Submission No 3

INQUIRY INTO APPLICATION OF THE CONTRACTOR AND EMPLOYMENT AGENT PROVISIONS IN THE PAYROLL TAX ACT 2007

Organisation: Certis Security Australia

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NSW Legislative Council

Portfolio Committee No. 1 – Premier and Finance

Inquiry into the application of the contractor and employment agent provisions in the *Payroll Tax Act 2007*

SUBMISSION

By Certis Australia Pty Ltd

(for itself and on behalf of its subsidiaries, collectively referred to as **Certis Security Australia**)

3 February 2025

A. Overview

1. Certis Australia Pty Ltd (for itself and on behalf of its subsidiaries, collectively referred to as **Certis Security Australia**) is grateful for the opportunity to make this submission to the Inquiry into the application of the contractor and employment agent provisions in the *Payroll Tax Act 2007* (NSW) (**PTA**). Certis Security Australia is a leading outsourced services partner in Australia that designs, builds and operates multi-disciplinary smart security and integrated services. More information about Certis Security Australia is set out in section F of this submission.

2. This submission will focus on the employment agency provisions in Part 3 Division 8 of the PTA. Recent developments in case law regarding these provisions have created substantial uncertainty and are of significant concern to businesses in NSW generally and to the security industry in particular. This submission will cover the following matters.

3. In section B, we explain that the intention of the employment agency provisions was to apply to individuals who, by reason of the interposition of an employment agent as traditionally understood, were not employees of anyone, but that this intention has substantially miscarried, and we recommend restoring the employment agency provisions to have this originally intended scope. We also explain how the existing mechanism for avoiding double taxation in s 41 of the PTA creates unfair and uncommercial results where a service provider is an employee of a subcontractor, as it operates to give the subcontractor (who is the actual employer) a windfall gain at the employment agent's expense, and we recommend amending this regime.

4. In section C, we explain how the employment agency provisions have been interpreted as being significantly broader than Parliament's original intention of applying to workers who behaved in substance as though they were the employees of a employment agent's client and how recent case law developments have not only created significant uncertainty in the application of these provisions but have also carried the scope of those provisions even further from their intended area of operation. We recommend amendments to be made so as to refocus the application of these provisions on their original target.

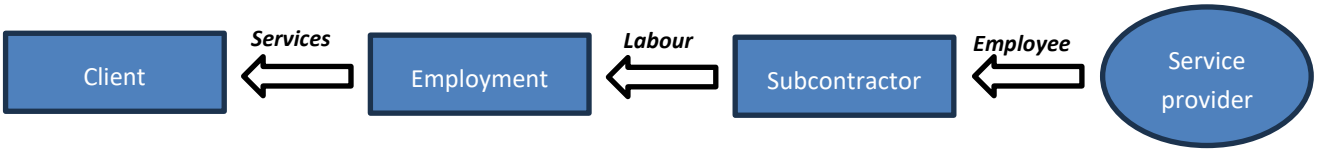
5. In section D, we explain how the employment agency provisions have been applied to arrangements in which one member of a corporate group procures labour for another member of the same corporate group, resulting in a liability to payroll tax even though no such liability would apply if the group were instead structured as a single legal entity. We recommend that this unintended result be reversed.

6. In section E, we recommend transitional relief for the implementation of the amendments we have proposed in the previous sections, and we also recommend the enactment of a binding ruling system to give businesses greater certainty for their future operations.

B. Employment agency provisions intended to capture non-employees

7. As the employment agency provisions in Part 3 Division 8 of the PTA are presently drafted, a worker (referred to as a "service provider") may be deemed to be an employee of an "employment agent" even if that service provider is already a common law employee of another person and even if that other person is already paying payroll tax in respect of the wages paid to that service provider.

8. The following is an illustration of the typical arrangement to which the employment agency provisions are sought to be applied:



9. At present, even if the service provider is an employee of the subcontractor and the subcontractor is paying payroll tax in respect of the service provider's wages, the employment agent can be deemed to be an employer of that service provider and will then be made liable to pay payroll tax on those same wages.

10. In this section, we will explain that:

    (a) the application of the employment agency provisions to service providers who are already employees of another person is entirely contrary to the original intention of those provisions, which was to address service providers who were not employees of anybody; and

    (b) the mechanism used to avoid double taxation of the service providers wages in s 41 of the PTA produces unfair and uncommercial results with the actual common law employer being relieved from payroll tax and so enjoying a windfall gain and the employment agent having payroll tax imposed on it instead.

B.1 The intended scope of the employment agency provisions

11. When originally enacted in 1985, the employment agency provisions were intended to apply to arrangements under which an employment agent – as that term is ordinarily understood – procures the services of a service provider for a client but the service provider is not an employee of either the employment agent or the client, and so the amounts paid to that service provider as wages escape payroll tax.

12. In the Second Reading Speech to the Bill that enacted those provisions, the Minister stated (underlining added):[1]

> This bill includes a number of measures which will catch schemes designed to avoid liability for pay-roll tax by severing the employer-employee relationship. […]
>
> A second area of avoidance that is dealt with by this bill is the use of employment agents. Such agents are being used increasingly by employers, particularly in the recruitment of professional people and also for temporary staff. In some cases it has been claimed, by virtue of the arrangements entered into, that the person whose services are provided is employed by neither the contract agent nor the client. The arrangements entered into have sometimes also involved the use of trusts, partnerships or companies. The legislation will confirm that payments by an employment agent made in respect of the provision of services to a client of the agent are liable for payroll tax.

13. Thus, the intended scope of the amendment was relevantly where the interposition of an employment agent between the client and the worker resulted in there being no employment relationship at all ("severing the employer-employee relationship") and hence what was in substance wages escaping payroll tax. It was not directed to the situation described above where a service provider is employed by a subcontractor and then the subcontractor provides the service provider's labour to the putative employment agent.

14. To implement that intended scope, the *Pay-roll Tax Act 1971* (NSW) was amended to include in the definition of "wages" amounts that were paid as remuneration by an "employment agent", and a definition of "employment agent" was inserted as a new s 3(4) in the following terms (underlining added):

> For the purposes of paragraph (f) of the definition of "wages" in subsection (1), a person (in this subsection referred to as the "agent") is an employment agent if the person procures by an arrangement the services of a person (in this subsection referred to as the "worker") for another person (in this subsection referred to as the "client"), under which arrangement—
>
> (a) the worker does not become the employee of either the agent or the client but does carry out duties of a similar nature to those of an employee; and
>
> (b) remuneration is paid directly or indirectly by the agent to the worker or to some other person in respect of the services provided by the worker.

