



**Professional
Contractors and Consultants
Australia**

PSI SOLUTIONS - CONTRACTUAL TERMS AND SATISFYING THE RESULTS TEST



PSI SOLUTIONS - CONTRACTUAL TERMS AND SATISFYING THE RESULTS TEST

Introduction

The wording of a contract in terms that satisfy the results test will not of itself guarantee that the ATO or the Courts will consider your consultancy operation a Personal Services Business. When called on to make a Determination on contractor status, a range of common law indicia will be referred to in addition to the contractual terms. This approach to determining contractor status was established in the High Court in 1986 where Justice Deane commented that “What is decisive of the question [of determining employee or contractor status] is the substantive content, rather than the technical characterization, of that relationship” - that is, the substance of the relationship rather than the contractual terms alone [Stevens v Brodribb Sawmilling]. In 2001, the Hollis v Vabu judgement similarly found that the “totality of the arrangements” should be considered when determining contractor status.

While including the clauses set out in Table 2 in the areas regarded by the ATO as determinative (as set out in Table 1) will not guarantee that the ATO will determine PSB status in your favour, they are a solution to resolving your PSI status to the extent that they reflect the substance of your relationship with the client who engages you. That is, if you include these clauses in your terms of engagement, and they reflect the substance of your relationship with the engaging client, you should satisfy all the conditions of the results test. Contractual terms remain a critical reference point when a contractor is seeking to establish their Personal Business Status and satisfy the Results Test.

What are the key areas?

The ATO has identified particular clauses as “determining” rather than indicative factors in deciding PSB status in relation to the results test. Where the ATO has identified the existence or absence of particular clauses as determining factors, both your relationship with the client and terms of engagement should be unequivocal in these areas (while also reflecting the actuality of your arrangements).

Table 1 - Determining or indicative factors for establishing contractor status

Features of the terms of engagement and payment structure	Determining or indicative factor	To be considered a contractor, answer should be:
Does the contract set out the result to be achieved rather than the scope of work or typical tasks to be performed?	Determining	Yes
Is payment based on specified outcomes or results set out under the contract?	Determining	Yes
Is payment conditional upon achieving these outcomes rather than for work performed?	Determining	Yes
Does the contract state that you have a high level of discretion and flexibility as to how the work is performed?	Indicator	Yes
Does the contract state that you have the right to subcontract the work?	Indicator	Yes
Does the contract state that you will provide all necessary tools and equipment required taking into account industry custom and practice and convenience?	Determining	Yes
Where the client provides tools and equipment, are they incidental rather than necessary to the achievement of the result or outcome taking into account industry custom and practice and convenience?	Indicator	Yes
Does the contract state that you are liable for the cost of rectifying any defects in the work performed?	Determining	Yes
Does the contract state that you will carry PI and PL insurance?	Indicator	Yes
If a daily/hourly rate or progress payments are specified in the contract, is payment tied to achievement of milestones or results set out within the terms of engagement and reimbursed if outcomes are not achieved?	Indicator	Yes
Does the contract contain provision for leave entitlements, expenses or any other disbursements or work-related outgoings?	Indicator	No
Can the contract be terminated without or with limited penalty?	Determining	No
Does the contract contain a termination clause?	Indicator	No
If the contract is for a specified period, is there provision for the contract to be rolled over?	Indicator	No
Are you exposed to the commercial risk of making a loss under the performance of the contract?	Determining	Yes
Are services offered to the public?	Determining	Yes - via website, print advertising, etc.

Suggested clauses

The following table has been developed with reference to ATO Determinations, and Federal and High Court judgements. It provides a basis for ensuring that your terms of engagement are drafted in such a way as to document and clarify the relationship between you and your client in the areas most important to satisfying the Results Test.

Where contractors do not satisfy the Results Test, all income earned will be taxed as if it were personal income. This means contractors will not be able to split their incomes with spouses or claim business-like tax deductions.

While every effort is made to update the material for the latest case law, it is intended to provide general information only, current at the time of publication. Its contents do not constitute legal advice and should not be relied upon as such. If PSI is a concern for you, you should seek advice from your own legal or financial advisor.

