

# **Submission for Review of PSI Legislation**

**By**

**Luigi Iemi**

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# 1. **Contact**

This submission is present by Luigi Iemi who can be contacted by the following means.

Telephone:

(08)9452-1355

Address:

82 Explorer Drive

Thornlie

WA 6108

E-mail:

[piengineering@westnet.com.au](mailto:piengineering@westnet.com.au)

## **2. Introduction**

As part of the drive for a more “flexible work force,” the federal government encouraged the start up of small scale businesses. The theory appeared to be that a large contracting force would allow more flexibility in labour deployment and reduce the overheads on business.

Established businesses saw an opportunity to reduce their overheads by removing the payment of holidays, sick leave and other entitlements. Staff were encouraged to resign and be reinstated as contractors. The reduction in permanent staff had the flow on effect of reduction in taxes such as payroll tax.

Some employees also saw benefit in reducing their personal taxes by establishing a business and paying themselves a reduced income.

Of course governments, both state and federal, viewed the loss of tax revenue with some concern and established the Personal Services Income (PSI) rules to cut back on the number of “sham” relationships between employers and employees.

This submission does not seek to challenge the requirement of the PSI rules but seeks to highlight the discrepancies where genuine businesses are unable to meet some of the PSI rules due to the nature of their businesses and circumstances beyond their control. In particular, this submission challenges the assumption that the 80/20 income rule is a viable proposition when it comes to judging whether a business is genuine or not.

This document shows how my business is being adversely affect by the current PSI legislation, and how the legislation forces it into a disadvantaged commercial position.

### **3. Consultancy**

My business is an Electronic Engineering Consultancy. It provides technical services to clients who wish to develop new electronic products. The products developed cast across a wide swath of fields, from the oil and gas industry to mechanical machine control and to sub sea communications system.

The diversity of clientele is also broad. They can range from large corporations with their own engineering departments, to individuals or small companies with no technical knowledge or engineering expertise of their own.

#### **3.1 Research and Development**

The primary focus of my consultancy is the development of new products. The development time for these projects can vary from several months to several years.

There appears to be a lack of understanding by bureaucrats as to exactly what is involved in the R&D process. R&D is not a known process. The outcomes may be different to those originally envisaged when the process began. It is not uncommon to change tack during a project to overcome unforeseen technical obstacles. It is NOT like selling commercial products such as washing machines or producing products which have previously been designed and built. It is not unusual to encounter companies which thought it would take six months to develop a product and it ended up taking several years.

Being on such a project requires a certain amount professional ethic. One cannot simply walk away with the excuse that one is unable to continue providing services due to economic circumstances imposed by government regulation. Should one leave the project, then the knowledge gain to date is lost and is not easily reattained by any subsequent consultant. This exposes the client to the possibility of severe disruption, leading to increased costs and project delays. In addition the reputation of the original consultant is severely tarnished which will eventually lead to loss of business and ultimately employment.

#### **3.2 Engineering Services**

The provision of engineering services is not a commodity which is purchased by the general public. The services provided are specialised and contribute greatly to our society. As such the proposition that one can easily find work amongst non related companies in any given year is preposterous.

We are not talking about selling lollies to a sweet toothed public!

#### **3.3 Consequences of the Current Policy**

So how does one meet the current rules? The following discussion shows the practicalities of trying to meet the current policy.

##### **3.3.1 80/20 Rule**

One can express to a potential client that they are only available 4 days a week. As most clients have schedule pressures to meet, they are unlikely to view this arrangement favourably. Unless the requirement is a short term project, or review, which is not time critical, one would be commercially disadvantaged trying to put a proposal forward which included anything less than at least a 40 hour week.

My experience has shown that the most practical way of meeting the 80/20 rule after the gaining of a primary contract, is to then seek additional small jobs or contract.