15. That definition excluded arrangements where the worker was an employee of the putative employment agent or the client, and it also required that the worker carried out duties of a similar nature to those of an employee.

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[1] Second Reading Speech to the *Pay-roll Tax (Amendment) Bill 1985* (NSW), Hansard, Legislative Assembly, 13 November 1985 at 9558-9559.

16. The next legislative development in the history of the employment agency provisions occurred in 1987, when the amendments referred to above were reversed, resulting in there being no express provision for employment agents.[2] In the Second Reading Speech to the Bill that reversed those amendments, the Minister stated (underlining added):[3]

> The bill makes an important change in the liability to payroll tax of employment agents. In response to a growing practice among employers of reducing their payroll tax liabilities by contracting their work force from employment agents, amendments were introduced in 1986 to make agents liable for payroll tax on remuneration paid by them to workers who performed services for their clients. However, the provisions have severely disadvantaged some employment agents who provide a genuine service, particularly those who specialize in the supply of home nursing services. Most employment agents operate with only a small staff and a payroll that would fall within the exemption level but, with the addition of the payments to their contract staff, they are required to pay tax on the combined payroll. To alleviate those difficulties, the bill will switch the liability of the employment agents to the client using the worker's services.

17. The intended effect of that reversal was to "switch" the liability from the employment agent to the client.

18. However, Parliament's attempt to do so simply by reversing the earlier amendment seems to have reflected a misunderstanding of the then existing provisions because, as has been demonstrated above, the then existing provisions only applied when the worker was not an employee. Reversing the earlier amendment would not then cause the client to be liable to payroll tax in respect of amounts paid to such a worker because it was a necessary element in paragraph (a) of the earlier definition of "employment agent" that the worker was *not* otherwise an employee. Simply reversing the earlier amendment would allow amounts paid to a worker who was not an employee to escape payroll tax.

19. On 23 June 1998, the Supreme Court of Victoria gave judgment in *Drake Personnel Ltd v Commissioner of State Revenue (Vic)* (1998) 40 ATR 304. That case concerned a taxpayer that functioned as an employment agent within the ordinary meaning of that term by supplying to its clients so-called "temporaries" including office staff, nurses and medical secretaries, professional people such as accountants, and labourers and tradespersons. The Supreme Court of Victoria held that those "temporaries" were *not* common law employees.

20. In response to that decision, and apparently recognising the effect of its earlier misunderstanding such that amounts paid to a worker who was not an employee of

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[2] *Pay-roll Tax (Amendment) Act 1987* (NSW) Sch 1 item (1).

[3] Second Reading Speech to the *Pay-roll Tax (Amendment) Bill 1987* (NSW), Hansard, Legislative Council, 24 November 1987 at 17057.

anyone would escape payroll tax, Parliament inserted s 3C into the *Pay-roll Tax Act 1971* (NSW). Subsection (1) was in the following terms:

> For the purposes of this Act, an employment agency contract is a contract under which a person (in this section referred to as an employment agent) by arrangement procures the services of another (in this section referred to as a contract worker) for a client of the employment agent (by a means other than a contract of employment between the contract worker and the client) and as a result receives directly or indirectly payment in respect of the services provided by the contract worker to the client, whether by way of a lump sum or ongoing fee, during or in respect of the period when the services are provided.

21. That definition is materially identical to that now found in s 37 of the PTA, and abandoned the requirements of paragraph (a) of the former definition.

22. Subsequently, in 2000, the earlier decision of the Supreme Court of Victoria was overturned by the Victorian Court of Appeal in *Drake Personnel Ltd v Commissioner of State Revenue (Vic)* (2000) 2 VR 635, with the Court of Appeal concluding that the "temporaries" *were* common law employees of the taxpayer. Thus, on the particular facts that arose in that case, the concern that the "temporaries" were not employees of anybody, and hence payments to them were not taxable, was illusory.

23. Nonetheless, in what seems to have been a hastily-drafted response to the Supreme Court of Victoria's decision (the amending Bill being before Parliament less than 4 months after the decision was handed down), the new employment agency provisions were enacted in overly broad terms that failed to restrict their scope to the problematic type of arrangements to which they were directed, being arrangements whereby a worker was not an employee of anyone but carried out duties of a similar nature to those of an employee.

24. In that respect, Parliament's intention as to the application of the new employment agency provisions substantially miscarried. In the Second Reading Speech to the Bill that inserted that s 3C, the Minister described the purpose of the amendment as being:[4]

> To secure the traditional tax base and make taxpayers [sic] obligations and point of liability absolutely clear […]

25. It was no part of Parliament's expressed intention to enact provisions that dramatically expanded the scope of the payroll tax base.

26. For that reason, our first recommendation to this Inquiry is that the scope of the employment agency provisions should be narrowed such that they only apply where the service provider is not an employee of another person. The intended scope of the provisions was that they applied where the interposition of the employment agent

[4] Second Reading Speech to the *State Revenue Legislation (Miscellaneous Amendments) Bill 1998* (NSW), Hansard, Legislative Assembly, 14 October 1998 at 8287.

"sever[ed] the employer-employee relationship" (see above at [12]). That intended scope should be given effect, rather than the broader scope that currently applies.

27. In making that recommendation, we are conscious that it might be suggested that the current scope of the employment agency provisions prevents taxpayers from artificially splitting their workforce among several separate entities each of which is below the threshold and so pays no payroll tax. That is, it might be suggested that a taxpayer X could cause unrelated but co-operative labour hire companies Y and Z between them each to hire half of X's workforce and supply the labour of that workforce to X, with each of Y and Z being below the threshold and so paying no payroll tax. The proposition that the employment agency provisions are necessary or appropriate to address that form of tax avoidance is illusory for two reasons.

28. *First*, such an attempt by a taxpayer would be unsuccessful because each of the separate entities (Y and Z in the example) would be grouped with the taxpayer (X in the example) under s 71(2) of the PTA and so those entities would have no threshold for payroll tax purposes under Sch 1 item 9(3) of the PTA.

29. *Secondly*, when the employment agency provisions apply, they result in the employment agent (Y and Z in the example) being deemed to be the employer, not the client (X in the example) (PTA s 38). As a result, the employment agency provisions themselves do not prevent workforce splitting, because they result in the wrong person being liable to payroll tax in respect of the wages (Y and Z, rather than X, in the example).

