Submission No 10

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

Organisation: Mastercare Australasia Pty Ltd

Date Received: 6 February 2025

6 February 2025

Portfolio Committee 1 - Premier and Finance
Legislative Council
NSW Parliament

Sent via Online Inquiry Portal

Dear Committee Members,

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

As an impacted member of the NSW economy, we write to respectfully lodge the *enclosed* submission for consideration as to why the contractor and employment agent provisions are crying out for legislative intervention.

It is the employment agent provisions which are presently directly impacting the Mastercare business and which have necessitated the business initiating costly and time intensive action in the Supreme Court of New South Wales (case number: 2023/00154667) such as to seek to reach the correct and intended application of these provisions.

I would greatly appreciate the opportunity to appear before the committee to discuss these submissions in further detail.

If you have any questions or wish to discuss any aspect of the submission, please do not hesitate to contact me on 0418 460 105.

Thank you in advance for your consideration of our submission on this very important issue.

Yours Sincerely,

Colin Walker
Managing Director

SUBMISSION TO THE 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* (NSW)

Introduction

1. We are making a submission to the Committee in respect of its Terms of Reference self-referred by the Committee on 26 November 2024 in the above Inquiry.

2. This submission is structured to first address the Payroll Tax Contractor Rules[1] and then the Employment Agent Rules.[2]

3. Both sets of Rules can be traced to legislation introduced in NSW in 1985. They were explicitly intended to be anti-avoidance rules designed to defeat payroll tax avoidance by artificial arrangements that involved the use of structures or arrangements to get around the taxation of salary or wages paid to employees. These avoidance schemes involved the use of contractors or employment agents. There was expressly no intention to apply these rules to legitimate arrangements, meaning they were not intended to apply to arrangements which were not tax avoidance arrangements.[3]

4. Yet the problem under both sets of Rules is that the law is being applied beyond the historic purpose of defeating tax avoidance arrangements. Contrary to the historic purpose, the law is being applied to legitimate arrangements.

5. This submission attributes the overreach of the legislation to the overly general terms of the legislation itself. It is in this area that legislative reform is required to restore the original purpose of Parliament.

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[1] Division 7 of Part 3 of the *Payroll Tax Act 2007* (NSW). All statutory references are to this Act unless otherwise stated.
[2] Division 8 of Part 3.
[3] The Parliamentary history will be examined later in our submission in respect of each of these sets of Rules.

Summary of Recommended Legislative Amendments

6. In relation to the Contractor Rules, we recommend retargeting and modernising the Rules by one of two alternative approaches:

   (a) *Approach One*: amend the Rules to provide additional exemptions for:

      (i) bare payment agent cases (such as Uber); and

      (ii) shared services business models (such as medical practices and mortgage brokers).

   (b) *Approach Two*: limit the Contractor Rules to traditional principal/sub-contractor arrangements.

7. In relation to the Employment Agent Rules, we recommend retargeting and modernising the Rules by:

   (a) extending the exemption under the Contractor Rules where a subcontractor supplies a valid written statement; and

   (b) in those cases where there is no valid written statement, then the current imposition of payroll tax on the employment agent would continue but, in our view, the Rules should be more particular as to bright-line practical factors as to what is not caught.

8. For example:

   (a) traditional labour hire arrangements would be caught, such as in the building and construction sector or the supply of drivers in the transport sector;

   (b) arrangements in which the service provider provides services in respect of functions that are not part of the client's traditional or normal functions would not be caught; and

   (c) assuming that the situation cannot be decided by either of the tests in paragraph (a) or (b), a multi-factorial approach would be required to answer the question of whether the workers are integrated with the workforce of the client and work as if they were employees of the client.

9. The Employment Agent Rules should also be amended to define:

   (a) the contract in subsection 37(1) as the contract between the service provider and the client;

   (b) the client in subsection 37(1); and

   (c) a service in subsection 40(1) as distinct from the provision of equipment or goods, such as consumables, so that payroll tax only applies to wages paid to a worker for a service.

10. The legislative amendments we recommend to both the Contractor and Employment Agent Rules should have retrospective effect, following the approach legislated to provide relief from the Contractor Rules for medical practices in 2024 (discussed below).

11. That is, where taxpayers have not paid payroll tax, they should be retrospectively relieved of paying payroll tax provided that they would not be liable to payroll tax under the amended rules. Refunds would not be available if payroll tax has been paid.

The Contractor Rules

Legislative History and Purpose

12. The introduction in NSW of both the Contractor and Employment Agent Rules occurred in 1985 as amendments to the *Pay-Roll Tax Act 1971* (NSW).

13. Giving effect to an announcement of the Wran Government in the State Budget, the Second Reading Speech for the *Pay-Roll Tax (Amendment) Bill* stated:[4]

> *I turn now to the subject of tax avoidance. It is a most unfortunate fact that in every walk of life there is a small minority of people who, by their unscrupulous behaviour, spoil things for everyone else. Thus it is that there has been a significant increase over the years in the use of artificial schemes and contrived arrangements by taxpayers attempting to avoid their liabilities to taxation. This has occurred in the area of pay-roll tax, just as it has in other more celebrated fields such as income tax.*
>
> ***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**. Such arrangements have included the use of so-called contractors to replace wages staff. Typical of the situations that are known to exist and are the target of the legislation is the employer who, by arrangement with an employee, enters into a contract for service with the employee's family trust, partnership or company for the provision of the employee's services. The employee then performs the services for the employer but his salary is paid to the trust, partnership or company, resulting in the avoidance of pay-roll tax by the employer. Certain contracts will be exempted from liability for pay-roll tax, including contracts in excess of $500,000 where the contractor would need to hire staff and would therefore be liable for pay-roll tax. **Bona fide independent contractors will not be caught by the legislation.***
>
> *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.*
>
> *As a complementary measure, the legislation also includes a general anti avoidance provision which will enable the commissioner for payroll tax to look*