This puts an immense amount of pressure on an individual to juggle several contracts. Scheduling of time to multiple projects is at best precarious and cannot be guaranteed. Whilst working on a new project, the previous client may have found issues with their product which required an immediate modification to their design. There was one occasion which ended up with myself working two full time projects simultaneously and several occasions where up to four projects, of various scale, are being juggled.

Assuming the main project requires a minimum 40 hour week. The 80/20 rule will require a minimum 50 hour week. Average times under these conditions are in the order of 60 to 80 hours per week, peaking for sustained periods at anything up to 100 plus hours. This does not include additional time requirements such as book-keeping, business administration, or, the reading of countless documents, journals and books for professional development.

This has the effect of severe stress not only on oneself but ones family, where the possibility of “burnout” or degrading health, are very real. With so much time spent working, there is little time for other activities. Family relations suffer and there is a loss of work efficiency.

Some people have suggested that this can all be overcome by employing additional staff. What these people fail to realise is that my clients are seeking the experience this consultancy provides. They are seeking individuals which have specific experience and expertise, not a person with generally available skills. In addition, to efficiently employ additional staff, my role would change to a managerial one tasked with finding additional work to keep the staff employed. This is not an area I wish to become involved in.

### **3.3.2 Other Rules**

#### **3.3.2.1 Results Test**

This consultancy operates in a manner which any other business operates. A client requests work to be performed. If that work is performed to their satisfaction they may wish to extend the scope of work or rehire at a later date.

If they are not satisfied with the work that has been performed they may redress this either by terminating the job or through legal action. As such this company carries public liability insurance and professional indemnity insurance. This not something that any employee I know of has to carry.

In a recent case brought before the Administrative Appeals Tribunal, the ruling had the following to say – “If the result is said to be the installation of an offshore pipeline it could hardly be said that *‘the company’* provided the equipment or tools required for that result.”

What they failed to state, was that the building of the pipeline came about as a direct result of the skills and expertise provided by the individual about who the company is built. This expertise was not available in the multi-national company which engaged the individual and otherwise, would probably have had to go to an overseas contractor who may not have had knowledge of local conditions or regulations.

#### **3.3.2.2 Tools Test**

Most clients do not have sufficient, or indeed any test equipment, to perform the required tasks. As a result, this consultancy has had to invest heavily in its own test equipment to efficiently perform its business.

Again no employee I know of needs to carry this expense, which extends to far more than merely purchasing a laptop computer.

A plumber, or electrician, probably carries far less in capital equipment than my company, yet they are considered independent merely because they have a wider customer base.

### **3.3.2.3 Rectifying Defects**

This topic is difficult to measure in my business. Research and development may go down a path which may ultimately be a dead end. Should a design prove faulty and an expensive recall initiated, any redress may be imposed on my company. Again, a reason for the insurance that I carry.

The potential for rectifying defects is definitely there.

How many investment advisers are currently rectifying their defective investment advice?

### **3.3.2.4 Business Premises**

Whilst operating a business premises would give a more defined indication that the company is operating as a business, why does a hairdresser, working from home and with a wide client base escape this clause when another contractor with a limited client base does not?

### **3.3.2.5 Contracts**

The business relationship between myself and my clients differs depending on individual circumstances.

Larger corporations generally prefer a contract based arrangement, whilst smaller companies and individuals prefer either a short work order or no contract altogether. They are happy to engage this company's services without the need for any formal contract. Whilst some commercial people would shudder at such an arrangement, is it really that difficult to envisage that two companies which trust each other sufficiently could carry out a commercial relationship under such conditions?

How many individuals, or companies for that matter, go through contract negotiations when engaging a plumber, electrician, hairdresser etc. Yet, again, these individuals can maintain their businesses merely because they have a wide client base from which to draw on.

## **4. Clayton's Business**

To paraphrase the famous commercial, this section will describe the concept of the "Clayton's Business." That is, the business that you operate when you're not operating a business.

The following sections will attempt to highlight the commercial penalties imposed by operating within the auspices of the PSI rule.

