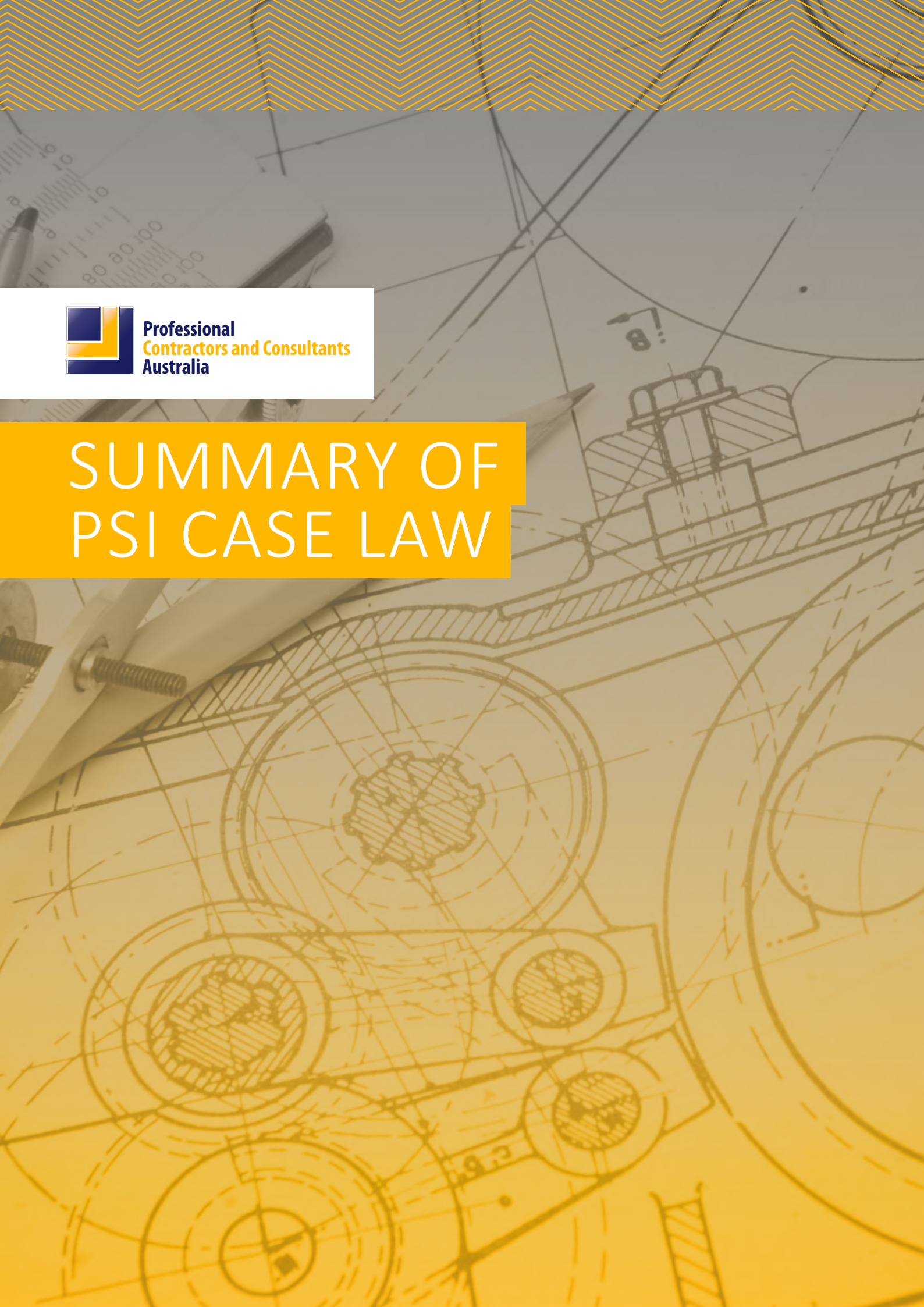

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SUMMARY OF PSI CASE LAW

Yalos - Final decision clarifies unrelated clients test

In the final chapter of the long-running Yalos saga which tested the unrelated clients provisions of the PSI Rules, the AAT has confirmed that the Rules apply on the basis that even though the taxpayer would have satisfied the unrelated clients test but for unusual circumstances, he did not make offers or invitations to the public at large or a section of the public as required by section 87-20(1)(b). The AAT found that contacting clients by phone or email through personal contacts or relationships in the industry did not satisfy the relevant provisions. The ATO has, since the decision, issued a statement setting out the clarification provided by the case including the view of the Federal Court that 'subsequent income years' in subsection 87-65(4) does not mean every subsequent income year, but such years generally, and that 'a section of the public' in paragraph 87-20(1)(b) can refer to the 'limited number of players' that might operate within the narrow area of activity for which the offered individual's skills and experience are suited. This final clarification is welcome, and will help Professionals Australia better advise its members. To view the ATO statement, visit http://law.ato.gov.au/atolaw/view.htm?docid=%22LIT%2FICD%2F2007%2F3018-3019%2F00001%22) and for Professionals Australia information on the PSI rules, visit the Guide 'Deciding your PSI status with certainty'.

Yalos case provides clarification on unusual circumstances in relation to the unrelated clients test, and what consistutes making offers to the public

On the grounds that the AAT had not considered whether Yalos's services were provided as a direct result of making offers or invitations to the public, the ATO appealed to the Federal Court the AAT's finding that Yalos Engineering would have satisfied the unrelated clients test but for unusual circumstances. The AAT has now finalised the matter ordering the Commissioner to issue a Personal Services Business Determination under the PSI rules on the basis that Yalos did offer their services to a section of the public, and, as found previously, they would have satisfied the unrelated clients test but for the unusual circumstance that delayed the project to which Yalos Engineering were contracted. The decision now provides clarification in two areas: firstly, that an unexpected delay beyond the control of the contractor in a construction project constitutes an unusual circumstance, and secondly, that in spite of the taxpayer's expertise being relevant only to a small number of potential clients, the companies constituted a section of the public, and that word of mouth and personal recommendations consituted making offers to the public.