[4] Emphasis added.

behind artificial arrangements in determining whether there is an employer employee relationship.[5]

14. A lively third reading debate of the Bill emphasised the anti-avoidance purpose of the amendments.[6] The concluding remarks of Mr Ernie Page MP (Labor) put the Government's position beyond any doubt when he said:[7]

> ***The whole aim of tightening up on contractors and agents is to pick those who are avoiders. The Minister has made it quite clear that there is no suggestion that anyone who is a legitimate contract worker, or a firm, should face an undue imposition of payroll tax.***[8]

The Case for Retargeting and Modernising the Contractor Rules

15. Difficulties with the Contractor Rules have however emerged in recent years. We draw three examples to the attention of the Committee and submit that in each case the arrangements have legitimate commercial explanations that have been subjected to the Rules contrary to the original legislated purpose. In each example, we outline how the decisions of the Courts highlight issues with the application of the Contractor Rules to particular industries in contemporary business operations.

Example One: Medical Practices

16. The Committee will no doubt be aware of the payroll tax issues affecting medical practices and how they have been addressed.

17. Nevertheless, we submit that the Committee should have regard to the problems facing medical practices as a case study illustrating flaws in the Contractor Rules that need to be amended to overcome them in other situations.

18. The leading case on medical practices is the decision of the NSW Court of Appeal in *Thomas and Naaz Pty Ltd v Chief Commissioner of Taxation* [2023] NSWCA 40. In that case, the taxpayer ran a medical centre where patients seeking medical services would come to the centre and see a general medical practitioner (a **GP**). The medical services were ultimately paid by Medicare bulk billing. The Court dismissed the taxpayer's appeal against the decision of the NSW Civil and Administrative Tribunal (**NCAT**) that payroll tax applied to 70% of the Medicare bulk billing payment paid to the taxpayer that was then paid to the GP (the remaining 30% was kept by the taxpayer). Although the GPs were not in law or fact employees, the Contractor Rules were found to deem them to be employees so that the 70% payments were wages subject to payroll tax. Importantly, the GPs were found to be providing services to the taxpayer as well as the patients (see paragraphs 36, 41 and 46) under contracts with the taxpayer as part of its

[5] NSW, Parliamentary Debates, Legislative Assembly 13 November 1985 pp9558-9559 (Mr Bob Debus, Blue Mountains, Minister for Employment and Minister for Finance).
[6] NSW, Parliamentary Debates, Legislative Assembly 20 November 1985 pp10114-10127.
[7] Emphasis added.
[8] NSW, Parliamentary Debates, Legislative Assembly 20 November 1985 pp10126 (The Hon (Ernie) Ernest Page, Member for Waverley (Labor).

business to attract patients to come to the centre for medical services (see paragraphs 42 and 43).

19. As the Committee would be well aware, the medical profession was up in arms and a moratorium on audits was put in place for a year whilst the Government considered the policy issues. The moratorium took effect by a combination of legislation and administrative action by Revenue NSW.[9]

20. In the 18 June 2024 Budget, the NSW Government announced legislative relief in the form of Division 2A of Part 3 of Schedule 2 to the *Payroll Tax Act 2007* (NSW) (the **Act**). The relief package is explained by Revenue NSW in Practice Note CPN 036 issued by the NSW Commissioner of State Revenue (the **Commissioner**) on 23 August 2024. The practice note summarises the relief in these terms:

> *The Revenue Legislation Amendment Act 2024 provides an exemption for past unpaid payroll tax that relates to "relevant general practitioner wages" and provides an ongoing rebate for relevant general practitioner wages.*
>
> *The rebate and exemption only apply to contractor general practitioner ("GP") services and does not extend to GPs engaged as employees and other staff such as nurses, reception, administration staff, pathology and allied health services*

21. We note that the relief from taxation did not extend to cases where payroll tax has been paid. That is, there would be relief from tax liabilities up to 4 September 2024 and then a rebate after that, but if the tax had been paid there would be no refund.

22. The issue of medical practices and the relief provided demonstrates that the Contractor Rules, in their current form, produced the wrong outcome. The outcome was wrong because the medical practice arrangements do not involve tax avoidance.

23. The root cause of the wrong outcome is legislation which fails to practically distinguish between tax avoidance and legitimate arrangements. It is also likely that the Contractor Rules, now four decades old, are no longer fit for purpose as they have not kept pace with contemporary business models (see further discussion of our second example, concerning Uber, and the third example, mortgage brokers).

Example Two: Uber

24. In *Uber Australia Pty Ltd v Chief Commissioner of State Revenue* (NSW) [2024] NSWSC 1124, the Court found that the ubiquitous ride share arrangements with drivers were not subject to payroll tax under the Contractor Rules. We understand that an appeal has been lodged.

25. The question of whether the Rules apply is highly fact dependent. The Court had regard to the exact terms of the contracts between Uber, the drivers and riders. It

[9] See addition of section 61A to the Act; NSW Revenue Ruling PRA 041 (issued 11 August 2023).

would, therefore, be a mistake to generalise from this one case as to the outcomes in other cases.

