

## **Issue**

In February, the Administrative Appeals Tribunal handed down a decision covering Personal Services Income ('PSI') legislation which has implications for income-splitting and tax deductions for personal companies and trusts.

The result means all independent contractors and the businesses that engage them need to be aware of the case. It is now expected that the Australian Tax Office will act with considerable confidence in expanded audit activities of personal companies and trusts. Anyone with these structures needs to review their arrangements.

## **Background**

There are more than 700,000 people in Australia with structures potentially affected and thousands of businesses which insist on requiring individual contractors to be structured as companies or trusts. The PSI legislation of 2002, and two recent important legal test cases within the last 15 months are causing the company and trust structures to be questioned by the ATO.

The PSI laws were directed at closing down illegitimate income splitting and the claiming of business-type tax deductions by individuals.

Last month, the ATO won another test case. An IT contractor with a company passed income to his wife and paid superannuation for her. The appeals tribunal ruled all the income was the contractor's and disallowed tax deductibility for payments to his wife.

Around 12 months ago, two mining engineers in Western Australia lost their legal case. One operated as a company and the other as a trust. The court supported the tax office view that the respective company and trust incomes were in fact the personal incomes of the two engineers and to be taxed as personal income.

## **Issues for farmers**

A number of prominent tax websites commenting on the Administrative Appeals Tribunal decision claim that a significant number of independent contractors who work through proprietary companies or through trusts are failing to pass the PSI rules. The articles stress that while it is not suggesting that the use of trusts or PTY companies is illegitimate or invalid for tax purposes, but that enormous care needs to be taken to ensure that the specifics of the results test are fully implemented in the ongoing contractual arrangements. The ATO continues to audit and review trusts and proprietary companies and will challenge arrangements where it believes the results test has not been applied.

The results test is a specific tax test with about 11 criteria that need to be passed in order to establish if the PSI rules apply to you (for more information on the PSI rules for companies, partnerships and trusts, please [click here](#) or visit the ATO website at [www.ato.gov.au/content/downloads/BUS00167666n725101008.pdf](http://www.ato.gov.au/content/downloads/BUS00167666n725101008.pdf)).

Agri-businesses that insist on forcing contractors to operate as companies or trusts have a responsibility to ensure proper 'results test' contracts are in place. Otherwise the financial assumptions around the arrangements could be construed as false and misleading with damages litigation a possibility.

Farmers should contact their financial advisor, tax accountant or Australian Tax office if they believe the above may have implications for their business.

*The above information should not be considered financial advice. If you have any questions regarding the structure of your business, we advise you to contact your financial advisor.*