30. For those reasons, we recommend that the following amendment be made to the PTA.

> **Recommendation 1**
>
> Replace s 37(2) of the PTA with the following:
>
> > However, a contract is not an employment agency contract for the purposes of this Act if the service provider performs the services referred to in subsection (1) as an employee of any person (apart from the operation of this Division).

B.2 Mechanism for avoiding double taxation is unfair and uncommercial

31. As explained above, at present, the employment agency provisions can apply to deem the employment agent to be an employer of a service provider and be liable to payroll tax on the wages paid to the service provider even if the service provider is the employee of another person and even if that other person has paid payroll tax on those wages.

32. To avoid double taxation in respect of that amount of wages, s 41 of the PTA provides:

> Subject to section 42, if an employment agent under an employment agency contract—

(a) by arrangement procures the services of a service provider for a client of the employment agent, and

(b) pays payroll tax in respect of an amount, benefit or payment that is, under section 40, taken to be wages paid or payable by the employment agent in respect of the provision of those services in connection with that contract,

no other person (including any other person engaged to procure the services of the service provider for the employment agent's client as part of the arrangement) is liable to pay payroll tax in respect of wages paid or payable for the procurement or performance of those services by the service provider for the client.

33. Thus, double taxation is avoided by relieving other persons from a liability to payroll tax in respect of an amount of wages once the employment agent pays its liability to payroll tax in respect of that amount of wages.

34. However, this mechanism produces an unfair and uncommercial result in the typical situation in which the employment agency provisions are sought to be applied. That typical arrangement is set out in the flowchart above at [8], where an employment agent supplies services to a client but, to do so, the employment agent obtains the labour of the services providers through a subcontractor.

35. Typically, the subcontractor will employ the service providers and pay payroll tax in respect of their wages and, as a matter of commercial reality, will pass on the economic impost of the payroll tax to the employment agent in the form of higher fees. Then, perhaps years later, Revenue NSW will conduct an audit of the employment agent's tax affairs and conclude that that person is an employment agent and so is liable to payroll tax on the amounts paid to the service providers. The employment agent will then have to pay payroll tax on those amounts. Once it does so, it is then the *subcontractor* that is relieved from its payroll tax liability under s 41 and so it is the *subcontractor* that will be refunded what is now, by the operation of s 41, overpaid payroll tax.

36. Such a result is palpably unfair and uncommercial. Even where the correct amount of payroll tax has been collected (by the subcontractor paying it), the employment agent is required to pay that amount of payroll tax and then the subcontractor gets a refund, effectively giving the subcontractor a windfall gain at the employment agent's expense, and even though there had been no loss to the revenue. In addition, where the subcontractor has been refunded the amount of payroll tax, it would be extremely difficult for the employment agent to recoup that from the subcontractor.

37. The operation of s 41 is even more unfair where there is a "chain" of employment agent relationships, such as where subcontractor X supplies labour to subcontractor Y, who on-supplies that labour to company Z who then uses it to provide a service to the ultimate client. Each of X, Y and Z is potentially an employment agent. The Supreme Court of NSW has confirmed that, even though Revenue NSW issued a ruling that it would normally seek to apply the employment agency provisions only to the "closest to end

user" (being Z in the example), that ruling is not binding and Revenue NSW can apply the employment agency provisions to *any* of X, Y or Z, with the one that Revenue NSW happens to pick being the one that suffers the tax impost.[5]

38. The resulting application of s 41 is arbitrary and highly uncommercial, particularly in circumstances where the correct amount of payroll tax has already been collected.

39. Accordingly, if this Inquiry is not inclined to adopt our Recommendation 1, as an alternative we recommend that the mechanism to avoid double taxation be amended such that an employment agent is only made liable to pay payroll tax in respect of an amount of wages to the extent that no other person is liable to pay payroll tax in respect of those wages apart from the employment agency provisions. Such an amendment would recognise that a common law employer should have the primary liability to pay payroll tax in respect of its common law employees' wages and that the employment agency provisions should only function to "top up" the payroll tax base.

Recommendation 2 (in the alternative to Recommendation 1)

Insert the following into s 40 of the PTA:

> (1A) However, reduce (but not below nil) the amount that is taken under subsection (1) to be wages paid or payable by the employment agent by the amount of wages paid or payable by any person (apart from the operation of this Division) for the procurement or performance of those services by the service provider for the client.

Replace s 41 of the PTA with the following:

> If a person is an employment agent in respect of a service provider and that person's client is also an employment agent in respect of that same service provider then the first person is not liable to pay payroll tax in respect of wages paid or payable for the procurement or performance of those services by the service provider.

C. Scope of the substantive definition – "for" a client

C.1 Express terms of the current definition

40. The substantive definition in the presently enacted employment agency provisions is located in s 37(1) of the PTA, which provides:

> For the purposes of this Act, an ***employment agency contract*** is a contract, whether formal or informal and whether express or implied, under which a person (an

[5] *Southern Cross Group Services Pty Ltd v Chief Commissioner of State Revenue* (2019) 110 ATR 16 at [50]-[59].

employment agent) procures the services of another person (a ***service provider***) for a client of the employment agent.

41. Whereas the original definition in the 1985 enactment (see above at [14]) expressly referred to a worker who was not an employee but who carried out duties of a similar nature to those of an employee and so gave some explicit content to the manner in which the worker performed the work, the current definition in s 37(1) of the PTA on its face does nothing of the sort.

42. It might be thought that, by defining the central concept used in the Division as an "employment agency contract" and defining the person who is deemed to be an employer (and hence the taxpayer) as an "employment agent", this might give some indication of the expected operation of the provisions that would assist taxpayers and the Court in applying the provisions. Thus, it might be thought that, by using those labels, the provisions are directed towards employment agents as that term is ordinarily understood.

