnership is generated by these employees and the partnership assets and goodwill.

***Example 8: Income from a business structure***

97. Jim is one of the employees of the accounting partnership and works in an audit area.

98. As such, Jim is employed to provide services to clients attracted by the goodwill of the partnership. When clients come to the firm seeking audit work by the firm, they are looking for a reputable well-known firm to deal with. They do not know Jim individually and do not care whether Jim is employed by the firm. When Jim is doing the client's audit work, his efforts are part of the team effort of the firm itself.

99. In the usual case, the income of the partnership is derived from the goodwill of the partnership (in attracting the custom) and the

organisation of the partnership's human resources and tangible assets to produce the required services, and it is that which is rewarded rather than the personal efforts or skills of Jim.

100. None of the firm's ordinary income or statutory income is Jim's personal services income because it is produced mainly by the firm's business structure, and the income of the partnership is not mainly a reward for Jim's personal efforts or skills. When Jim provides his services, he is working on behalf of the partnership rather than for himself.

***Example 9: Income that is personal services income***

101. Ralph is in partnership with his spouse to provide accounting services and the partnership only has one client.

102. Ralph's spouse does not participate in the partnership activities other than to answer the phone and do the banking. The spouse does not do any of the partnership's principal work.

103. In this situation, Ralph is doing all of the principal work of the partnership and it is Ralph's personal efforts that are generating the partnership income. Accordingly, all of the partnership income would be the personal services income of Ralph. This example has similarities with the facts in *Egan v. FC of T* (2001) 47 ATR 1180 where Senior Member Pascoe found the facts to be as follows:

“the technical expertise of Mr Egan was the principal or sole reason which enabled TM to derive fees...I am unable to find that any other service of significance was provided...It appears that TM owns some computer and other office type equipment but the accounts of the company do not show any extensive investment in equipment and all indications are that it was no more than a busy computer consultant would have at his home.”

104. This example can be contrasted with Example 8 in that the partnership in which Ralph is a partner does not have significant assets, has no employees, and only has one client.

***Example 10: Income that is mainly from the use of an asset***

105. Moov Pty Ltd owns one semi-trailer, and Bob is the only person who drives it. Moov Pty Ltd has a contract with a large supermarket chain to transport goods throughout Australia. The semi-trailer is a substantial asset which is specifically suited to Bob's transport business (and is not generally suitable for private purposes). Based on market rates, the use of the vehicle for the relevant period represents substantially more than 50% of the contract price; whereas,

Bob's services as driver of the semi-trailer represent substantially less than 50% of the contract price.

106. Because the income is not mainly a reward for Bob's efforts or skills, the income is not personal services income and not subject to this measure. The situation would not be any different if the semi-trailer is leased by Moov on an arm's length basis.

***Example 11: Income that is personal services income***

107. Dihanne is a welder who operates through a partnership with her spouse. The partnership contracts with SkyWeld Pty Ltd to provide the services of Dihanne on a major project. The contract is for a term of 18 months and the contract specifies that the work is to be done by Dihanne. Under the contract, the partnership is not liable for defects in the work, although Skyweld is able to terminate the contract if her work is unsatisfactory. The partnership is paid on an hourly basis. Dihanne works on the project site, which is about 50 kilometres from where she lives.

108. Dihanne has a station wagon that amongst other things she uses to transport her welding equipment to and from the site.

109. In this case, income from the welding work that Dihanne does is her personal services income. This is because the income is mainly a reward for the personal efforts and skills of Dihanne as a welder. The efforts and skills of Dihanne exceeds the value of all other inputs such as the use of plant and equipment. In other words, the income generated under the contract relates mainly to the labour component.

**Distinction between personal services income and income from the supply or sale of goods**

***Example 12: Income that is personal services income***

110. Donna is a computer programmer who writes programs under a contract with Big Computer Co. Under the contract, Donna is required to do the work at the premises of Big Computer using the company's equipment. She has no ownership of the programs that are written. She gets paid on an hourly basis and is not liable for defects in this work, although BC Co. can terminate the contract if the work is unsatisfactory.

111. In the evenings, at home, Donna also writes and produces computer games that she sells to Internet service providers for on-line computer games players. She usually approaches the Internet service providers and sells the game to the highest bidder.

112. The ordinary income of Donna that is derived under her contract with Big Computer Co. is mainly a reward for Donna's

personal efforts or skills and would be personal services income under subsection 84-5(1). This is because it is mainly her particular skill that is generating the income.

113. Income under the contracts for sale of the computer games would not be mainly a reward for Donna's personal efforts or skills but would be from the sale of the software. This income would not be personal services income within the meaning of subsection 84-5(1).

***Example 13: Income from the supply or sale of goods***

114. Rick is a tax expert who writes a book on the new PAYG measures. He approaches a number of publishing houses to get it printed and finally enters into a contract under which he sells the copyright to the book for \$20,000 plus a royalty of 40 cents per book.

115. Income from the sale of the copyright is not personal services income. Rather, it is a transfer of property and income is consideration for the transfer of the proprietary rights from Rick to the publishing house.

***Example 14***

116. Rick is a tax expert who is commissioned by a publisher of taxation books to write a book on the new PAYG measures. The contract specifies that when the book is finished to the standard required by the publisher and the copyright passes from Rick to the publisher, Rick will be paid a sum of \$150,000.

117. It is not considered the contract is for the sale of property or goods, like example 13, because in this case it is Rick's efforts and skills that mainly generate the income. Therefore, Rick's income from the contract is personal services income.

***Example 15***

118. Jim is a medical practitioner who operates his practice through a company, Jim Pty Ltd, at business premises in a busy shopping centre. The company employs Jim as a doctor and the practice has many clients. Jim Pty Ltd makes a monthly payment of \$20,000 to Jimbo Pty Ltd, trustee of the Jim Family Trust. Jimbo Pty Ltd holds the premises from which the practice is conducted. It also holds all the assets used in the medical practice. Jimbo Pty Ltd also employs the administrative staff (3 in number) whose services are used in the medical practice. The payment by Jim Pty Ltd to Jimbo Pty Ltd as trustee is in line with guidelines established by *Phillips v. FC of T* 78 ATC 4,361; (1978) 7 ATR 345 for payments to service entities and covers the use of the plant and equipment and the cost of providing a

receptionist, filing clerk and an assistant. The premises are leased to Jim Pty Ltd under a separate lease agreement.

119. Jimbo Pty Ltd pays wages to each of the 3 administrative staff, who work 40 hours a week, at the rate of \$15 per hour.

120. The payment of \$20,000 per month is an arm's length amount to cover a number of services, all of which comprise the business being conducted by the trust. The payment is not mainly a reward for an individual's efforts or skills, having regard to the relative worth and market value of the use of the assets compared with the personal services provided. In these circumstances, income of the trust is not personal services income as defined.

121. As for Jim, the patients' fees are mainly a reward for his efforts and skills, but the alienation measures would not apply where, for example, the practice has more than one unrelated client, or has separate business premises.

## **Detailed contents list**

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**Commissioner of Taxation**

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TR 2001/8; IT 2121; IT 2330;  
IT 2503; IT 2639

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- employee
- entity
- income
- income alienation
- independent contractor issues
- master/servant relationship issues
- ordinary income
- PAYG
- personal efforts or skills
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- result
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