

Personal services income (PSI) is income produced mainly from your personal skills or efforts as an individual. You can receive PSI in almost any industry, trade or profession. However, some common examples include financial professionals, information technology consultants, engineers, construction workers and medical practitioners. PSI does not affect you if you're an employee receiving only salaries and wages.

Income is classified as PSI when more than 50% of the amount you received for a contract was for your labour, skills or expertise.

The first thing you need to do is work out if any of your income is classified as PSI. If it is, you then need to work out if special tax rules (the PSI rules) apply to that income. There's a series of steps to follow to help you do this.

If the PSI rules **apply**, they affect how you report your PSI to the ATO and the deductions you can claim. They will essentially limit your tax deductions to what you would have been eligible to claim if you were an employee, and will prevent you from income splitting or retaining profits in a business structure.

If the PSI rules **don't apply**, your business is a personal services business (PSB). When you're a PSB, there are no changes to your tax obligations, except that you need to declare any PSI on your tax return.

You can receive PSI regardless of your business structure. If you're producing PSI through a company, partnership or trust, the income may be treated as your individual income for tax purposes.

Working out if the PSI rules apply

When working out if the PSI rules apply, you need to look at each contract or job to determine if you have received PSI. If you have received PSI (including if you've received it through a company, partnership or trust), you then need to work out if the PSI rules apply to that income.

Step 1: Have you received PSI?

When working out if your income is PSI, you need to look at the income received from each separate contract. The terms and conditions of the contract, as well as invoices and written agreements (which show the arrangement for the work), are important in working out if the income is PSI.

Calculate what percentage of income from each job was for:

- your labour, skills, knowledge, expertise or efforts for the services you provided
- anything else, such as the materials supplied and/or tools and equipment used to complete the project.

If **more than 50%** of the income received for a contract was for your labour, skills or expertise, then **all** income for that contract is PSI.

If **50% or less** of the income received for a contract was for your labour, skills or expertise, then **none** of the income for that contract is PSI.

Step 2: Results test

If you've worked out that your income includes PSI, your next step is to work through the results test. This test is about the nature of your agreement to perform the work, including the basis on which you are paid. If you're paid on an hourly basis or daily rate for the services you provide, it's unlikely that you will meet the first condition of the results test.

To pass the results test, you need to meet the following three conditions:

1. Paid to produce a specific result
2. Required to provide the equipment or tools
3. Required to fix mistakes at your own cost

Step 3: The 80% rule

If you've worked through the results test but did **not** pass, your next step is to apply the 80% rule. This step is about your PSI client base and how much of your PSI comes from one client.

For this step, you need to work out the amount of PSI that comes from each client (including their associates) in an income year. If you're a commission agent, the clients of a principal can be treated as your own clients. If you're paid by a labour hire firm, the labour hire firm is treated as your client.

Step 4: The remaining tests

If your result at Step 3 is '**less than 80%**', there are three remaining tests to work through:

- a) **Unrelated clients test** - To pass the unrelated clients test your PSI must be produced from two or more clients who are not related or connected, and the work must be obtained by making offers to the public or sections of the public. You do **not** pass the unrelated clients test if you source all your work through arrangements such as a labour hire firm. You pass the test in an income year if you meet **both** of the following conditions:
 - o Two or more unrelated clients
 - o Making offers to the public
- b) **Employment test** - To pass the employment test, your business must employ or contract others to help complete the work that generates your PSI. To pass the test, you must meet either **one** of the following conditions:
 - o Principal work performed by others - To meet this condition, your employees or other contractors must perform at least 20% of the principal work.
 - o Apprentices - To meet this condition, you must employ one or more apprentices for at least six months of the income year.
- c) **Business premises test** - To pass the business premises test, your business premises must meet certain location and usage criteria. You pass the test if at **all times** in the income year, your business premises meets **all** of the following:
 - o Used mainly for personal services work
 - o Used exclusively for your business
 - o Physically separate from your home
 - o Physically separate from your clients.

If you don't pass any of these tests, but still believe that the PSI rules should not apply to you, you can lodge a Personal Services Determination, and request that the ATO treat your business as being a personal services business.

For more information on Personal Services Income, or to discuss how this can affect you, please give our office a call.

Source: <https://www.ato.gov.au/Business/Personal-services-income/>