43. However, those labels have been held to provide no such assistance, with the Supreme Court of NSW finding that those labels did not affect the scope of the defined term.[6] Indeed, the orthodox position in the law of statutory interpretation is that the label chosen by Parliament to be defined (i.e. the "X" in "X means Y") cannot be used to understand the meaning of the defined term – that label is just a label, and nothing more.[7]

C.2 The "in and for" test

44. Nonetheless, the Supreme Court of NSW has recognised that the literal effect of the definition in s 37(1) would produce absurd results.[8] For that reason, the Court construed the phrase "for a client" in s 37(1) as meaning "in and for the business of a client". The Court stated (underlining added):[9]

> […] I think that the definition of an employment agency contract as being a contract under which a person (the employment agent) "… procures the services of another … for a client of the employment agent" can be read as meaning a contract under which a person procures the services of another person in and for the conduct of the business of the employment agent's client. That was the intended scope of the provisions. […]
>
> Whether the worker is to be characterised as an employee or a contractor, the employment agency contract provisions were intended to apply to cases where the

[6] *UNSW Global Pty Ltd v Chief Commissioner of State Revenue* (2016) 104 ATR 577 at [50]-[56].

[7] *Owners of Ship Shin Kobe Maru v Empire Shipping Co Inc* (1994) 181 CLR 404 at 419; *Australian Securities and Investments Commission v King* (2020) 270 CLR 1 at [18]; *Minister for Immigration and Border Protection v WZAPN* (2015) 254 CLR 610 at [48]; *LibertyWorks Inc v Commonwealth* (2021) 274 CLR 1 at [276]; *Kelly v The Queen* (2004) 218 CLR 216 at [103].

[8] *UNSW Global Pty Ltd v Chief Commissioner of State Revenue* (2016) 104 ATR 577 at [46]-[50].

[9] *UNSW Global Pty Ltd v Chief Commissioner of State Revenue* (2016) 104 ATR 577 at [62]-[64].

> employment agent provided individuals who would comprise, or who would be added to, the workforce of the client for the conduct of the client's business. The mischief apprehended by the legislature following the first instance decision in *Drake Personnel Ltd v Commissioner of State Revenue (Vic)* (2000) 2 VR 635; 44 ATR 413; 105 IR 122; 2000 ATC 4500 was that the supply of temporary personnel by a labour hire company resulted in the avoidance of payroll tax because it muddied the waters as to whether the individuals concerned might be classified as independent contractors, although they would be serving the same function for the client as its employees.
>
> One of the hallmarks of an independent contractor is that he or she carries on his or her own business. But sometimes that is done, or is said to be done, by the individual, in substance, working for the client in the same way as would an employee of the client. Where the services of the individual are provided through the intermediary, that is, the employment agent, to help the client conduct its business in the same way, or much the same way, as it would do through an employee, then the arrangement is within the intended scope of the section.

45. That construction was subsequently adopted and applied on several occasions in later decisions of the Supreme Court of NSW, where the Courts sought to determine whether the service provider was sufficiently integrated into the client's business to be seen as an addition to the client's workforce and to work in much the same way as the client's employees, with that test being directed to whether "the service provider is in the position of an employee in relation to the client".[10]

46. The focus of that test as so articulated was *not* on whether the services performed by the service provider were integral to the client's business, in the sense that the business could not operate without those services, but whether the workers were incorporated, or added, into the business and workforce of the client.[11]

47. Thus, the application of that test was concerned with the *manner* in which the service provider provided the services, and whether that manner of provision of services was indicative of the service provider being integrated into the client's workforce and working in much the same manner as the client's employees.[12]

48. The practical application of that test in any given case was fact-sensitive and involved a consideration of indicia recognised in the authorities. Those indicia included the wearing

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[10] *Southern Cross Community Healthcare Pty Ltd v Chief Commissioner of State Revenue* (2021) 113 ATR 601 at [240]; *Southern Cross Group Services Pty Ltd v Chief Commissioner of State Revenue* (2019) 110 ATR 16 at [60]; *HRC Hotel Services Pty Ltd v Chief Commissioner of State Revenue* (2018) 108 ATR 84 at [153]; *E Group Security Pty Ltd v Chief Commissioner of State Revenue* [2021] NSWSC 1190 at [318].

[11] *E Group Security Pty Ltd v Chief Commissioner of State Revenue* [2021] NSWSC 1190 at [196], [318], [323].

[12] *E Group Security Pty Ltd v Chief Commissioner of State Revenue* [2021] NSWSC 1190 at [196]; *Bayton Cleaning Co Pty Ltd v Chief Commissioner of State Revenue* (2019) 109 ATR 879 at [104]-[105], [266]; *Securecorp (NSW) Pty Ltd v Chief Commissioner of State Revenue* [2019] NSWSC 744 at [97].

of distinguishing uniforms, the location at which services are provided, interactions with the client's employed staff and customers and the use of staff facilities, among others.[13]

49. That construction was subsequently endorsed by the NSW Court of Appeal in 2022.[14]

C.3 The new test in *Integrated Trolley Management*

50. On 13 December 2023, the NSW Court of Appeal gave judgment in *Chief Commissioner of State Revenue v* ***Integrated Trolley Management*** *Pty Ltd* [2023] NSWCA 302, which in several ways significantly departed from the existing authorities referred to above as to the understanding and application of the substantive definition in s 37(1) of the PTA.

51. *First*, whereas previous Court decisions had recognised that the employment agency provisions were directed to the "substance" of the arrangement and were concerned with the manner in which service providers in fact carried out their work in practice,[15] the Court in *Integrated Trolley Management* held that the actual operation of the arrangement will generally provide little guidance and that the focus for the application of the provisions was on the express terms of the contract between the employment agent and the client.[16]

52. *Secondly*, the Court in *Integrated Trolley Management* reformulated the test for the application of s 37(1) of the PTA. The Court did so in two different parts of its judgment, but it is immensely difficult to reconcile those two different parts. As to the first part, the Court said (underlining added):[17]

> That language requires the identification of (i) the work to be done by persons who provide the services to a client and (ii) the nature and ordinary conduct of the client's business. It is the relationship between the two which <u>determines</u> the application of s 37(1) in a particular case.

53. That would appear to indicate that it was the relationship between those two matters – the work and the nature and ordinary conduct of the client's business – that is determinative of the application of s 37(1).

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[13] *E Group Security Pty Ltd v Chief Commissioner of State Revenue* [2021] NSWSC 1190 at [318]; *Southern Cross Community Healthcare Pty Ltd v Chief Commissioner of State Revenue* (2021) 113 ATR 601 at [242], [248].

[14] *Chief Commissioner of State Revenue v E Group Security Pty Ltd* (2022) 109 NSWLR 123 at [45]-[47].

