



The Association of Professional Engineers, Scientists and Managers, Australia

GPO Box 1272, Melbourne VIC 8060

Phone: (03) 9695 8800

Facsimile: (03) 9696 9312

163 Eastern Road, South Melbourne VIC 3205

info@apesma.asn.au

www.apesma.asn.au

Board of Taxation releases Report on the Alienation of Personal Services Income (PSI) Rules

The Board of Taxation has released its report on the Post-Implementation Review of the Alienation of Personal Services Income Rules. The report found that the PSI rules in their current form fail to "provide adequate levels of integrity and equity" and identified a number of potential areas for reform.

The Board identified major issues with non-compliance, the continuing reliance on Part IVA (anti-avoidance) measures, limited taxpayer understanding of allowable deductions, and the complexities and grey areas involved in applying the Personal Services Business (PSB) tests.

The report specifically highlighted concerns raised by APESMA that the PSI rules fail to take into account actual taxpayer circumstances and the reality of commercial practices for engineers, scientists and IT professionals. The report recognised that the ATO's interpretation of the legislation and Rulings TR 2001/7 and 8 as they stand potentially disadvantage those who offer advice and business services in favour of those producing tangible property. This "apparent bias", they suggested, could lead to outcomes that are inconsistent with the intent of the rules. APESMA welcomes formal acknowledgement of these critical issues in the report.

The Board has suggested possible reform options including introducing various forms of reporting obligations to assist with identifying non-compliance, extending the attribution rules to PSBs, clarifying and simplifying the deduction provisions, implementing a test or definition of "employee-like" characteristics of work arrangements to clarify who is affected by the rules and introducing a deemed labour income approach.

In a statement on the report, Assistant Treasurer Nick Sherry commented on the use of sham contracting arrangements by employers to avoid their employment obligations. "The use of sham contractors", he said, "is a threat to the integrity of the taxation system and a threat to working conditions of employees". APESMA also notes the comments of ATO Second Commissioner Bruce Quigley on this issue who said the ATO would target businesses engaging contractors under disguised employment arrangements who failed to withhold appropriate tax and make superannuation guarantee contributions as a means of creating a level playing field in the current difficult economic environment.

APESMA concurs with the Senator Nick Sherry's view that where sham contracting is being used to disguise employment arrangements, the taxation system can provide a means of putting in place mechanisms which will act as a disincentive for using such arrangements. We do however hold the strong view that in identifying contractors engaged in employee-like arrangements, the taxation system must not by way of unintended consequences penalise legitimate independent contractors and consultants.

While the Government has indicated that it will not determine reforms until the Henry Tax Review has reported, APESMA has some concern about the Board's proposed options for reform in relation to the results test.

The report notes that the amendment to the original PSI rules which allowed taxpayers to self-assess as a PSB where more than 80 per cent of PSI is derived from a single source was a

departure from the recommendations set out in the Ralph Report. With over 88 per cent of taxpayers self-assessing against the results test, the Board suggests that removing access to the results test for those earning more than 80 per cent of their income from a single client would “bring more taxpayers into the ambit of the rules” - that is, the Board suggests the removal of the option for self-assessment and a requirement to apply for a PSB Determination in **all** cases where the taxpayer earns more than 80 per cent of their income from a single source as a means of addressing non-compliance arising from incorrect self-assessment.

APESMA is concerned that such a change could increase costs and administrative burden for a significant proportion of APESMA’s genuine consultants and contractors who correctly self-assess against the results test.

APESMA also agrees in-principle with the report’s finding that better definition of employee-like arrangements may address some of the misunderstanding which contributes to non-compliance. We do however note the difficulty involved in developing a definition which will adequately and comprehensively distinguish between employees and contractors.

As the Board acknowledged in its report “.. drawing the line where income ceases to be personal services income and becomes income generated from a business structure is difficult ..” APESMA will continue to work with Government and the ATO to ensure that legislative reforms remove the uncertainties around the existing tests, better define employee-like arrangements to provide more certainty and better distinguish between those in disguised employment arrangements and genuine contractors and consultants, not add to the compliance and administrative burden for contractors and consultants operating PSBs, and take into account the commercial realities of contracting and consulting members.

To read the report, visit

http://www.taxboard.gov.au/content/alienation_of_personal_services_income_rules/report/PIR_Alienation_PSI_Rules.pdf. To read APESMA’s submission, visit http://www.apesma.asn.au/employment/connect/pdfs/submission_board_of_taxation_review_of_psi_july2009.pdf.