26. The decision of the Court boils down to the finding that the contract under which the driver is paid is with the rider and Uber is merely a collection agent that pays the driver after deducting a fee from what is paid by the rider (see paragraphs 179 to 183). In other words, Uber is not deemed to be the employer of the driver.

27. This situation should be contrasted with the case of medical practices. Whilst, in both cases, there is no legal employment relationship, in the medical practice case, the GP provides services to the medical centre owner and receives payment for that. In that case, the centre is more than a mere collection agent for the GP.

28. The Court in Uber made significant observations as to the operation of the legislation. At the outset, the Court said at paragraph 25:[10]

> ***What the changes perhaps reveal are the conceptual complexities of applying Division 7 to a system*** *like Uber's,* ***the likes of which did not remotely exist when the Division was introduced****.* ***It is worthy of observation that in the Second Reading Speech when Division 7 was introduced, it was said to be "to deal with the practice of using contractors who provide services on a similar basis to ordinary employees but who are regarded at law as independent contractors", as a basis to avoid, amongst others, charges and taxes such as payroll tax. There is no suggestion in this case that the Uber system is structured to avoid tax obligations.***

29. Further, in bolstering its conclusion, the Court said at paragraph 171:[11]

> ***The overall intention behind Division 7*** *and its predecessor inserted into the Payroll Tax Act 1971 (NSW) in 1985 as elucidated by the Explanatory Note to the 1985 Bill and referred to by Payne JA at first instance in Downer EDI Engineering Pty Ltd v Chief Commissioner of State Revenue [2019] NSWSC 743* ***is to capture several means of disguising the employer-employee relationship by contractual arrangements which had been increasingly resorted to by persons seeking to defeat the objects of the Act.*** *That is not this case.*

30. These observations underscore our submission that the Contractor Rules now overreach their original anti-avoidance purpose and are no longer fit for purpose.

Example Three: Mortgage Brokers

31. In *Loan Market Group Pty Ltd v Chief Commissioner of State Revenue* (NSW) [2024] NSWSC 3990, the Court upheld the imposition of payroll tax on payments by a mortgage broker to its agents. It is understood that no appeal has been lodged.

32. There is reportedly another case involving another mortgage broker, currently undergoing litigation in NSW, brought by the Finsure Group. It has been reported that

[10] Emphasis added.
[11] Emphasis added.

the CEO of Finsure considers that the Uber case may assist the arguments of the mortgage broking industry.[12]

33. Whilst it would be inappropriate to comment on current litigation, the fact of issues with the Contractor Rules arising in another industry, following the issues faced by medical practices and Uber, adds to the evidence that the legislative rules are not fit for purpose. There is certainly no suggestion that the mortgage broking industry employs contracting structures for tax avoidance.

34. Rather, business structures have developed in recent times that take advantage of digital technology and aggregation of services of multiple operators (be they GPs, brokers or drivers, for example) to market more successfully and to operate with significant economies of scale through shared services. None of these structures, or the commercial reason for them, are illegitimate or motivated by tax avoidance.

35. These structures, however, were likely not in the minds of legislators when the Contractor Rules were enacted in 1985 because they largely did not exist - contemporary business operations (particularly as a result of advancements in technology) look very different in 2025 to what they looked like in 1985.

Reform Proposals

36. In our submission, whilst the original purpose of the Contractor Rules remains a legitimate purpose in respect of traditional contractor and sub-contractor arrangements, the Rules should be clearly retargeted and modernised to only achieve this purpose.

37. It would, however, be a big mistake to consider that each wrong outcome can be resolved on an industry-by-industry basis, such as what was done for medical practices. Besides medical practices, there are other examples of industries that are negatively impacted by the current overreaching scope of the Contractor Rules - of which we refer to merely two in this submission (while payroll tax was not imposed on Uber in the end, it was still required to undergo the costly and time-consuming process of litigation in order to ascertain its tax liability, which whilst that may not present a significant impact to a business like Uber, is considered to be crippling for many small Australian businesses). In our view, the Contractor Rules need to be revised to provide for clear factors that practically differentiate between contracts subject to payroll tax and those that are not.

38. Further, in our view, the solution for medical practices is cumbersome in that it involves a specific rebate, reflecting that it is a “band-aid” solution for one industry rather than a genuine systemic solution to the underlying legislative problem.

39. In our submission, the right approach is to modernise the Rules in a way that brings them into the 21st century (with view to the way businesses now operate versus in 1985 when the Rules were originally drafted) and in a way that applies a single, principled reform equitably across all industries.

[12] https://www.brokerdaily.au/regulation/19473-imposing-payroll-tax-on-brokers-would-be-unjustifiable (17 September 2024).

40. One approach, based on the three examples just considered, are additional exemptions for:

    (a) bare payment agent cases (such as Uber); and

    (b) shared services business models (such as medical practices and mortgage brokers).

41. Another approach would be to limit the Contractor Rules to traditional principal/sub-contractor arrangements.

Retrospective Reform

42. In our view, the approach to relief for medical practices (discussed above) provides a template for how to provide relief more generally.

43. That is, where taxpayers have not paid payroll tax under the Contractor Rules, they should be retrospectively relieved of paying payroll tax provided that they would not be liable to payroll tax under the amended rules. Refunds would not be available if payroll tax has already been paid.

44. There would, however, be no need for a rebate, as in the case of GPs in the medical practice cases, as the amended Contractor Rules would not apply to impose payroll tax on legitimate arrangements prospectively. By contrast, the relief for medical practices did not include a prospective exemption. Rather, the Contractor Rules continued to impose payroll tax and medical practices would be entitled to receive a rebate corresponding to that payroll tax amount.