[Case reference: Yalos Engineering Pty Ltd and FCT (AAT, Ref No: 2007/3018-3019, Pascoe SM, 3 June 2010]

Latest PSI judgement confirms problems with Results Test for IT Contractors - Taneja and FCT (2009)

The AAT has rejected an IT contractor's claim that, when industry custom and practice was taken into account, they satisfied the results test conditions set out in 87-18(a),(b) and (c) and was therefore a Personal Services Business. The custom and practice provisions set out in subsection 87-18(4) state that "regard is to be had to whether it is the custom or practice (a) for the personal services income from the work to be for producing a result, (b) for the entity to be required to supply the plant and equipment or tools of trade needed to perform the work, and (c) for the entity to be liable for the cost of rectifying any defect in the work performed as the case requires.

The AAT examined agreements entered into with Taneja's clients and found nothing in the contract provisions that indicated it was being paid to produce a result. Rather it formed the view that the company (of which the taxpayer was one of the Directors) "was being paid for the time that it spent … doing what the client asked …" The Tribunal also found that the custom and practice provisions could only be applied where the first condition of the results test was satisfied, that is, that payment was for producing a result.

This judgement confirms the particular difficulties experienced by IT contractors in relation to the results test. Industry custom and practice for IT contractors is that they are likely to be engaged and paid on an hourly basis with their contracts setting out the scope of work to be performed rather than results to be achieved, making the first condition of the results test difficult to satisfy. IT contractors also often use the IT equipment of the client and it is difficult to put the case that this equipment is incidental to rather than necessary for completion of the work required as needed to satisfy the second condition of the results test. Contract documentation for IT professionals seldom hold the contractor to high levels of liability because of the large number of contingencies unrelated to the contractor which may contribute to defects in the work which would limit their liability at common law. In addition to these difficulties, IT contracts for service often provide for rollover of the contract at the discretion of client and subsequently periods of engagement which extend beyond 12 months.