### **4.1 Liability**

The Clayton's business is exposed to public and professional liability like any other. Yet the government wishes to treat them like any individual earning a wage. Though no employee is exposed to potential litigation.

### **4.2 Resource Allocation**

Any normal business can allocate as many resources as they wish to a project. If they wish to they can allocate 100% of their time and resources to any one project without incurring a penalty.

The Clayton's business can only allocate a maximum of 80% of its time to any one project over the course of a year. Placing unwarranted pressure on the company client relationship.

### **4.3 Tax Liability**

A normal business has a fixed tax rate against which can it can budget.

The Clayton's business has a varying tax rate, dependent on whether or not they meet the PSI rules. Generally, this can not really be determined until it is too late to perform any remedial action.

### **4.4 Budgeting**

A normal company is permitted to purchase plant and equipment when and how their financial resources allow. At their discretion they can reserve capital to meet future expenditure.

The Clayton's company must withdraw all their capital, pay the full rate of tax, and then reinvest what is left over to purchase any plant or equipment. On this matter, some have suggested that one merely take out a loan to purchase the required item. Assuming the money was available to purchase a piece of equipment, the cost of paying the additional tax added to the cost of bank interest, makes the "real" cost of that piece of equipment much higher than what it would have been – a cost penalty simply because one does not have a large client base.



## **5. PSI Rule Improvements**

The following is a list of suggestions where the current PSI rules may be enhanced to cater for those who run genuine businesses and still maintain a barrier against “sham” relationships.

### **5.1 Time Test**

Scrap the 80/20 rule and replace it with a more commercially reasonable time limit. Most projects with which a consultant would be engaged would be over within three years. I believe it would be reasonable to limit anyone, in a consulting role, to a maximum tenure of three years, if they have done no other work for an unrelated company. Otherwise, they must not perform work for that company for a minimum of six months, before being re-engaged.

### **5.2 Insurance Test**

A company must carry either one or both public and professional liability insurance. This is recommended by most professional associations and should already be carried.

### **5.3 Tools Test**

This requirement should be kept as most employees prefer their employer purchase the required tools.

### **5.4 Results Test**

This should be scrapped as results can come in many forms.

### **5.5 Rectifying Defects Test**

This should be scrapped as it has been shown that liability for defect rectification is a commercial and legal issue as to when and how this is done.

### **5.6 Business Premises Test**

This should be kept with the addition of a dedicated space at a residence which is allocated for the purpose of conducting ones business.

### **5.7 Contracts Test**

This should be kept as a guide, however, extended to recognising where formal contracts may not be implemented. The provision of services and the exchange of payment would be considered a commercial relationship.

### **5.8 Multiple Clients Test**

A recognition should be made where a company has provided services to other companies in the past.

## 6. Conclusion

This document has highlighted the effects of the current PSI legislation and its adverse effects, both commercial and social, in the running of a small business consultancy.

It has attempted to balance the requirement for allowing the operation of a small business within existing rules and tax guidelines, whilst still trying to delineate the difference between genuine business activity and those merely trying to reduce their tax burden.

It is this person's opinion that the current PSI legislation in general and the 80/20 rule in particular, provides a punitive burden, both socially and commercially, on businesses which do not by their nature have a wide customer base.

In my experience, individuals who find the burden too excessive, will either take up one of the following options

- 1) Seek less specialised employment in another company. The effect of which is that their skills are now limited to that one company.
- 2) Seek work as a consultant overseas
- 3) Leave the industry altogether.

One must agree this is counterproductive, as those skills, which are essential in a modern industrialised society, should be available to as wide a variety of customers as possible.

I implore the committee looking into this review to keep in mind the contributions made by individuals in a wide variety of specialized areas, not just in engineering, but health and safety, education and medicine, just to name a few. I don't believe it would going to far in stating that it is ultimately in the national interest that these small companies with a wealth of knowledge, which can be made available to a large customer base, be encouraged to thrive.