The Employment Agent Rules

Introduction

45. The Committee's Inquiry is timely as it has been over 25 years since the Employment Agent Rules were introduced in their current form in NSW in 1998, following the introduction of rules in a different form in 1985. The Rules were first implemented in NSW and have been copied in the Australian Capital Territory, South Australia, Tasmania, Victoria and the Northern Territory[13] with aligned provisions in Queensland and Western Australia.[14]

46. In 1998, the Minister observed that "[t]*he provisions have been developed in collaboration with the major agency associations and have the support of small business and the accounting professions."*[15]

[13] *Payroll Tax Act 2011* (ACT) Division 3.8 of Part 3; *Payroll Tax Act 2009* (NT) Division 8 of Part 3; *Payroll Tax Act 2009* (SA) Division 8 of Part 3; *Payroll Tax Act 2008* (Tas) Division 8 of Part 3; *Payroll Tax Act 2007* (Vic) Division 8 of Part 3.
[14] *Payroll Tax Act 1971* (Qld) Division 1B of Part 2; *Payroll Tax Act 2002* (WA) Subdivision 7 of Division 2 A of Part 2.
[15] NSW, Parliamentary Debates, Legislative Assembly 14 October 1998 p8287 (Mr Michael Knight, Campbelltown, Minister for the Olympics).

47. We, however, are aware of various business and industry interests that do not support the Rules in their current form and have come to this view after 25 years' experience of the current Rules overreaching, being practically uncertain and being costly to comply with.

48. We think there is a better way. Our submission is intended to promote reform of the Rules to:

(a) retarget them to achieve their original purpose, as stated in the Second Reading Speech, to be "*anti-avoidance provisions designed to bring to tax wages paid to persons who are, for all intents and purposes, performing duties similar to those of employees*";[16]

(b) ensure that they are modernised in line with current and emerging business models;

(c) achieve practical certainty; and

(d) reduce the costs of compliance for taxpayers and the community.

<u>The Case for Retargeting and Modernising the Employment Agent Rules</u>

49. The Employment Agent Rules should be reformed because:

(a) the Rules overreach and are uncertain in practice;

(b) the judicial interpretation of the Rules highlight that the Rules, as drafted, fail to practically distinguish between employment agents (such as those providing labour hire that are integrated with the workforce of the ultimate client) and businesses that provide services through workers who are not integrated with the workforces of the ultimate client;

(c) as the Rules are highly fact sensitive, no case is of precedential value; and

(d) ascertainment of the correct application of the Rules to particular industries and taxpayers remains highly fact dependent so taxpayers require costly legal advice and may be exposed to costly tax audits and disputes. These uncertainties must also become costs for the community generally because of the need for Revenue NSW to undertake compliance, audit and dispute activity, with a number of cases continuing to go to litigation, which is itself a costly process.

50. The Committee should recommend legislative amendments to address these problems by:

(a) amending the Employment Agent Rules to practically distinguish between what is caught and what is not by reference to explicit legislative criteria; and

[16] Ibid.

(b) introducing an exemption from the Rules where a subcontractor completes a written statement of a type that is already legislatively mandated in the Contractor Rules to relieve a principal contractor of payroll tax liability.[17]

A Deep Dive into the Employment Agent Rules is Necessary

Original purpose of the Rules

51. In the Committee's Inquiry, it is appropriate to identify the policy objectives or purpose of the Rules so that they can be compared against the actual operation of the legislation as drafted and now experienced over the last 25 years. These current Rules replaced earlier rules in the *Payroll Tax Act 1971* (NSW) added in 1985.

52. In the Second Reading speech to the 1998 amendments, the Minister[18] explained that the Government policy sought to achieve two goals:

(a) fix the liability for payroll tax on the employment agent and thereby secure the tax base with anti-avoidance rules "*to bring to tax wages paid to persons who are, for all intents and purposes, performing duties similar to those of employees*"; and

(b) "*make taxpayers obligations and point of liability absolutely clear*".

[17] See Division 7 of Part 3 of the *Payroll Tax Act 2007* (NSW) and Schedule Two clauses 17 and 18.

[18] See n 15. The full statement of the Minister states: *The Pay-roll Tax Act currently provides that wages paid to temporary staff provided through employment agents are taxable in the hands of the end user of the labour services. An administrative arrangement allows the agent to take responsibility for the tax but only if the end user agrees. Traditionally, the majority of temporary staff have been accepted as common law employees of the end user. Some are deemed to be employees under the relevant contract provisions. The relevant contract provisions are anti-avoidance provisions designed to bring to tax wages paid to persons who are, for all intents and purposes, performing duties similar to those of employees. Recent judicial pronouncements in other jurisdictions have confused the issue of liability to the point that employers and employment agents are unsure of their obligations. The uncertainty has prompted refund claims by employment agents which are likely to reach some $200 million in New South Wales alone. Those claims represent windfall gains for employment agents as the payroll tax would already have been passed on to the clients.*

To secure the traditional tax base and make taxpayers obligations and point of liability absolutely clear, the bill introduces specific provisions relating to payments to workers engaged through employment agents. The agent will now be liable for payroll tax, bringing New South Wales into line with Victoria, Western Australia, South Australia and Queensland. The other jurisdictions do not have specific agency provisions. Concessions have been provided where the end user of the services is exempt, such as a public hospital or a charity and where the end user is under the payroll tax threshold. The provisions have been developed in collaboration with the major agency associations and have the support of small business and the accounting professions.)