The implications for IT contractors are that if a PSB Determination is requested by an IT contractor who is operating in line with industry custom and practice as set out above – either through an agency or directly with a client – the ATO is unlikely to find the results test satisfied and PSB status established on the basis of the results test. For information on arrangements which IT contractors can put in place to maximise their chances of satisfying the results test, visit the PSI for IT Contractors section of the website.

Taxpayer fails to obtain personal services business determination

-- AAT Case [2008] AATA 934, re The Engineering Company and FCT

In an interesting case concerning the PSI rules in Pt 2-42 of ITAA 1997, the AAT has upheld the Commissioner's refusal to issue a personal services business determination: AAT Case [2008] AATA 934, Re The Engineering Company and FCT (AAT Ref No 2007/3360, Frost M, 21 October 2008, to be reported in ATR).

Background

The taxpayer company was a personal services entity that provided engineering and related services to clients. One of the employees who actually provided those services was the director of the taxpayer. The other employees who provided services were Mr O, a long-term employee, and Mr D, who was employed during the 2003-04 income year. It was accepted that some of the taxpayer's income was the director's personal services income (PSI).

The company applied for a personal services business (PSB) determination under s 87-65 of ITAA 1997 in relation to the 2005-06 income year, which would have had the effect of not attributing certain of the company's income to the director personally. The Commissioner declined to make the determination and subsequently disallowed the taxpayer's objection.

The taxpayer submitted that it was entitled to a PSB determination because, but for unusual circumstances in the 2005-06 income year, it would have satisfied the "employment test" (the second alternative: s 87-65(3B)) or the "unrelated clients test" (the fourth alternative: s 87-65(6)).

Director's PSI

The first issue for the AAT was how to work out the director's PSI, ie the income that was mainly a reward for the director's personal efforts or skill (s 84-5). There were a number of possible approaches including a "global approach", but the AAT decided that, where possible, each discrete amount of income received from the taxpayer's clients should be examined. Thus, if the amount shown on an invoice can be dissected into distinct components, the AAT said each component should be examined to see if the amount is "mainly" (to the extent of more than 50%) a reward for the relevant individual's personal efforts or skills. Otherwise, the AAT considered the question is whether the whole amount shown on the invoice is mainly a reward for the relevant individual's personal efforts or skills.

Employment test - "principal work"

A personal services entity will meet the employment test in s 87-25 if it engages one or more other entities (excluding individuals whose PSI is included in the entity's ordinary or statutory income and associates of the entity that are not individuals) that contribute at least 20% to the entity's "principal work". The AAT decided that, by the use in s 87-25(2) of the alternative, unqualified expression "principal work", the Parliament intended to identify a different concept from the one represented by the longer, qualified expression (in ss 85-10, 85-20 and 85-25) "principal work for which you gain or produce your personal services income". In the AAT's opinion, the entity's "principal work" in s 87-25(2) is the principal activity undertaken by the personal services entity in question, in this case the provision of engineering services to the taxpayer's clients.

In reaching this conclusion, the AAT commented that both the Explanatory Memorandum to the legislation enacting the PSI rules and Ruling TR 2001/8 appeared to "lapse into the same confusion of concepts".

Employment test - unusual circumstances

The AAT then concluded that the taxpayer had met the employment test in each of the 2002-03, 2003-04 and 2004-05 income years because it had engaged "one or more other entities to perform work" (Mr O in each year and Mr D in 2003-04) and they were not individuals whose PSI was included in the taxpayer's income.

The next question was whether the taxpayer would have met the employment test in 2006 but for "unusual circumstances" (s 87-65(3B)(a)). The unusual circumstances relied upon by the taxpayer were that, in March 2005, a long-term client indicated that it had no plans to engage the taxpayer's services for the foreseeable future and, in May 2005, Mr O resigned and took another client with him when he left. The AAT decided that they were unusual circumstances and that but for those circumstances, the taxpayer could reasonably have been expected to meet the employment test in 2005-06.

