IT 2639 - Income tax : personal services income

Taxation ruling it 2639

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I 1012690	**income**	**6(1)**
	- from personal services	**25**
	personal services income	

other rulings on this topic: it 25, it 135, it 2121, it 2330, it 2403, it 2408, it 2503

title: income tax: personal services income

note: . Income tax rulings do not have the force of law.

Each decision made by the Australian Taxation Office is made on the merits of each individual case having regard to any relevant ruling.

preamble

1. This Ruling:

a. consolidates the views of this Office on the concept of income derived from rendering personal services; and

b. sets out factors for determining whether particular income constitutes income derived from personal services.

2. The Ruling will assist tax officers and practitioners in applying the following Taxation Rulings:

a. Taxation Ruling IT 2503 (Incorporation of medical and other professional practices). It deals with the incorporation of a practice company to take over the activities of a professional practice but is concerned only with those practice companies where income flows directly or predominantly from the rendering of personal services by the professional practitioner. Incorporation here is acceptable if it does nothing more than reduce the professional's income by the amount of an appropriate superannuation cover.

b. Taxation Ruling IT 2121 (Family companies and trusts in relation to income from personal exertion). It deals with income splitting arrangements by which individuals try to split their personal services income among family members by diverting it to a family company or trust. It regards these arrangements as ineffective for income tax purposes under section 260 or Part IVA of the Income Tax Assessment Act 1936 ("the Act").

c. Taxation Ruling IT 2330 (Income splitting). It is also concerned with the income tax consequences of income splitting arrangements involving trusts and the transfer of income producing assets or the purported transfer of income from the rendering of personal services.

RULING

A. Concept of Income Derived from Personal Services

Income from personal services defined

3. "Income from personal services" is income that an individual taxpayer earns predominantly as a direct reward for his or her personal efforts by, for example, the provision of services, exercise of skills or the application of labour. The inclusion of predominantly in this definition allows for the situation where personal services involve the use of some equipment, for example the drawing board of an architect.

4. Some examples of income from personal services included in Taxation Rulings IT 2121 (para 17) and IT 2330 (para 36) are:

a. salary and wages;

b. income derived by a professional person who practises on his or her own account without professional assistance;

c. income payable under a contract, for example a fencing contract, where the payment under the contract relates wholly or principally to the labour of the person concerned;

d. income derived by a professional sportsman or entertainer from the exercise of his or her particular skills.

5. The concept of income from personal services is to be contrasted with the term "income from personal exertion" as defined in subsection 6(1). That definition includes income consisting of earnings, salaries, wages, commissions, fees, bonuses, pensions, superannuation allowances, retiring allowances and retiring gratuities, allowances and gratuities received in the capacity of employee or in relation to any services rendered, the proceeds of any business carried on by the taxpayer either alone or as a partner with any other person, ... and so on. As can be seen, the concepts of income from personal services and income from personal exertion may overlap but are not coextensive.

6. For a more detailed consideration of the views expressed in paragraphs 3 to 5, see Tupicoff v. F.C. of T. 84 ATC 4851; 15 ATR 1262 and C. of T. v. Gulland, Watson v. C. of T. and Pincus v. C. of T. 85 ATC 4765; 17 ATR 1. See also IT 25, IT 2121, IT 2330 and IT 2503 for a full discussion of the interactions between personal services income, income splitting, section 260 and Part IVA of the Act.

Income from the business structure defined

7. In this Ruling "income from the business structure" refers to income other than "income from personal services". Income derived by a firm or practice which has substantial income producing assets, or many employees, or both, is more likely to be generated from the income yielding structure of the business rather than from the rendering of personal services.

B. Factors for Identifying Income from Personal Services

8. Whether a taxpayer derives income from rendering personal services is a question of fact and degree to be determined in the circumstances of each case. The crucial issue is the extent of the connection between the income concerned and the services rendered by the particular taxpayer involved. The following factors need to be considered in determining whether a taxpayer derives income from personal services, though no one factor is determinative.

a. The nature of the taxpayer's activities

The activities of salary and wage earners and professionals practising on their own account clearly generate personal services income.

Radiologists or pathologists who operate on their own account, however, often employ many technical staff and operate an array of technical equipment. Their income is generated from the business structure rather than from their rendering of personal services.

The activities of consultants, salespersons, journalists, life insurance agents and tradespersons are also likely to give rise to income from personal services. These examples are far from being exhaustive.

b. The extent to which the income depends upon the taxpayer's own skill and judgment

The more the income producing activities involve the exercise of the taxpayer's own skill and judgment the more probable it is that the income will be derived from personal services rather than from the business structure.

c. The extent of the income producing assets used to derive the income

The more substantial the income producing assets employed within a practice the more likely it is that the income of the practice will be derived from the business structure rather than from the rendering of personal services. For example, the array of equipment used by radiologists and pathologists may often suggest that their income is being derived from the business structure. However, minor equipment such as the drawing board of an architect or the heart monitor/blood pressure machine of a medical practitioner would not suffice to change what would otherwise be personal service income into income from the business structure.

The expression "income producing assets" is used in this context to include any investment of the practice in tangible business assets such as premises, fixtures and fittings, plant, equipment and industrial or intellectual property (whether owned or leased). However, the significance of these assets would have to be weighed against their relevance to the derivation of income - given the other factors mentioned in this paragraph.

d. The number of employees and others engaged

The more substantial the number of employees, practitioners or technicians used in a practice the more probable it is that the income is derived from the business structure rather than from the rendering of personal services (see Henderson v. F.C. of T. 70 ATC 4016; (1970) 1 ATR 596). For example, large accounting and legal firms with tens, or even hundreds, of practitioners but without extensive or substantial equipment would also be considered to be generating their income from their business structure.

Income from several sources

9. In some situations, a taxpayer may derive both personal service income and other income. For example, as explained in Taxation Ruling IT 2408 (Income splitting: insurance commissions), an insurance agent may derive income from initial commissions (personal service income) and from renewal commissions (other income). Similarly, a sole medical practitioner may also derive investment income. In these cases the two types of income should be apportioned and treated independently.

Income of a practice company or trust

10. For the purpose of determining whether a practice company or trust falls within the scope of IT 2503 (and only for that purpose), this Office will apply the following guidelines as a general rule of thumb:

a. If the practice company or trust has at least as many non-principal practitioners (see paragraph 11) as principal practitioners, then income is considered to be derived from the business structure (and therefore does not fall within the scope of IT 2503).

b. If the practice company or trust has fewer non-principal practitioners than principal practitioners, then whether it derives income from personal services will still need to be determined by considering the factors contained in paragraph 8 of this Ruling and the guidelines in previous Rulings on this issue. If these factors indicate that the practice company or trust derives income from personal services, it will fall within the scope of IT 2503. If they indicate that the practice company or trust derives its income from the business structure, it will not fall within the scope of IT 2503.

11. In paragraph 10:

a. "Practitioners" include both full-time professional and non-professional staff whose function is to derive material fees for the practice. Part-time staff count proportionately. The term does not include administrative, clerical or support staff. For example, a nurse under the direction of a doctor or a legal secretary under the direction of a solicitor are not "practitioners" unless they earn material fees in their own right.

b. "Principal practitioners" are those practitioners who own or share in the ownership of the practice, whether directly or indirectly.

c. "Non-principal practitioners" are those practitioners who are not "principal practitioners".

12. The paragraph 10 rule of thumb applies to income derived in the income year commencing 1 July 1991 and later years of income.

<u>commissioner of taxation</u>
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