Drafting of the Rules to give effect to the stated policy

53. The key legislative provision in the Rules is section 37 of the Act, which defines what is an "employment agency contract". It states:

> ***37 Definitions***
>
> *(1) 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 **employment agent**) procures the services of another person (a **service provider**) for a client of the employment agent.*
>
> *(2) However, a contract is not an employment agency contract for the purposes of this Act if it is, or results in the creation of, a contract of employment between the service provider and the client.*
>
> *(3) In this section—*
>
> ***contract** includes agreement, arrangement and undertaking.*

54. Section 38 of the Act fixes the liability to pay payroll tax on the employment agent under an employment agency contract as defined in the above section 37 because the agent is deemed to be the employer.

55. It is critical to observe that the wording of the above definition in subsection 37(1) is at a high level and the Courts have struggled with this wording in numerous cases. Before turning to how the Courts have interpreted subsection 37(1), it may be observed that there is no practical legislative guidance as to what falls in and out of the definition (such as specific factors or criteria).

56. For taxpayers and Revenue NSW, this lack of practical legislative guidance has given rise to uncertainty and unnecessarily high costs of compliance, audits and disputes.

Current Judicial Position

The UNSW Global test or the "in and for test"

57. In ***UNSW Global Pty Ltd v Chief Commissioner of State Revenue*** [2016] NSWSC 1852; 104 ATR 577 (***UNSW Global***) at paragraph 62, White J held 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*.'

58. That test has become known as the "in and for test". Although that test has been approved by the NSW Court of Appeal,[19] it has done little to provide certainty to taxpayers and in some cases, has had unintended consequences.[20]

59. In the decision of Ward CJ in Eq (now President Ward of the New South Wales Court of Appeal) in *E Group Security v Chief Commissioner of State Revenue* [2021] NSWSC 1190 at paragraphs 30 and 196, the *UNSW Global* decision was referred to and it was said:

> *the focus of the enquiry is on the manner in which the service provider provides the services, and whether that manner of provision of services is indicative of the service provider being into the client's workforce and working in much the same manner as the client's employees.*

60. In *Chief Commissioner of State Revenue v Integrated Trolley Management Pty Ltd* [2023] NSWCA 302 (***Integrated Trolley***), at paragraphs 2 and 86, it was held by the NSW Court of Appeal (Ward P, Payne JA, Basten AJA) that the statutory test for the engagement of sections 37 to 39 of the Act required that subcontractors who carry out work for the client "*should do so in much the same way as would an employee*". At paragraph 4, Ward P confirmed that the reference to integration, such as quoted in *E Group*, meant that "*the workers were an addition to the work force of the employment agent's client (i.e., whether they were performing services in and for the conduct of the client's business)*."

61. The *UNSW Global* test has now developed to the point that the NSW Court of Appeal in *E Group No 1 Appeal* (Bell CJ, Gleeson and Leeming JA) have observed at paragraph 52 that:[21]

> ***It is in those circumstances far better for the law to be changed, if indeed it is to be changed, by legislation, and with clearly stated transitional provisions.***

62. In our submission, the Courts have gone as far as possible to make difficult legislation work and the time has come for legislative reform.

Drafting flaws in the Rules exposed by the judicial analysis in UNSW Global

63. It is vital that the Committee appreciate that the *UNSW Global* test was the result of the best efforts of the Court to deal with legislative provisions that, if read literally, clearly overreached because they fail to distinguish between employment arrangements that are caught and those that are not. The Courts have sought to

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[19] *Chief Commissioner of State Revenue v E Group Security Pty Ltd* [2022] NSWCA 115; 109 NSWLR 123 at paragraph 5 (***E Group No 1 Appeal***). There is potential for confusion with the various related E Group cases. There are three NSW Court of Appeal decisions in cases involving the Chief Commissioner of State Revenue and E Group Security Pty Ltd. The second decision is cited later, as is the primary decision of the Supreme Court of NSW.

[20] *Southern Cross Group Services v Chief Commissioner of State Revenue* [2019] NSWSC 666; 110 ATR 16 at paragraph 60; *Bayton Cleaning Company Pty Ltd v Chief Commissioner of State Revenue*; *International Hotel Services Pty Ltd v Chief Commissioner of State Revenue* [2019] NSWSC 657; 109 ATR 879 at paragraph 100 (***Bayton***); *HRC Hotel Services Pty Ltd v Chief Commissioner of State Revenue* [2018] NSWC 820; 108 ATR 84 (***HRC***).

[21] Emphasis added.

achieve justice by taking a purposive interpretation to the legislation but cannot go further as it is clearly inappropriate for the Courts to rewrite the legislation.

64. In *UNSW Global*, White J explained:

(a) the NSW amendments followed Victorian amendments, both designed to be anti-avoidance rules to secure the Revenue but not to broaden the tax base (paragraphs 36 and 40);

(b) the NSW rules would have one critical difference to Victoria, namely to impose liability on the deemed employer, that is the employment agent (paragraph 36);

(c) "*the mischief against which the employment agency contract provisions was directed was the avoidance of payroll tax through the interposition of an agent to give the appearance of a contractor relationship where one did not exist in substance.* ***The mischief to which the provisions were directed was not where the service provider was a genuine independent contractor whose services were provided to a client through an intermediary***" (paragraph 41);[22]

(d) the NSW legislation did not, however, refer to the distinction between employee and contractor (paragraph 42);

(e) his Honour was apparently concerned that the literal construction of the Rules could go too wide, capturing employees and expert consultants (paragraphs 42 to 43);