[15] *UNSW Global Pty Ltd v Chief Commissioner of State Revenue* (2016) 104 ATR 577 at [64]; *E Group Security Pty Ltd v Chief Commissioner of State Revenue* [2021] NSWSC 1190 at [318]; *Southern Cross Community Healthcare Pty Ltd v Chief Commissioner of State Revenue* (2021) 113 ATR 601 at [242], [248].

[16] *Chief Commissioner of State Revenue v Integrated Trolley Management Pty Ltd* [2023] NSWCA 302 at [111].

[17] *Chief Commissioner of State Revenue v Integrated Trolley Management Pty Ltd* [2023] NSWCA 302 at [49].

54. As to the second part, the Court said that s 37(1) would apply if the service provider's work in relation to the client's business had:[18]

> a degree of regularity and continuity, and where the nature of the work was to a significant degree under the control and direction of the client

55. If one accepts at face value what the Court said in the first part of its judgment then it is difficult to see what role control and direction by the client – referred to in the second part – plays in the application of s 37(1) as, according to that first part of the judgment, the analysis required by s 37(1) is purely one of determining whether the function performed by the service provider is part of the ordinary conduct of the client's business. One might think that if a service provider performs a function for the client that is regular and continuous – something that the client needs on a regular and continuous basis for its business – then, taking the first part of the Court's judgment at face value, the employment agency provisions would apply regardless of the degree of control and direction exercised by the client.

56. However, even if it is correct that the employment agency provisions only apply "where the nature of the work was to a significant degree under the control and direction of the client", there is still a substantial degree of uncertainty as to what this means.

57. If one accepts that the intended scope of the employment agency provisions is where "the service provider is in the position of an employee in relation to the client",[19] then the employment agency provisions should only apply when the client is able, as a matter of substance, to treat those service providers as being its employees so that the client is able to give, and does as a matter of practical reality give, directions *directly* to the service providers as to the manner in which they perform their work and the service providers would be expected to comply with all such directions, provided that they are reasonable and within the service provider's competence. That is, the service providers function practically as though they are part of the client's employed workforce.

58. However, it is far from clear that the above is required for the employment agency provisions to apply, based on the Court's judgment in *Integrated Trolley Management*.

59. From our interactions with Revenue NSW, we understand that Revenue NSW takes the view that, as a result of the Court's judgment in *Integrated Trolley Management*, the employment agency provisions will apply if the client is able *indirectly* to control the nature of the work being done by the service providers by being able to specify to the putative employment agent (rather than to the service provider) what tasks are to be completed and the standard to which they are to be completed.

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[18] *Chief Commissioner of State Revenue v Integrated Trolley Management Pty Ltd* [2023] NSWCA 302 at [86].

[19] *Southern Cross Community Healthcare Pty Ltd v Chief Commissioner of State Revenue* (2021) 113 ATR 601 at [240].

60. However, setting such a low bar would result in almost every commercial contract being subject to the employment agency provisions. Almost every commercial contract will specify, or allow the client to specify, what it wants done and the standard to which it should be done, whether through key performance indicators or some other measure. It is inconceivable that any prudent commercial party would contract to acquire services but disclaim any control over the nature and quality of the services provided.

61. Merely because a client chooses to specify to the putative employment agent what it wants done and the standard to which it wants it done does not mean that the individuals who the putative employment agent procures to do the work behave as though they are employees of the client and so within the intended scope of the employment agency provisions.

C.4 A case study: the security industry

62. One of the subsidiaries of Certis Security Australia has operated in the security industry since 1923 and Certis Security Australia is highly familiar with the types of contracts under which security services are provided to clients. Unsurprisingly, those contracts inevitably specify what type of security services are to be provided (e.g. crowd control, patrolling, alarm and CCTV monitoring, etc.), where they are to be provided, when they are to be provided and the standard to which they are to be provided. It would be commercially nonsensical for a client not to want to specify such matters.

63. Despite that, security guards do not behave as though they are employees of the client. They are required by legislation to remain under the control of a licensed security firm (such as Certis Security Australia) at all times. They cannot be subject to the control of an unlicensed client who is unfamiliar with appropriate security procedures. That is so in order to promote the safety of the general public and the security guard, as the client is not appropriately qualified to be giving directions to a security guard.

64. Part 2 Division 2 of the *Security Industry Act 1997* (NSW) (**SIA**) provides for three classes of security licences, each of which is divided into subclasses.

65. Section 11 provides for class 1 licences which, depending on the subclass, allow the licensee to carry on certain security activities, such as patrolling, bodyguarding or acting as a crowd controller.

66. Section 12 provides for class 2 licences which, depending on the subclass, allow the licensee to carry on certain other types of security activities, such selling security methods or principles, acting as a consultant in relation to security risks and providing advice in relation to security equipment.

67. Section 10 provides for master licences, which allow the holder of the licence to provide her or his services to carry on security activities (subclass MA) or to provide other persons to carry on security activities, each of whom must hold a class 1 or class 2 licence (subclasses MB through ME). The subclass determines the number of persons

who the licensee may provide. For example, subclass MB allows the provision of up to three persons, whereas subclass ME allows the provision of 50 or more persons.

68. Section 7 provides for offences for unlicensed persons engaging in the conduct that would be permitted by the licences. That section relevantly provides:

> (1) A person must not provide persons to carry on security activities unless—
>
> (a) the person is the holder of a master licence, and
>
> (b) the person provides no more persons on any one day than the number of persons authorised by the master licence.
>
> Maximum penalty—
>
> (a) in the case of a corporation—1,000 penalty units, or
>
> (b) in the case of an individual—500 penalty units or imprisonment for 2 years, or both.
>
> (2) A person must not carry on a security activity (other than providing persons to carry on security activities) unless the person is the holder of a class 1 licence or class 2 licence that authorises the person to carry on the security activity.
>
> Maximum penalty—500 penalty units or imprisonment for 2 years, or both.

69. The expression to carry on a "security activity" is defined in s 4(1), and relevantly sets out a variety of activities, such as patrolling, protecting or guarding any property, when done in the course of conducting a business.

70. Section 10(3) provides:

> A master licence does not authorise the licensee to enter into any arrangement, by contract, franchise or otherwise, with another person for the purpose of providing persons to carry on security activities unless the other person is the holder of a master licence or is a person holding a visitor permit authorising its holder to carry on security activities of a kind authorised by a master licence.

71. Section 38(1) provides:

> A licensee must not delegate the carrying on of a security activity to a person who is not the holder of a licence authorising the person to carry on the same security activity.
>
> Maximum penalty: 40 penalty units.