However, there are 2 parts to s 87-65(3B) and a PSB determination could only be made under the second alternative if the director's PSI that was included in the taxpayer's income was, or could reasonably be expected to be, from the taxpayer conducting activities that met one or more of the results, employment and business premises tests (s 87-65(3B)(b)).

In this case, the relevant test was the employment test. According to the AAT, this meant the taxpayer had to show that some of its income in 2005-06 could reasonably be expected to be from engaging one of more other entities (excluding the director as his PSI was included in the taxpayer's income) to perform work. However, the AAT was not satisfied this was the case. The determination was requested at the end of May 2006, yet 11 months of the income year had already passed without the taxpayer engaging additional employees (Mr O and Mr D having left before the start of the year) and there was no evidence to suggest that that position would change by the end of the year. Accordingly, the AAT said it could not make a PSB determination under the second alternative.

Unrelated clients test

The fourth alternative (s 87-65(6)) concerns the unrelated clients test. The evidence showed that the taxpayer had 2 broad approaches to obtaining work. One was to respond to advertisements and the other was to make direct approaches to companies that the taxpayer thought might be able to use its employees' skills ("cold calling"). The AAT concluded that neither kind of approach amounted to making offers or invitations to the public at large or to a section of the public and, therefore, the taxpayer failed the unrelated clients test for 2002-03, 2003-04 and 2004-05. Consequently, the taxpayer could not expect to meet the unrelated clients test in 2005-06.

Source: Trevor Snape, Thomson Weekly Tax Bulletin, Issue 45, 24.10.2008

PSI provisions held to apply to computer consultant - Fowler v FCT

The Federal Court has dismissed a taxpayer's appeal and upheld the Commissioner's assessment for the 2001 to 2003 tax years under the personal services income (PSI) provisions contained in Divs 84 to 87 of Pt 2-42 of the ITAA 1997: Fowler v FCT [2008] FCA 528 (Federal Court, Lindgren J, 21 April 2008.

Background

The taxpayer was a computer consultant and the sole director and shareholder of a company that derived income from contracts entered into with certain labour hire firms. The taxpayer was also the sole employee of the company. The agreements entered into between the company and the labour hire firms allowed for the provision of the taxpayer's services for a set period for an agreed hourly rate. The work was normally carried out at the premises of the end users using their equipment and software.

In its decision in AAT Case [2006] AATA 808, Re Fowler and FCT (2006) 64 ATR 1113, the AAT concluded that the PSI legislation was designed to tax income in the hands of the person whose exertion caused its receipt even though it was contractually derived by another entity. Here, the AAT said the taxpayer provided personal exertion services in exactly the situation contemplated by the PSI provisions and the assessments were accordingly upheld. The taxpayer appealed to the Federal Court.

Taxpayer's argument

The Federal Court said the taxpayer argued that the various provisions in Pt 2-42 are not independent provisions but are subject to constraints to be found by implication in Pt 1-3 of the ITAA 1997. The taxpayer submitted that the use of the concept of derivation of income in Pt 1-3 signified that it is only income of which a person becomes the beneficial owner that is assessable income. In the present case, the taxpayer said it was the company that derived and became the beneficial owner of the amounts paid by the labour hire firms. The taxpayer particularly argued that the Tribunal had erred in law by:

• treating s 86-15 of the ITAA 1997 as an assessing provision divorced from Div 6;

• accepting there was no doctrine of law which would require that the taxation of income depends on ownership of that income;

• failing to consider whether the taxpayer derived ordinary income as prescribed in s 6-5;

• treating an amount deemed under s 86-15 as the source of statutory income of the taxpayer under s 6-10(4).

Commissioner's argument

The Commissioner contended that the PSI provisions made the amounts in question part of the taxpayer's "statutory income", and therefore part of his assessable income, even though, according to ordinary concepts, the amounts were income derived by the company.

Decision

The Federal Court said there was no overriding principle that, in order for income tax to be imposed, there must be a derivation by an entity beneficially, so that owner becomes the beneficial owner of the income. The Court held that the ITAA 1997 made the amounts received by the company from the labour hire firm "statutory income" and therefore assessable income of the taxpayer.

