HOUSE OF REPRESENTATIVES

NEW BUSINESS TAX SYSTEM
(ALIENATION OF PERSONAL SERVICES INCOME) BILL 2000

Second Reading

SPEECH

Thursday, 13 April 2000

BY AUTHORITY OF THE HOUSE OF REPRESENTATIVES
Mr COSTELLO (Higgins—Treasurer) (4.41 pm)—I move:

That the bill be now read a second time.

The New Business Tax System (Alienation of Personal Services Income) Bill 2000 will improve the integrity and fairness of Australia's taxation system. The government announced on 11 November 1999 that it would proceed to legislate in relation to the alienation of personal services income, following a recommendation from the Review of Business Taxation which was chaired by Mr John Ralph AO.

This bill will prevent individuals reducing their tax by diverting the income generated by their personal services to a company, partnership or trust and limit work-related deductions available in those cases (and to an individual contractor in similar circumstances).

The Ralph Review of Business Taxation noted that the practice of the alienation of personal services income posed a growing threat to the income tax base. In addition, the review noted that it was clearly inequitable that some taxpayers should be reducing their tax liability by using interposed entities or claiming excessive deductions, while other taxpayers also deriving personal services income, including ordinary wage and salary earners, pay the correct amount of tax.

The measures contained in this bill implement the Ralph review's recommendations to address the alienation of personal services income. Rules are introduced dealing with the income tax treatment of the personal services income of interposed entities and individuals.

Those rules will not apply where the individual or the entity is conducting a personal services business.

Individuals and interposed entities who receive at least 80 per cent of their personal services income from one source will come within the provisions of the bill, unless the commissioner makes a determination that the income is from conducting a personal services business.

The commissioner's determination that a business is a personal services business may be given on one of four grounds:

. . . having two or more unrelated clients;
. . . having one or more employees; or
. . . having a separate business premises; or
. . . that the individual or entity is producing a result, supplies their tools of trade and is liable for the cost of rectifying defective work.

Legitimate contractors, for example those operating in the building industry, who are contracted to produce a result, supply their own tools or equipment and are liable for the cost of rectifying any defective work, will be covered by this last test.

The object of these rules is to treat earnings from work in the same way under the income tax law, regardless of the legal structure used by the income earner.

This bill only deals with issues of taxation.

Specifically, the bill addresses the income tax treatment of personal services income and related deductions of an individual or entity earning personal services income.
This bill does not affect the legal status of an interposed entity or deem an individual to be an employee for the purposes of any other legislation or industrial award.

There is nothing in this bill which requires, or would require, an individual or entity earning personal services income to alter their current legal relationship between themselves and the source of their income.

Personal services income may continue to be earned through an interposed entity, with no further tax consequences, if the income is not alienated and there is compliance with the other general provisions of the tax laws. This is the situation under the current tax laws and will continue to apply under the provisions of this bill.

The new rules in this bill will:

... treat income obtained by an interposed entity from the rendering of an individual's personal services as the income of the individual, unless the entity pays that income promptly to the individual as salary; and

... limit deductions that the interposed entity is entitled to offset against the amount that is treated as the individual's income; and

... limit the deductions that an individual can offset against their personal services income.

Individuals who are entitled to claim business related deductions under current tax arrangements including insurance, workers compensation and the costs of obtaining work will still be entitled to claim these deductions, irrespective of whether they are a personal services business.

The measure includes collection arrangements as part of the pay-as-you-go withholding system to ensure that tax is paid in a timely way where income obtained by an interposed entity is attributed to the individual worker.

The measures only affect the tax obligations of the individual or entity earning personal services income and in some circumstances, their associates. The measure does not impose any additional obligations—including withholding obligations—on the acquirer of personal services.

The personal services income measure will apply to assessments for the 2000-01 income year and later income years. The accompanying collection arrangements will apply to payments received by interposed entities from 1 July 2000.

The government has also included in the bill a specific transitional provision to minimise the compliance burden associated with moving to the new tax system.

Under this transitional provision, the Commissioner of Taxation will be able to make a declaration that has the effect that the regime will not apply to a class of contractors under the prescribed payment system who have payee declarations with the commissioner as of today. The declaration will apply for a period of two years, ending in July 2002.

In designing this transitional provision, the government has had regard to the fact that taxpayers under the prescribed payment system are currently subject to withholding arrangements and are specifically recognised as independent contractors under the tax laws. The government has also had regard to the logistics of the commissioner being able to process a potentially large number of requests for an individual determination prior to 1 July 2000.

The transitional arrangement will remove any additional compliance burden from the new rules that independent contractors currently in the prescribed payment system face in transferring to the new tax system.

The legislation to implement the personal service income regime includes two tax imposition bills to safeguard the legislation against constitutional challenge.

The government estimates that the alienation measure will result in increased revenue of $190 million in 2000-01 financial year, $290 million in 2001-02, $435 million in 2002-03 and $515 million in 2003-04.

I commend the bill and present the explanatory memorandum to the House. I also present the explanatory memorandum to the New Business Tax System (Alienated Personal Services Income) Tax Imposition Bill (No. 1) 2000 and the explanatory memorandum to the New Business Tax System (Alienated Personal Services Income) Tax Imposition Bill (No. 2) 2000.
Debate (on motion by Mr Kelvin Thomson) adjourned.