72. Thus, to carry out security activities, one must hold the relevant type of licence. Further, the SIA prohibited a licensee from delegating its functions to another person who is not the holder of the relevant class of licence, and a master licence does not permit the provision to an unlicensed person of persons to carry on security activities. The SIA expressly prohibited not only the hiring of security guarding labour to unlicensed persons, but it also prohibited the delegation of the functions of a master licensee to an unlicensed person.

73. Section 29B(1) provided:

A person who is the holder of a class 1 or class 2 licence must not carry on a security activity authorised by the licence unless the person:

(a) is employed by a master licensee or the holder of a visitor permit authorising the holder to carry out security activities of a kind authorised by a master licence, or

(b) is self-employed and is the holder of a master licence.

Maximum penalty: 500 penalty units or imprisonment for 2 years, or both.

74. Consequently, the SIA also requires that individuals carrying out security activities must be employed by the holder of a master licence (or be self-employed and herself or himself the holder of a master licence).

75. The second reading speech to the *Security Industry Bill 1997* (NSW) identified that the licensing system under that new legislation was "largely based on the IRC recommendations", which was a reference to the 28 February 1997 report of Justice Peterson of the Industrial Relations Commission of NSW in relation to the cash in transit ("CIT") security industry.

76. That report recognised that it was appropriate for the clients of the cash in transit security industry not to have involvement in the control or direction of security personnel in the industry, as those clients had neither the ability nor the expertise appropriately to manage the risks inherent in the industry. At pp. 37-39, under the heading "The Role of Clients" it was observed:

> The raison d'être of the CIT industry is to satisfy the desire of a customer or client to have cash or valuables transported in a secure way by another whose business it is so to do. The virtually universal attitude of clients appears to be that the responsibility for the carriage, including safety of goods and personnel, is that of the CIT operator.
>
> In the case of the banks, the ABA accepts that its members do seek to transfer responsibility in this way. However, overwhelmingly they engage either Brambles or Armaguard, who are regarded by the banks as the experts in this field, with an experience and ability the banks lack. The banks rely on the operators' ready acceptance of the responsibility the banks transfer to them. […]
>
> The ABA says, I think with some force, that it is difficult to understand how the banks can take more responsibility. Apart from changes in building structure, there are no obvious steps the bank could take in current circumstances of delivery which the law ought impose as a duty.
>
> There can be no efficacy in the imposition by statute of a duty to care for contractors, particularly crew members, unless the means by which the duty may be, or is intended to be, satisfied is understood. If, for example, a cash delivery to a bank across a public footpath was thought to oblige the bank to make the delivery crew secure outside the bank while on the footpath, presumably that might be met by the bank's provision of security staff to assist the delivery crew. But the security of the crew is already the

responsibility of their employer; it is the employer who must make adequate the response to the obligation imposed by s.15 of the OH&S Act.

77. The report also recognised deficiencies in the predecessor legislative regime, which imposed training and competency requirements on the individual holders of security licences but imposed no such requirements on the holders of business licences (then referred to as class 2 licences) (at pp. 175-176). This led to a number of recommendations as to the requirements that should apply to the holder of a business licence. Recommendation 10(d) was that business licensees should (at p. 182, underlining added):

> be responsible for all failures by their franchisees, licensees and sub-contractors to satisfy minimum conditions while working for them. This is a two-fold requirement. <u>The principal must exercise supervision and control to ensure that all requirements of the Code of Practices are met</u>, as well as rectify and be responsible for any failures by his franchisees, licensees and sub-contractors to meet the conditions referred to above.

78. The report further recognised problems with the competence of managers and supervisors in the industry (at pp. 17-18):

> 6. Managers and supervisors appear sometimes to be unqualified and inexperienced.
>
> 7. There is very often, particularly in soft-skin operations, a lack of the minimum operating conditions needed to maintain adequate safety standards for employees and the public.
>
> 8. Many employers and employees adopt unsafe operating procedures.
>
> 9. Many employers provide their employees with little or no post-entry training, even in safe operating procedures. […]
>
> 11. Industry clients (such as banks, local councils, shopping centres and retail stores) have had, and have desired to have, little input into improving the safety of CIT guards, and there is no, or inadequate, consideration of the risks to CIT operations when planning, designing or building major shopping centre developments. It follows that there has been no particular care taken with respect to the safety of members of the public in the vicinity of relevant CIT operations.

79. Consequently, the report recognised that clients of providers of security services were not taking responsibility for the control, direction and supervision of security personnel, *nor was it appropriate for them to do so* as they lacked the ability and expertise to do so in a manner that resulted in an effective service delivery and promoted the safety of those security personnel who work in a dangerous industry. The report also recognised that existing standards of supervision were sometimes lacking because of insufficient training and competency requirements for the holders of business licences. The solution proposed by the report was for business licensees to remain responsible for the control, direction and supervision of security personnel as they had, or should have, the ability and expertise to provide it, and further to impose stricter licensing requirements for business licensees to ensure that they did have that ability and expertise.

80. The SIA implemented that policy choice. As observed in the explanatory note to the *Security Industry Bill 1997* (NSW):

> The object of this Bill is to replace the *Security (Protection) Industry Act 1985* with a legislative scheme that reflects the expansion and changing nature of the security industry.
>
> The main feature of the proposed Act is a modified licensing scheme that is designed to provide greater control over persons who work in the security industry or who conduct a business in the security industry. Under the proposed Act, a person will require a licence if the person intends to work in the security industry (eg as a security guard, bouncer or security consultant) or to conduct a business in the security industry. A licence applicant will need to satisfy stringent probity assessments and suitability criteria in order to obtain a licence.

81. For deliberate policy reasons, the SIA prohibited security guards from operating as a labour force available for hire to be added to an unlicensed person's workforce as though they were employees, because an unlicensed person does not have the ability and expertise to control, direct and supervise security guards in a way that will promote the safety of those guards and members of the public.

82. For Revenue NSW to suggest that the employment agency provisions apply to security guards because client specifies the type of work that is to be done by them and the standard to which that work is to be performed means that the operation of the employment agency provisions has fundamentally miscarried as, if that is the correct view, the scope of those provisions has immensely broadened beyond Parliament's expressed intention. Security guards are prohibited from behaving as though they are employees of unlicensed clients. They are not an appropriate target for the employment agency provisions.