[ATP Divs 84-87 ITAA 1997 ATH Ch 4]

by Terry Hayes

Source: Weekly Tax Bulletin, 24.4.2008, Issue 17

PSI rules - business premises test:

ATO Decision Impact Statement

On 3 December 2007, the Tax Office on the AAT decision in AAT Case [2007] AATA 1786, Re Dixon Consulting Pty Ltd and FCT. The case concerned whether the taxpayer satisfied the business premises test and as a result was entitled to a personal services business determination from the Commissioner. released a Decision Impact Statement

In AAT Case [2006] AATA 186, Re Dixon Consulting Pty Ltd and FCT (2006) 62 ATR 1104 (see 2006 WTB 10 [423]), the taxpayer succeeded in arguing that its business premises were separate from the residence for the purposes of the 'business premises test' in s 87-30(1) of the ITAA 1997. However, on appeal, the Federal Court in FCT v Dixon Consulting Pty Ltd (2006) 65 ATR 290 (see 2006 WTB 53 [2406]) held that the premises had to be used 'exclusively' by the taxpayer. As a result, the Court remitted the matter to the AAT to determine if the premises had been used exclusively by the taxpayer. The AAT found that the premises (ie a garage) had not been used "exclusively" by the taxpayer in carrying on its business for the purposes of satisfying the "business premises test" under the PSI rules.

The Tax Office said this was the first case to consider the application of the 'business premises test' in s 87-30. The Tax Office said the findings of the Federal Court and the Tribunal confirm its view in Taxation Ruling TR 2001/8.

Source: Lisa Mak, Thomson Weekly Tax Bulletin - 7 December 2007, Issue 51

Commentary

This case is noteworthy only in its confirmation of the need for business premises to be used exclusively for business purposes to satisfy the business premises test.

Test case: Entities fail "results test" for PSI purposes IRG Technical Services Pty Ltd & Anor v DCT

In a test case, the Federal Court has dismissed the appeals of two taxpayer entities against the Commissioner's refusal to grant them Personal Service Business Determinations for engineering work carried on in relation to the construction of a major gas plant. The Court did so on the basis of finding that the taxpayer entities did not pass the 'results test' as the individual engineers who carried out the work did so in an 'employee-like' manner: (IRG Technical Services Pty Ltd & Anor v DCT [2007] FCA 1867 (Federal Court, Allsop J,).

Background

The taxpayers were, respectively, a private company and a family trust each controlled by a qualified engineer who specialised in the area of instrumentation systems. In the relevant income years, the taxpayers entered contracts with human resources recruitment companies to provide engineering services in relation to the construction of a liquefied natural gas plant by a Woodside Petroleum joint venture. The terms of the engagement provided for, among other things, the requirement to provide services to the joint venture, payment at an hourly rate (to be payable by the HR company), the requirement to submit timesheets and invoices to the HR company, and the extent to which they were to provide their own equipment.

The taxpayers sought a Personal Services Business Determination under s 87-65 of the ITAA 1997 on the basis that they were carrying on a 'personal service business' in terms of the 'results test' in s 87-18. (This requires that at least 75% of the personal service income of one or more individuals that is included in the entity's income is for 'producing a result', where the entity is required to provide the plant and equipment or tools need to perform the work and is also responsible for rectifying any defects in the work. In effect, the income is required to be generated as if the individual operates on a 'contractor' basis by reference to these criteria.) The Commissioner refused to grant the Determination.

Decision

In dismissing the taxpayers' appeal, the Federal Court first took into account the history of the PSI provisions, including the 1999 Ralph Report which recommended that income should be attributed to an individual if they carried out personal services through an interposed entity as if they were an employee of the party requiring the services. It then dismissed the taxpayers' claim that the focus should be on the contract between the taxpayers and the recruitment companies. Instead, the Court said the 'results test' should be determined by reference to the party who requested their services and to whom the services were provided, namely the Woodside Petroleum joint-venture.