Table 2 - Clauses that reflect a contractor/client relationship

Contractual area	Feature of the terms of engagement and payment structure	Common problems in contract documentation which do not provide the ATO with a basis for allowing an exemption from PSI rules	What should be included in the terms of engagement?
Basis of contract	Does the contract set out the result to be achieved rather than the scope of work or typical tasks to be performed?	Contract sets out scope of work and typical tasks without Schedule of outcomes or Appendix - it does not specify specific results or milestones	Income must be derived for producing a result rather than for the performance of work. Contractors must be running their own business rather than being an integrated part of another business (IRG Technical Services Pty Ltd v Deputy Commissioner of Taxation [2007] FCA 1867 (5 December 2007). Therefore, a Schedule of outcomes or Appendix which makes explicit specific results or milestones to be achieved upon which payment is conditional should be included in the contract for service, and this should reflect the substance of the actual arrangement between the parties.
Payment	Is payment based on specified outcomes or results set out under the contract?	There is no statement that progress payments are tied to specific explicit milestones and reimbursed if results or milestones are not achieved	Not just a statement setting out the scope of the work and nature of tasks to be performed. The Schedule of outcomes needs to be explicit, specific, results-based and the contract should state that payment is subject to achievement of results
	Is payment conditional upon achieving these outcomes rather than for work performed?	Not stated	The contract should state that progress and final payments are subject to the achievement of milestones or results, and reimbursable or reduced to the extent that the contractor caused or contributed to the failure to achieve the outcome
	If a daily/hourly rate or progress payments are specified in the contract, is payment tied to achievement of milestones or results set out within the terms of engagement and payment reduced or reimbursed if outcomes are not achieved?	Not stated	As above

Control	Does the contract state that you have a high level of discretion and flexibility as to how the work is performed?	This is not explicitly stated, or work is to be checked extensively by Client	<p>Include a clause stating that the Contractor has a high level of discretion and flexibility as to how the work is performed (refer to Note 2).</p> <p>Note that where a Contractor’s work is incrementally checked by the Client, and work extensively coordinated with other professionals on site, the Federal Court has found that this makes any “liability to rectify” provisions “irrelevant” (IRG Technical Services Pty Ltd v Deputy Commissioner of Taxation [2007] FCA 1867 (5 December 2007)).</p>
	Does the contract state that you have the right to subcontract the work?	Not stated	<p>If not, consider including a substitution clause allowing the work to be performed by another person provided by your business (there will usually be terms relating to right of veto, suitable qualifications etc.) and a No Control clause (See Notes 1 and 2 below).</p> <p>Even if the contract provides for substitution or subcontracting, if an extensive selection process has occurred and the result to be achieved is subject to the particular skill and expertise of the Contractors, the Federal Court has found that such delegation is not meaningful or real (IRG Technical Services Pty Ltd v Deputy Commissioner of Taxation [2007] FCA 1867 (5 December 2007))</p>
Tools and equipment	Does the contract state that you will provide all necessary tools and equipment required?	Not stated	<p>Contractors must supply all tools and equipment necessary to achievement of result. Provision of an office, computer system and information will indicate that client provides tools and equipment necessary for achievement of result. Where these are provided by the client, these may be considered indicators that the contractor is not providing the tools and equipment necessary to completion of the specified result/s. Provision of laptop and programs may not be considered sufficient (IRG Technical Services Pty Ltd v Deputy Commissioner of Taxation [2007] FCA 1867 (5 December 2007)).</p> <p>Include a clause stating that the Contractor will provide all necessary tools and equipment required to achieve the results set out in the Schedule of outcomes.</p> <p>A clause which requires the Contractor to update their tools and equipment within the contract period should provide for a negotiation process if needed and have specifications reasonably equivalent to the tools and equipment being replaced (Keldote Pty Ltd & Ors v Riteway Transport Pty Ltd [2008] FMCA 1167 (22 August 2008))</p>
	Where the Client provides tools and equipment, are they incidental rather than necessary to the achievement of the result or outcome taking into account industry custom and practice and convenience?	Not stated	<p>Where tools and equipment are provided by the Client, it should be noted in the terms of engagement they are incidental rather than necessary to the achievement of result/s. In the case of IT Contractors, it may be necessary to qualify this to state that where the tools such as software and hardware are provided by the Client, they are incidental to results being achieved and the practice is in line with industry custom and practice</p>