C.5 Recommendation

83. The Court's decision in *Integrated Trolley Management* effected a substantial departure from both the existing state of the law and the intended operation of the employment agency provisions, which was to apply to arrangements whereby in substance a service provider was added to the client's workforce and behaved as though he or she was an employee of the client (see above at [44]).

84. Accordingly, we recommend that the substantive definition in s 37(1) of the PTA be amended to reflect that intended operation of the employment agency provisions. We recommend that a definition be adopted that is similar to that originally enacted in 1985 (see above at [14]) but that makes clear that:

(a) the focus of the enquiry is on the practical operation of an arrangement between a client, an employment agent and a service provider; and

(b) it is an assessment of whether the service provider behaves as though he or she is an employee by reference to the extent to which the client directly instructs the service provider as to the manner in which they perform their work.

Recommendation 3

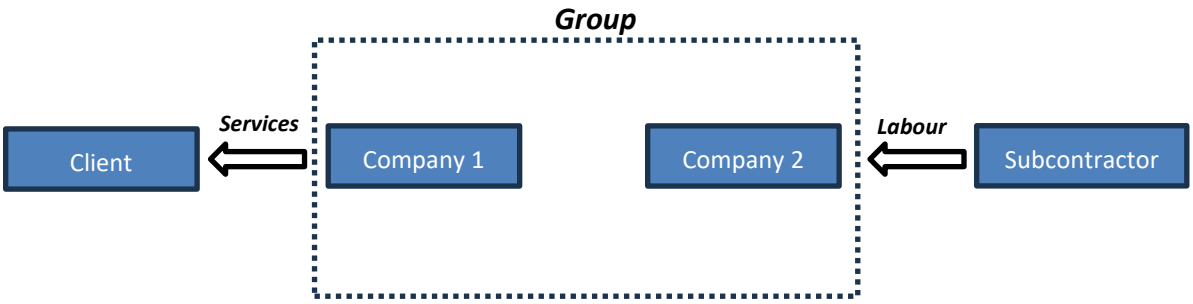
Replace s 37(1) of the PTA with the following:

> For the purposes of this Act, an ***employment agency contract*** is a contract, whether formal or informal and whether express or implied, between a person (an ***employment agent***) and a client of the employment agent under which the employment agent procures the services of an individual (a ***service provider***) and, having regard to the extent to which and manner in which the client in practice provides directions and instructions to the service provider, it would be concluded that the service provider behaves as though he or she is in substance an employee (within the ordinary meaning of that term) of the client in the client's regular workforce.

D. Intragroup arrangements

85. As the employment agency provisions are presently drafted, it is possible for one member of a group of companies to be an employment agent with another member of that same group of companies being that first company's "client" such that an arrangement between those two companies is an employment agency contract.

86. This typically occurs where one company in the group enters into a contract with the ultimate client to provide services to that client but another company in the group enters into a contract with a subcontractor to obtain the labour to fulfil the first company's obligations under the contract with the ultimate client. The following is an illustration of this typical arrangement:



87. Such an arrangement may come about for legitimate commercial reasons. For example, it is a common business structure for all employees to be employed, and for all contractors

to be retained, by a separate entity in a corporate group. Alternatively, it may come about simply by inadvertence – that is, where the group of companies behaves as a single economic unit and, by mistake, different companies in the group execute the two different contracts.

88. The NSW Court of Appeal has held that, in those circumstances, there is an arrangement between the two companies in the group that is an employment agency contract, as the company that contracts with the subcontractor to obtain the labour is procuring the services of the individuals provided by the subcontractor and is doing so "for" the company in the group that contracts with the ultimate client.[20] That was so even though in the first instance decision[21] the Supreme Court had held that the company that contracted with the client did not procure the services of the service providers "for" the client within the meaning of the authorities discussed above at [44]-[49], and there was no challenge to that conclusion on appeal.

89. There is no indication in any of the extrinsic materials to any of the versions of the employment agency provisions that they were intended to apply to such "intragroup" arrangements. Moreover, there is no policy reason at all why the employment agency provisions should apply in such circumstances.

90. Indeed, it is nonsensical that the employment agency provisions would not apply on a given set of facts where a taxpayer is a single company but that they would apply on the same set of facts but with the only difference being that the taxpayer is a member of a group of companies and, by accident or for legitimate commercial reasons unconnected with payroll tax, different companies in the group contract with the client on the one hand and the subcontractor on the other.

91. For that reason, we recommend amending s 37 of the PTA to ensure that such "intragroup" arrangements are not made subject to the employment agency provisions.

Recommendation 4

Insert the following into s 37 of the PTA:

(2A) A contract is also not an employment agency contract for the purposes of this Act if the employment agent and the client are members of the same group.

[20] *Chief Commissioner of State Revenue v E Group Security Pty Ltd (No 2)* [2022] NSWCA 259 at [68]-[70].

[21] *E Group Security Pty Ltd v Chief Commissioner of State Revenue* [2021] NSWSC 1190 at [328]-[329].

E. Transitional relief and certainty into the future

E.1 Transitional relief

92. The last 11 years have seen a substantial degree of change and uncertainty in the scope and application of the employment agency provisions, with the case law in the area developing rapidly and causing business significant challenges in understanding and keeping up with their payroll tax obligations.

93. Most notably, as explained above, the Court's decision in *Integrated Trolley Management* has significantly changed the current state of the law as to how the employment agency provisions have been applied. For example, whereas previously the application of those provisions required a fact-sensitive consideration of various indicia, that has now been held to be irrelevant.

94. Whereas previously it had been held by the Supreme Court of NSW that security guards were *not* procured "in and for" the business of clients,[22] the Court in *Integrated Trolley Management* suggested that security guards *would* normally be procured "in and for" the business of clients,[23] even though that case did not concern the security industry and there were no submissions by either party to the Court about the security industry generally or the legislative framework for the security industry (discussed above at [62]-[82]) in particular.

95. It is deeply concerning and disruptive to business for what amounts as a matter of practicality to a change in the law to occur with no notice or consultation.

96. Nonetheless, because the Court's decision in *Integrated Trolley Management* is taken to be declarative of the law as it has always been, businesses are confronted with entirely unexpected payroll tax liabilities as a result of an interpretation of the PTA that does not accord with the originally intended scope of the employment agency provisions.

97. For that reason, we recommend that transitional relief be provided to taxpayers such that, for historical years, the employment agency provisions only apply if both they applied under the old law and also they would have applied under the new law as amended as a result of this Inquiry had those new provisions been in force in the historical years.