(f) "[t]*his is not a case in which a literal construction fails to address the mischief that Parliament was concerned to address,* ***but rather a case in which the literal words used to address that mischief go far beyond the mischief intended to be addressed***" (paragraph 49);[23]

(g) "*… the Chief Commissioner ultimately accepted that a literal interpretation would have far-reaching and unintended consequences*" (paragraph 50);

(h) nevertheless, "*I observed in Freelance Global Ltd v Chief Commissioner of State Revenue (NSW) (2014) 2014 ATC 20-445 (at paragraph 160) that one cannot read down the operation of the employment agency contract provisions by making assumptions about the intended operation of the relevant contract provisions because they operate in different fields and the boundary of those fields is marked out by the terms of the employment agency contract provisions, not by assumptions as to the operation of the relevant contract provisions*" (paragraph 61); and

(i) a purposive interpretation may be taken to the interpretation of the legislative provisions (paragraph 62), resulting in what we now have as the *UNSW Global* test.

[22] Emphasis added.
[23] Emphasis added.

65. The *UNSW Global* test, developed by White J, should be seen as the result of a purposive construction of inadequately drafted legislation that would overreach if read literally. It is in this context that the Committee should read the comments of the NSW Court of Appeal in *E Group No 1 Appeal* (quoted above) that the *UNSW Global* test is the settled judicial position and now it is a matter for the legislature to change it, if change is warranted. The Courts can do no more to fix the Rules.

Continuing difficulties in applying the *UNSW Global* Test in operation

How should the UNSW Global test be applied to the facts?

66. The NSW Court of Appeal, in *Integrated Trolley*, has sought to resolve the application of the test by reference, as far as possible, to the terms of the contract with the client.

67. Basten AJA, said at paragraph 111:

> *… the application of s 37 must be assessed by reference to the terms of the employment agency contract relied upon by the Chief Commissioner as the basis of the assessment under challenge. In principle, that will be the agreement between the employment agent and its client. Generally, the actual operation of the agreement, including arrangements between the employment agent and its service providers and between the service providers and the persons performing the work will not form a necessary part of the analysis, and will provide little guidance as to the characterisation of the employment agency contract.*

68. Ward P, who (at paragraph 1) said she broadly agreed with the reasons of Basten AJA, and Payne JA, who said at paragraph 6 that he also agreed with them, however, left the door open to fact-sensitive or multi-factorial analysis depending on the facts of the case before the Court.

Identifying the employment agency contract?

69. Reliance, primarily, on the contract is appropriate and understandable where the contract exists and it is followed but this is not always the case. For example, in *E Group*, there were over 600 contracts, largely undocumented.[24]

[24] *E Group Security v Chief Commissioner of State Revenue* [2021] NSWC 1190 at paragraph 327.

70. The Courts have struggled, in some cases, to identify the contract, and the parties to it, with the prevailing view being that it is the contract with the client, not the contract between the employment agent and the subcontractor.[25]

Who is the client under the contract?

71. The application of the Employment Agent Rules may depend on corporate structures because this may determine which entity is the "client", a term that is not defined in section 37 of the Act.

72. The case of facility managers is one example. In such a case, a facility manager, which is a company that provides facility management services to another company, will be the client of the employment agent, not the ultimate end user. For example, there may be a facility manager that provides services to a Westfield shopping centre, which is held in a separate entity. In that case, the facility manager is the client, not Westfield. Further, were the facility manager a company within the Westfield group that company would be the client, not the entity that owns the Westfield shopping centre.[26] The outcome in such a case appears to be appropriate.

73. Another case where, however, the outcome is inappropriate, is where the employment agent is a subsidiary in a corporate group and it procures (for legitimate commercial reasons) workers to supply its parent company (or another group company) that in turn contracts with the ultimate end user. In that case, depending on the facts, the subsidiary may be considered to be an employment agent and the parent (or other company) may be considered the client, not the ultimate end user.[27]

74. The inappropriateness is that, had the taxpayer simply contracted with the end user client directly, they would have not been taxed under the Employment Agent Rules. The *E Group* decision was only reversed on appeal because of contracting with the end user by an interposed group entity. This is arbitrary but also encourages entities to structure themselves in a particular way based on tax outcomes. This would discourage having separate entities that otherwise may exist for legitimate commercial reasons (such as centralisation of finance and administrative functions, and asset protection).

Does it matter if equipment is supplied to the client?

75. An employment agency contract involves the procurement of services of another person (see subsection 37(1)). The "wages" paid or payable under the contract include "*any amount paid or payable to or in relation to the service provider in respect of the provision of services in connection with the employment agency contract*" (see subsection 40(1)(a)).

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[25] See *Integrated Trolley* at paragraph 34, preferring the majority of the Court of Appeal in *Chief Commissioner of State Revenue v E Group Security Pty Ltd (No 2)* [2022] NSWCA 259; (2022) 115 ATR 448 (***E Group No 2 Appeal***).
[26] *Securecorp (NSW) Pty Ltd v Chief Commissioner of State Revenue* [2019] NSWSC 744.
[27] *E Group No 2 Appeal*.

76. The term, "services", is not defined. By contrast, in the Contractor Rules, there is an exclusion for goods supplied that are ancillary to services or services solely for the conveyance of goods in a vehicle by the service provider (see subsection 40(2)(a)(d)).

77. The question arises as to whether the supply of "services" under the Employment Agent Rules includes the supply of equipment or consumables. In *Integrated Trolley*, it was found that the supply of equipment by the subcontractor did not change the fact that the *UNSW Global* test applied to the taxpayer, but that it might be relevant to reduce the amount of "wages" under subsection 40(1): see Payne JA at subparagraph 14(10) and Basten AJA at paragraph 80.