Liability	Does the contract state that you are liable for the cost of rectifying any defects in the work performed?	Contract may accord the Contractor liability beyond the common law position, and may state that the Contractor is liable for rectifying faults in the work rather than the cost of rectification	Firstly, ensure your liability is limited to that which is reasonable under the contract. While not an issue directly relating to PSI, you should beware any attempt to contract out of Proportionate liability arising out of Professional Standards legislation (see Notes 3 and 4).
	Does the contract state that you will carry PI and PL insurance?		Secondly, the clause should state that the Contractor is liable for the cost of rectification - you can sub-contract if necessary. Thirdly a clause which states that the Contractor is required to carry their own PI and PL insurance should be included. Note that having the Contractor's work regularly checked by the Client has been found by the Federal Court to make a clause stating that a Contractor is liable to rectify "irrelevant" (IRG Technical Services Pty Ltd v Deputy Commissioner of Taxation [2007] FCA 1867 (5 December 2007) (see also Control)
Commercial risk/mutuality of obligation	Are you exposed to the commercial risk of making a loss under the performance of the contract? Is the relationship between the Client and Contractor explicitly set out?	Exposure to commercial risk is limited in critical ways which may be regarded by the ATO as limiting the commercial risk to which the Contractor is exposed	Generally, a Contractor needs to make a voluntary assumption of risk when performing work. They stand to make a profit or loss on the task and must bear the responsibility and liability for any poor work or injury sustained in the performance of the task. If exposure to commercial risk is limited in critical ways, this suggests to the ATO that the relationship is more in line with employment-like arrangements. Where possible, include a "No mutuality of obligation" clause in the agreement to explicitly define the nature of the relationship (see Note 5)
	Can the contract be terminated without or with limited penalty?	The contract can be varied without penalty – this is likely to be regarded by the ATO as limiting the commercial risk to which the Contractor is exposed	Where a commercial contract can be terminated or varied with limited penalty, the ATO is likely to suggest that this mitigates commercial risk being borne by the Contractor and means payment is being made for services performed rather than a result. While Professionals Australia would normally suggest the inclusion of a termination clause to protect the Contractor, if the results test is being relied upon to establish PSB status, our advice would be to include a termination clause only if it is in the format established in the Fabsert decision (Fabsert Pty Ltd v ABB Warehousing (NSW) Pty Ltd [2008] FMCA 1198 (30 September 2008) - and confirmed in the ATO's interpretive advice sought by Professionals Australia (see Note 7).
	Does the contract contain a termination clause?	Terms of engagement which include a contractual condition allowing payment for services up to the date of termination are likely to be regarded as limiting the commercial risk undertaken by the Contractor	
	Does the contract contain provision for leave entitlements, expenses or any other disbursements or work-related outgoings?	Disbursements clause – this is a problem as these clauses are regarded by the ATO as an indicator that the Contractor is not bearing commercial risk	Unlike employees, Contractors normally cover their own costs and expenses. Disbursements clauses are regarded by the ATO as suggesting that the Contractor is not covering his/her own expenses in this way. Where it's feasible (and quite clearly very often it is not) a disbursements clause should be avoided where the results test is being relied upon. Leave entitlements indicate "employment-like" arrangements and do not generally form part of a contract for service. To insert a clause claiming travel expenses including travel time, refer to Note 6
	If the contract is for a specified period, is there provision for the contract to be rolled over?	Contract may have a starting but no finishing date, or provide for a rollover of the contract	Where the contract for service includes a rollover clause, this is something that is likely to be regarded by the ATO as an indicator that the commercial risk being borne by the Contractor is limited
Nature of appointment	Are services offered to the public?	Being available through a labour hire agency is not sufficient	While sometimes not included in the actual contract, if relevant, include details of how the Client learned of the Contractor's services. Word of mouth, responding to tenders, website, print advertising, etc. are acceptable. The AAT has found that responding to advertisements and making direct approaches to companies or 'cold calling' does not constitute making offers to the public at large (AAT Case [2008] AATA 934, Re The Engineering Company and FCT)

Note 1 - Sample “Substitution” clause

Where agreed, the work carried out to achieve the results set out in this Agreement can be undertaken by another person provided by the Contractor. This arrangement will be subject to the substitute Contractor having the appropriate qualifications and relevant experience, and to the Client’s approval.

