

ALIENATION OF PERSONAL SERVICES INCOME

The Government will introduce measures to limit the avoidance of income tax that occurs through alienation of personal services income.

Under the measures, income earned by an interposed entity for the personal services of an individual will be treated for tax purposes as the income of the individual.

The provisions will not apply where the services are provided in the manner of a personal services business. A personal services business is one which, for example, would provide its services generally to the public at large, accept some entrepreneurial risk in the way it provides its services or provides its own infrastructure. Detailed criteria will be developed (based on the criteria set out in the Ralph Report) to determine whether the services are provided in the manner of a personal services business.

The measures will also limit work-related deductions available to entities covered by these provisions (and to individuals in similar circumstances) to those that would have been available had the service provider been employed by the service requirer.

Key features

The personal services income of entities that fall within the scope of the measures will be treated for income tax purposes as the income of the individual who provided the personal services.

- The measures will apply if 80 per cent or more of the personal services income received by the entity for the services of the personal service provider is from one service requirer (including associates of the requirer).
 - Entities that receive 80 per cent or more of their income from one service requirer will be able to seek a ruling from the Commissioner of Taxation that they are providing their services in the manner of a personal services business and are outside the scope of the measure.
- The measures will also apply to entities that receive less than 80 per cent of their income from one service requirer but do not provide the services in the manner of a personal services business.

The measure will not affect the relationship between the service provider and the service requirer.

- There will be no assessment and no withholding for tax purposes on the part of those requiring the services.
- The tests will be self-assessed by the service provider, except where a ruling is sought from the Commissioner of Taxation.

The provisions will not affect other aspects of the entity arrangements, such as entitlement to an Australian Business Number or registration for GST. Deductions for specified expenditure related to the maintenance of the interposed entity will be allowed. The entity may also make superannuation contributions for the benefit of the service provider and be entitled to employer deductions.

Commencement date

The measures will apply from 1 July 2000.

Current arrangements

Personal services income is income that is earned by the personal exertion of an individual. This income can be 'alienated' when an entity (a company, trust or partnership) is interposed between the individual and the person paying for their services, so that the interposed entity derives the income rather than the individual. The income can then be split with other members of the interposed entity or retained within the interposed entity, allowing less tax to be paid or tax to be deferred. More deductions against assessable income may also be claimed than if the service requirer employed the individual. The Australian Taxation Office has previously applied the general anti-avoidance rule to these arrangements.

Why the change is needed

The increasing avoidance of tax through the alienation of personal services income poses a growing threat to the income tax base.

The use of interposed entities to avoid or defer income tax raises issues of equity between those that can take advantage of these arrangements and other providers of personal services, including wage and salary earners, who pay the correct amount of tax.