78. Were there to be equipment supplied, under the contract with the client, by the purported employment agent, which would be separate to any services supplied, it may be that this is a factor in favour of concluding that the contract is not an employment agency contract.

Fact-sensitivity means no precedents

79. Fact-sensitive cases do not create precedents: *Integrated Trolley* at paragraph 9, per Payne JA at paragraph 8 and Basten AJA at paragraph 40.

80. Fact sensitivity results in the inability to make generalisations about how the Employment Agent Rules apply to particular industries. For example, in cases concerning security guards, at first instance, the taxpayer was found to be caught, in *Southern Cross Group Services Pty Ltd v Chief Commissioner of State* [2019] NSWSC 666; (2019) 110 ATR 16, whilst in *E Group Security v Chief Commissioner of State Revenue* [2021] NSWSC 1190, the taxpayer was not. Her Honour, Ward CJ in Eq, presided in both cases and observed in the latter case, at paragraph 321, that "*the mere fact that two cases may concern the provision of services of security guards does not (and the Chief Commissioner does not suggest this) mandate a similar conclusion*."

81. It follows that previous cases cannot be relied upon as to how particular industries are treated under the Rules. Those cases relate to, for example:

    (a) the Security Industry (as noted in the previous paragraph);[28]

    (b) hotel room cleaners;[29]

    (c) retail shopping trolley pushers;[30]

    (d) retail store cleaners;[31] and

    (e) academics as consultants and expert witnesses.[32]

[28] *Infinity Security Group v Chief Commissioner of State Revenue* [2023] NSWCATAD 28 (***Infinity***).
[29] *Bayton; HRC*.
[30] *Integrated Trolley*.
[31] *Integrated Trolley*; *JP Property Services Pty Ltd v Chief Commissioner of State Revenue* [2017] NSWSC 1391; 106 ATR 639 (***JP Property***).
[32] *UNSW Global*.

82. A taxation law is unjust if it is so uncertain that taxpayers are unable to confidently interpret and apply it. The volume of litigation over the Employment Agent Rules in the last 10 to 15 years demonstrates that not even judges and highly paid tax lawyers are able to consistently agree on how the legislation should be interpreted. These circumstances are crying out for legislative intervention.

Continuing potential for overreach the mischief

83. The Committee is reminded of the concerns of White J in *UNSW Global* that, read literally, the Employment Agent Rules would go beyond the mischief of avoiding payroll tax by the interposition of an agent where direct employment would have been subject to payroll tax. Under the *UNSW Global* test, the only protections against application of the Rules boil down to the judicial gloss on subsection 37(1) explaining that, where the workers are not working in and for the client, or are not integrated in or added to the workforce of the client, the Rules should not apply. The Courts, as noted, have also described this criterion as being that the worker works as if they are an employee of the client.

84. In our submission, this clarification, whilst an improvement on the literal drafting of subsection 37(1), begs the question in each case and requires a broad and detailed examination of the facts against highly conceptual and broad criteria. The Courts cannot be criticised, however, because it is beyond their jurisdiction to redraft legislation – that is only for the legislature.

85. It is not as simple, under subsection 37(1), to employ commonly used concepts, such as what is an employment agent, or to restrict the provision to labour hire arrangements (the latter term having no definition in NSW legislation in any event).

86. Taxpayers are left to contend with audits and disputes with Revenue NSW in the absence of statutory criteria. Instead, at best, opinions as to what is caught or not, requires a careful examination of the case law, with the heavy qualification that no case is a precedent because it is fact specific, against the totality of their own facts (whether or not there is a documented contract with the client).

87. There is also potential for overreach in that the Rules might be contended, by Revenue NSW, to apply beyond labour hire arrangements (as generally understood) to the provision of services (and sometimes equipment) in which the purported agent is, in fact, providing a total service or solution. In such cases, a careful examination of the facts should result in the conclusion, based on the *UNSW Global* test, that the Rules do not apply. The problem for taxpayers is being subject to a costly audit in which they bear the burden of proving, on the facts, that this is the result. This requires not merely demonstrating that there is no labour hire, but also advancing evidence as to:

    (a) the documented client contracts;

(b) the service provider's entire system of work, which will usually comprise:

(i) the service provider's definition of specific client requirements, reflecting that the client does not have the skills, knowledge or will to acquire the ability to define its own needs;

(ii) on site control and direction of workers by the service provider, not the client, under area managers or site supervisors engaged by the service provider, which may also be necessary given the nature of their functions (such as licenced security guards who must not perform their functions except as directed by a master licence holder under the *Security Industry Act 1997* (NSW));

(iii) workers on client sites that are entirely distinguishable from the client workforce due to, for example:

(A) distinctive uniforms;

(B) the location of where they work (or do not work), including work areas that may be separate and apart from areas utilised by the workforce of the client; and

(C) functional separateness of their work from the client's workforce. This would be the case where the function is "*outside the ordinary day to day activity of the client's workforce*": Ward CJ in Eq (now President Ward of the Court of Appeal) in *E Group Security v Chief Commissioner of State Revenue* [2021] NSWC 1190 at paragraph 331;

(iv) training of workers that is not undertaken by the client and could not be undertaken by the client;

(v) software systems for work management, reporting and client communication – with such systems operating online across multiple sites to monitor virtually all aspects of the performance of the contracted services, including worker site access, worker time management (replacing the old Bundy clock), incident and injury monitoring;

(vi) management of all work and workers against standard operating procedures, including safe work management standards; and

(vii) responsibility for meeting all regulatory standards, such as workplace health and safety, industry specific standards for the security industry, financial services, and hazardous chemicals; and

(c) provision of equipment and consumables.