Note 2 - Sample “No control” clause

The Contractor will not be subject to the supervision, direction or control on the manner in which the Contractor renders/delivers the agreed services. Checking of the Contractor’s work by the Client or co-ordination with other onsite/project activities will not constitute control in these terms.

Note 3 - Sample “Liability” clause

The Contractor will indemnify the Client for claims or loss arising from a breach of professional duty in the provision of professional services. The liability of the Contractor is reduced to the extent that the Client or other person(s) caused or contributed to the loss or occurrence which gives rise to a claim.

Note 4 - Beware of Proportionate Liability exclusions

While these comments about proportionate liability exclusions are not relevant to PSI status other than the fact that a liability clause should be included in a contractor’s terms of engagement, it is worth noting how engaging clients may attempt to include proportionate liability exclusions in these clauses.

The wording of exclusions for **Proportionate Liability** may typically be as follows:

“The parties agree that Part (XX) of the Civil Liability Act (year) in (State or Territory) is excluded from operation with respect to any dispute, claim, action or other matter brought by any party against another arising out of or in connection with this Agreement.”

The wording of exclusions under the **Professional Standards Act** may typically include the following:

“The Consultant”

(a) confirms that at the date of executing this Contract it is not a person to whom a scheme under the (State or Territory) Professional Standards Act applies;

(b) undertakes for the period of its potential liability at law in respect of the Contract, it will not become a person to whom such a scheme applies, including a scheme which may become applicable under legislation of similar intent to the (State or Territory) Professional Standards Act, unless it receives prior written advice from the (Client) that the (Client) has no objections to the Consultant becoming a person to whom such a scheme applies”

(Source: ACEA Outlook, Jan-March, p.4).

Note 5 - Sample “No mutuality of obligation” clause

Nothing in this Agreement constitutes a relationship of employer and employee. The Contractor must not act in any way other than as an independent contractor of the company. The parties acknowledge and agree that this is fundamental to the basis on which they have entered into this agreement.

(While the parties cannot deem the relationship between themselves to be something that it is not by simply including a clause such as this, the ATO is likely to consider such a clause an indicator of the true nature of the relationship.)

Note 6 - Sample “Travel expenses” clause

(a) The Contractor is responsible for and must pay expenses incurred in fulfilling the terms of this contract other than expenses nominated in this clause or as agreed between Client and Contractor.

(b) The Client will reimburse properly incurred expenses including travel-related expenses (and any other disbursements nominated by the parties such as accommodation, taxi fares, etc).

(c) A travel-related expense is defined as costs and time incurred in travel properly incurred to fulfil the terms of this contract;

(d) The Client will reimburse properly incurred travel-related expenses in full;

(e) The Client will reimburse properly incurred travelling time at the rate of 50 per cent of the Contractor’s hourly rate as set out in clause X;

(f) A travel-related expense is properly incurred by or on behalf of the Contractor if -

(i) the expenses are approved by the Client; and

(ii) the expenses are properly substantiated.

Note 7

ATO interpretive advice (November 2008) has confirmed that a Termination clause that provides for

(i) a reasonable period of notice to provide time for a Professional Engineer, Scientist or IT contractor to take up an engagement with another client, and/or

(ii) to provide an orderly handover to another contractor, and/or

(iii) to provide for the winding down of the contractor’s operation

will not of itself cause a Contractor to fail the first condition of the results test (75% of income must be for producing a result).



**Professional
Contractors and Consultants
Australia**

PSI SOLUTIONS - CONTRACTUAL TERMS AND SATISFYING THE RESULTS TEST

STREET ADDRESS

163 Eastern Rd, South Melbourne
Victoria 3205, Australia

POSTAL ADDRESS

GPO Box 1272, Melbourne
Victoria 3001, Australia

HOTLINE

1300 273 762

EMAIL

info@professionalsaustralia.org.au

WEB

www.professionalsaustralia.org.au

Copyright© 2017 Professionals Australia

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system or transmitted in any form or by any means, electrical, mechanical, photocopy, microfilming, recording or otherwise, without written permission from Professionals Australia.

Disclaimer

This material is intended to provide general information, current at the time of first publication. Its contents do not constitute legal advice and should not be relied upon as such. You should seek advice on particular matters from your own legal or financial advisors.