After close examination of the factual background and, in particular, the exact manner in which the engineers provided their personal services to the joint-venture, the Court concluded that the income they derived was not for 'producing a result' but, rather, was for the performance of work as a skilled engineer within the business structure of the joint venture, and as part of a co-ordinated team of engineers. In other words, the two engineers were not conducting their own business, but rather were an integrated part of the business in terms of the work they carried out and the manner in which they were remunerated at an hourly rate for the work performed.

Moreover, in terms of the criterion in the 'results test' to provide their own tools and equipment, the Court found that while the engineers had recourse to their own laptops and programmes, nevertheless, the joint-venture provided all the necessary equipment and tools (ie office, computer systems, information etc) as were necessary for them to perform their work. Likewise, because of the close co-ordinated manner in which the team of engineers carried out and incrementally checked their work, the requirement to rectify any work rarely arose and was, in effect, irrelevant. Finally, the Court noted that while delegation was permissible, it ran contrary to the whole selection process of selecting these two engineers for their particular skill and expertise.

Source: Kirk Wilson, Thomson Weekly Tax Bulletin - 7 December 2007, Issue 51

Commentary

On the basis that the Engineers were deemed to have been engaged to provide services rather than produce a result, did not provide the tools necessary to undertake the work, that there was no explicit liability for rectifying defects in the work, minimal discretion and flexibility as to how the work was performed (with the work being regularly checked), payment made on an hourly basis without being linked to milestones or results achieved and no real right to delegate or sub-contract the work, the Court upheld the ATO's decision to refuse a Personal Services Business Determination.

This test case confirms that the PSI results test checklist developed by Professionals Australia and set out in the PSI Solutions document remains an accurate way to determine your status with certainty.

Personal services income attributed to electrical engineer - AAT Case [2007] AATA 1705, Re Skiba and FCT

An electrical engineer has unsuccessfully challenged the Commissioner's decision to attribute to him, under the alienation of personal services income rules in Pt 2-42 of ITAA 1997, personal services income derived by a company of which he was a director: AAT Case [2007] AATA 1705, Re Skiba and FCT (AAT, Ref No WT200400501, Sweidan SM, 27 August 2007).

Background

The taxpayer was an electrical engineer whose services were provided through a company, M Ltd, the directors of which were the taxpayer and his wife. Most of the company's contracts were with agencies under which the taxpayer's services were provided to clients of the agencies.

For the 2001 and 2002 income years, the taxpayer was assessed on salary received from M Ltd ($26,000 in total) and various other amounts. However, the Commissioner issued amended assessments for both years, attributing to the taxpayer under s 86-15 of ITAA 1997 income derived by the company from providing the taxpayer's services. After adjustments, the total amount attributed was $268,517. It was not disputed that the income derived by M Ltd was personal services income under s 84-5, received as reward for the personal efforts and skills of the taxpayer, and that the company was a personal services entity.

The taxpayer contended that s 86-15 did not apply as M Ltd conducted a personal services business (PSB) within the meaning of s 87-15, because it met the results test in s 87-18(3) and the unrelated clients test in s 87-20. The taxpayer also contended that the income from one of the contracts was exempt under s 23AG of ITAA 1936 as the contract was governed by Canadian law and was performed in Canada.

Decision

The AAT decided that the results test was not satisfied, primarily because the income received by M Ltd under the relevant contracts was not for producing a result, but was received for the ongoing performance by the taxpayer of work assigned to him. Factors in support of this conclusion were that the work was completed by teamwork, all documentation was produced on the computer systems of the agencies or their clients, the taxpayer was not permitted to sign off on his own work, he could only delegate his contract work with the approval of the agencies or their clients and no specified result had to be produced before the company was paid. In addition, M Ltd was not required to provide the equipment and tools needed to perform the work and the company was not liable for the cost of rectifying any defect in the work.