[22] *E Group Security Pty Ltd v Chief Commissioner of State Revenue* [2021] NSWSC 1190 at [328]-[329].

[23] *Chief Commissioner of State Revenue v Integrated Trolley Management Pty Ltd* [2023] NSWCA 302 at [54].

Recommendation 5

Insert the following as a new clause in Sch 3 of the PTA:

(1) The amendments made to this Act by the amending Act have effect for the financial year ending 30 June [20XX] and later financial years.

(2) For the transitional years, a contract is taken to have been an ***employment agency contract*** if and only if it would have been both an employment agency contract as defined in section 37 as enacted during such a year and an employment agency contract as defined in section 37 had the amendments made by the amending Act been in force during such a year.

(3) In this clause:

(a) ***amending Act*** means [name of amending Act]; and

(b) ***transitional years*** means the financial years ending 30 June 2013 through 30 June [20XX] inclusive.

E.2 Certainty into the future – a binding ruling system

98. Any amendments made to the PTA as a result of this Inquiry will not prevent all future uncertainty as to the application of the PTA to particular facts and will not avoid all future disputes between taxpayers and Revenue NSW. Payroll tax is fundamentally a tax on payroll.[24] Not only is it debatable in particular factual circumstances whether an individual is a common law employee, it is inevitable that any provisions that seek to deem a relationship falling short of employment to be one of employment will be fact-sensitive and there will be room for argument as to how such provisions apply, particularly as significant changes in how commerce is carried out – such as the gig economy – bring about for good commercial reasons new ways of doing business and deploying human labour.

99. Businesses require certainty in their expenses, including taxes, in order to be confident in the decisions that they make as to how they invest their capital. This is especially so in the case of payroll tax, because its imposition fundamentally affects "business as usual". That is, if payroll tax applies to a particular means of deploying human labour, then a business that adopts that means will be subject to that impost on an ongoing basis.

100. That makes certainty in the scope of the PTA vital because the imposition of payroll tax could make the difference between whether a particular business model is viable or unviable.

[24] *Chief Commissioner of State Revenue v E Group Security Pty Ltd* (2022) 109 NSWLR 123 at [45].

101. For many businesses, the service that is provided to clients most significantly involves the deployment of human labour to do things, with the "value add" provided by the business beyond the physical exertion of those individual workers being the organisation of how those individual workers are deployed and the use of systems, software and other intellectual property to manage the deployment of those individual workers in a way that best meets the client's needs. That "value add" provided by such a business is important to the client, but is often one that, due to volume and standardisation, is low margin for the business. The result is that a significant portion of what the client pays for a service ultimately remunerates the individual workers, with only a small profit margin being retained by the business after payment of those workers and payment of other overheads and income tax. Many businesses are profitable by operating on low margins but high volume, but the profitability of such a business critically depends on each such transaction being profitable.

102. Consequently, if after operating such a business for several years the business discovers that it has to pay payroll tax on those payments to the individual workers, the amount of payroll tax can readily far exceed the profit margin, resulting it what was believed to be a viable business model being discovered to have been unprofitable for many years.

103. To give two real life examples of this, the taxpayer in one of the first cases on the employment agency provisions in recent years, Freelance Global Ltd, appointed administrators the same day that the Supreme Court of NSW gave judgment against it,[25] and the taxpayer in *Integrated Trolley Management* appointed administrators approximately two months after the NSW Court of Appeal allowed Revenue NSW's appeal against it.[26]

104. It is not hyperbole to say that the unexpected imposition of payroll tax can destroy a business.

105. To increase business confidence so as to promote investment, businesses need to be able to obtain certainty as to how the tax system will apply to them *before* they carry out business in a particular way, rather than only after they have carried out business in that way and only to find out many years later that Revenue NSW takes the view that they have been liable to tax the whole time.

106. At present, taxpayers can approach Revenue NSW to seek a ruling, but such rulings are not binding on Revenue NSW and will only protect a taxpayer against the imposition of penalties and interest if Revenue NSW later chooses to depart from a ruling it has given. Moreover, because the practice of giving rulings is not provided for formally in any legislation, it is used relatively infrequently.

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[25] *Freelance Global Ltd v Chief Commissioner of State Revenue* [2014] ATC 20-445.

[26] *Chief Commissioner of State Revenue v Integrated Trolley Management Pty Ltd* [2023] NSWCA 302.

107. In contrast, at the Commonwealth level, the tax legislation provides for a binding ruling system. Among other things, this allows taxpayers to approach the Australian Taxation Office to seek a ruling as to how the tax legislation applies to a specified set of facts and then that ruling is binding, and so will prevent the taxpayer from having to pay increased amounts of tax (as well as penalties and interest) if it is subsequently found to be wrong.[27]

108. That Commonwealth regime contains appropriate safeguards for the revenue. For example, a ruling is only binding if the facts that were the subject of the ruling are not materially different from the actual facts that applied to the taxpayer, and the ruling does not apply if Parliament changes the law.[28]

109. Additionally, rulings are normally given in terms that they apply for a particular period only (say, several years) so that, if a taxpayer continues to engage in the facts that are the subject of the ruling and wants certainty after that period has expired, that taxpayer needs to seek a new ruling and if, in the meantime, the understanding of the existing law has changed by reason of Court decisions or because the Australian Taxation Office has taken a different view, then the new ruling may be given in different terms.

110. We recommend that the NSW Parliament enact a binding ruling system similar to that which applies at the Commonwealth level. Such a binding ruling system could apply to payroll tax in particular or to NSW tax laws more generally.

> **Recommendation 6**
>
> Amend either the PTA or the *Taxation Administration Act 1996* (NSW) to enact a binding ruling regime similar to that contained in the *Taxation Administration Act 1953* (Cth) Sch 1 Part 5-5.

F. About Certis Security Australia

111. Certis Security Australia is a leading outsourced services partner in Australia that designs, builds and operates multi-disciplinary smart security and integrated services.

112. Certis Security Australia provides a range of services to clients, including but not limited to, security screening, gatehouse security, mobile patrols, event security and crowd control and integrated technology services.

[27] *Taxation Administration Act 1953* (Cth) Sch 1 s 357-60.

[28] *IOOF Holdings Limited v Commissioner of Taxation* (2014) 224 FCR 535 at [141].

Date: 3 February 2025

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