The unrelated clients test was also not satisfied because no services were provided to clients as a direct result of making offers or invitations to the public, as required by s 87-20(1). Section 87-20(2) was relevant as it provides that being available to perform services through an agency does not mean that offers or invitations have been made to the public. The AAT commented that it was clear that the unrelated clients test was concerned with the identity of the client to whom services are provided rather than the identity of the payer (this is particularly relevant where the services are provided through an agency).

In any event, even if the unrelated clients test was satisfied, the 80% test in s 87-15(3) was not satisfied as more than 80% of the personal services income came from, in 2001, one entity and its associate and, in 2002, one entity.

The AAT also decided that M Ltd was not a "PPS entity" for the purposes of the transitional period in Item 26 of Sch 1 to the New Business Tax System (Alienation of Personal Services Income) Act 2000 as no "payee declaration" (under the prescribed payments system) was in force at 13 April 2000. Accordingly, an exemption from the alienation of personal services income rules in the 2001 and 2002 income years did not apply.

The argument that the income from the one contract was exempt under s 23AG was dismissed, as the term "foreign earnings" in that section does not extend to attributed personal services income. However, the income was considered to be foreign income of the taxpayer for the purposes of s 6AB of ITAA 1936. The taxpayer was therefore deemed, under s 6AB(3), to have been personally liable for, and to have paid, the foreign tax withheld from the payments under the contract. Accordingly, the taxpayer was entitled to a foreign tax credit under s 160AF(1) of ITAA 1936 for the withheld tax.

As regards penalties, the AAT said that the omission of the personal services income from the taxpayer's 2001 and 2002 returns, in circumstances where the taxpayer's tax agent was aware of and informed the taxpayer of the provisions of Pt 2-42, was reckless and confirmed the 50% penalty imposed by the Commissioner under s 284-90 in Sch 1 to the Taxation Administration Act 1953. The AAT noted that the tax agent was not blameless, failing to ascertain all the relevant facts, assess whether Pt 2-42 applied and consider whether the taxpayer had a reasonably arguable position.

Source: Issue 37, Weekly Tax Bulletin, 31.8.2007, by Trevor Snape

Commentary - lessons from this Ruling

This Ruling confirms that the AAT has applied the principles as set out in the checklist in the Professionals Australia PSI Solutions document).

Specifically, the Ruling confirms that:

- the income to be received should be for producing a result which is explicitly specified as part of the contract documentation, not for services or work performed;
- the contractor should provide the tools and equipment necessary for completing the work;
- the contractor should be able to delegate work;
- the contract documentation should explicitly state that he/she is liable for the cost of rectification;
- payment should be subject to achievement of the specified result;
- services should be offered to the public - being available through an agency is not sufficient

and finally,

- that many Accountants are not across the PSI rules.

Rolling temp contracts are not 'sham' arrangements

There is nothing in the WR Act preventing an employer from offering a series of temporary contracts to a long-term employee, an AIRC Full Bench has ruled. In doing so the bench quashed an earlier decision by an individual commissioner that the non-renewal of such a contract by the Department of Justice was a termination at the initiative of the employer.

Vice President Michael Lawler, Senior Deputy President Anne Harrison and Commissioner Frank Raffaelli yesterday upheld an appeal by the Department against the earlier decision that an articled clerk was entitled to unfair dismissal relief. Both the original case and the appeal were heard under the old WR Act.

The woman had worked for the Department since May 1998 on a series of temporary contracts ranging from three months to several years long. She was told in March 2005 her final contract, entered into in January that year, would not be renewed. The woman successfully claimed this was a termination at the initiative of her employer because she had been led to believe her employment would continue, despite the contract's end date.

The Full Bench characterised the final contract as an "outer limit" contract rather than a "fixed-term contract". When an outer limit contract reaches the nominated end date, the contract terminates "through the effluxion of time and there is no termination of employment at the initiative of the employer", the bench said. The question was whether that applied in this case.

‘Contentious’ but within rights

During the appeal, counsel for the woman claimed the series of contracts were “sham” arrangements and the real agreement between parties was ongoing employment.

The Full Bench said employment contracts should be taken as binding according to their terms, including their specified end date, unless a specific exception applies. In this case, the exception had to be more than the original cmr’s finding that “strong countervailing factors” mitigated against the contract, it said. “The ‘strong countervailing factors’ relied upon by the commissioner was the Department’s practice of engaging all or almost all staff on a series of temporary contracts,” the bench noted. “The mere fact that all or almost all of the Department’s staff were engaged on temporary contracts and that there was a strong expectation that contracts would be renewed upon their expiry simply does not permit a conclusion that, determined objectively, there was a common intention (that is, the objective intention of both the Department and the relevant employee) that the contracts were not to create the legal rights and obligations which they give the appearance of creating.”

While the Department’s practice of employing nearly all staff on temporary contracts “may be viewed by some as industrially contentious … subject to legislative constraints, employers are entitled to structure their affairs, including the contracts they offer to employees, in the way that they think best suits their interests”, it said in upholding the appeal. (Lunn v Dept of Justice. PR974185. 27/11/06)

Source: Workforce Daily - Tuesday, November 28, 2006

AAT decision provides for broader interpretation of 80/20 rule

In a decision handed down by the Administrative Appeals Tribunal on 1 November 2002 (AATA 1121, Re Creaton Pty Ltd and FCT) a taxpayer has successfully argued that a less restrictive approach should be taken by the ATO in determining “unusual circumstances” in relation to the 80/20 Rule.

Creaton, a contract consultancy providing services in the form of management and administration of engineering assets in buildings, was contracted to a single client, the Fire Code Reform Centre (FCRC) for a period of seven years between 1994 and 2001.

Creaton sought exemption from the 80/20 Rule on the grounds that unusual circumstances applied. The AAT agreed that Creaton should be excluded from having to satisfy all the personal services business tests on the basis that they could demonstrate unrelated clients in the seven income years prior to being engaged by FCRC. The ATO’s argument that the unusual circumstances had become “usual” was rejected.

This provides guidance for professionals delivering business services who may have applied to the ATO for a PSB Determination on the grounds that they would have been engaged by two or more unrelated clients but for “unusual circumstances”. The AAT relied on the taxpayer being able to demonstrate multiple clients in one or more preceding income years in making its decision.

The decision is significant to Professionals Australia and its members in that it vindicates our stance that narrow application of the 80/20 Rule does not reflect the reality of commercial practice for those delivering business services.

80/20 Rule – more “unusual circumstances”

The AAT has handed down another decision providing for broader interpretation of the 80/20 Rule.

In the 2001 tax year, Metalskills Pty Ltd was unable to satisfy the PSB tests because its major revenue source was from a single client, a head contractor in the business of hiring out IT professionals to carry out specific projects, and for part of the year, they did not have separate business premises.

The taxpayer sought exemption from the PSB tests on the basis of “unusual circumstances”.

Following the reasoning of Sassella SM in an earlier decision (AAT Case [2002] AATA 1121, Re Creaton Pty Ltd and FCT) Allen SM accepted that “unusual circumstances” existed, relying upon the fact that work had been carried out for a number of clients in earlier tax years.

This decision again vindicates Professionals Australia’s stance that the PSI legislation and rulings fail to provide for the complexity of commercial arrangements covering the delivery of business, engineering and IT services, and that requiring contractors to adhere to an arbitrary “normal” contract duration of 12 months has the effect of penalising genuine independent contractors and consultants.

Applying to the ATO for a PSB Determination – advice for contractors

If contractors/consultants don’t satisfy the Results Test and more than 80% of their income is from a single client, the PSI measures will apply and this could affect the entity’s tax obligations. If unusual circumstances prevent a contractor from meeting one or more of the tests, they can apply to the ATO for a Determination that the PSI measures do not apply. These recent AAT decisions have provided much needed clarification on how the ATO should interpret the “unusual circumstances” provisions, and taxpayers should now feel more confident applying for exemption from satisfying the PSB tests if they can clearly demonstrate multiple clients in previous income years.

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SUMMARY OF PSI CASE LAW

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