88. In our submission, the Committee should have regard to the changes, since 1998 when the current Rules were legislated, in the business environment, largely because of technology enabling completely different models of work. The issue is not one of

outsourcing versus insourcing, or whether the services are integral to the business of the client (the latter reflecting an incorrect understanding of the *UNSW Global* test).[33] The issue is that it is increasingly common for clients to be seeking services (and sometimes also equipment) for which is not part of the functions of their workforce to perform within the normal or traditional functions of the business.[34] Usually, there is no client workforce performing any aspect of this function and the client engages service providers through a competitive tendering process. This is quite different to labour hire on, for example, a construction project or for truck drivers.

89. Examples of these services, include:

    (a) security guarding operations; and

    (b) sophisticated cleaning services for multiple sites.

90. Further, there is a completely arbitrary difference in outcome depending on which entity is identified as the client as illustrated by the facts in *E Group* that were initially found in favour of the taxpayer until, on appeal, a different client was identified, being another company in the taxpayer corporate group. In other words, the NSW Court of Appeal ruled against the taxpayer because it had utilised a group entity, that had in turn contracted with the end user, in circumstances where that end user was the client from the perspective of the taxpayer's business. Had the taxpayer contracted directly with the end user, the Rules would have not applied to impose payroll tax.

Revenue NSW Guidance

91. Revenue NSW has published guidance on its website. The main publications, addressing the application of the Rules, are:

    (a) *Commissioner's practice note: Employment Agency Contracts Guidelines* (CPN 005 issued effective 2021); and

    (b) *Employment agency contracts: chain of on-hire* (PTA 027 issued 30 June 2008). This deals with the Commissioner's practice, where technically there may be multiple layers of employment agency contracts, to assess payroll tax on the contract directly with the end user client.

92. In our view, CPN 005 is of limited utility because it is out of date and has insufficient examples.

93. Examples of issues with CPN 005 include:

    (a) none of the *E Group* cases are dealt with;

    (b) *E Group No 1 Appeal* established that the *UNSW Global* test is settled law;

[33] *E Group Security v Chief Commissioner of State Revenue* [2021] NSWSC 1190 at paragraphs 318 and 323.
[34] Ibid at paragraph 331.

(c) were the *E Group* cases dealt with, Example 4, which concerns security guards, would need to be significantly revised to address, as noted earlier, different outcomes depending:

(i) on the facts as to the integration of the guards into the workforce of the client (compare the decisions of Ward CJ in Eq in *E Group* versus *Southern Cross* and see also *Infinity*); and

(ii) on the corporate structure, which affects who the "client" is;

(d) the principles arising from *Integrated Trolley* are not addressed, such as:

(i) the application of the Rules is fact sensitive;

(ii) the primacy of the written contract, if there is one, in applying the *UNSW Global* test, noted earlier;

(iii) there may still be a need to take a multi-factorial approach, being an approach that assumes greater importance where there is no documented contract with the client; and

(iv) confirmation that the decision in *JP Property* should largely not be followed, including as to the significance of cleaners working out of hours – see paragraphs 4, 16, 53 and 107; and

(e) key terms, such as "client" in subsection 37(1) and the distinction between "services" and equipment in section 40, are not addressed.

94. Whilst it could be updated, the underlying legal problems cannot be resolved by administrative publication. Legislative reform is required.

95. In our view, PTA 027 is appropriate.

Summary of Current Legal Problems

96. To summarise:

(a) the current Rules are broken. The *UNSW Global* test is a purposive construction of legislative drafting that, if accepted literally rather than purposively, would significantly overreach. The Courts have gone as far as is reasonably possible to settle on an interpretation that achieves the legislative purpose of addressing the underlying mischief of employment agents supplying workers that may not technically be employees (for example, contractors);

(b) the Courts are unable (because of a lack of legislative definition of factors to determine when the Rules apply) to provide meaningful practical guidance as to which cases are in or out;

(c) cases are always fact sensitive so they cannot provide precedential guidance to particular industries or fact situations;

(d) reference to a contract is helpful where it exists and it is followed, but many cases involve undocumented contracts with clients;

(e) the current Rules may also lead to distortions in tax outcome based on the client choice of corporate structure (see the *E Group* cases);

(f) there is a lack of clear and appropriate definitions for key terms, namely to identify the contract, client and services (as against equipment);

(g) the world of business and employment has changed a lot since the current Rules were introduced in 1998. The Rules fail to clearly capture labour hire on the one hand or exclude cases where the client's workforce does not perform the functions for which the service provider is contracted to perform on the other;

(h) current Revenue NSW guidance is out of date and lacks sufficient examples. In any event, such administrative guidance cannot rectify flawed legislation; and

(i) taxpayers are faced with excessive costs of compliance and distraction from their businesses to seek legal advice and to contend with Revenue NSW compliance reviews, audits and disputes. Revenue NSW action to seek to enforce flawed legislation is also a direct cost to the NSW budget.

<u>Reform Proposals</u>

97. In our submission, the Committee should recommend that the current Employment Agent Rules should be amended as follows.

Exemption from the rules where a subcontractor supplies a valid written statement

98. *First*, as a matter of principle, Revenue NSW will be protected if the wages of the worker (whether an employee or independent contractor) have been subject to payroll tax where appropriate. This is the clear legislative policy underlying the current provision in NSW, in the Contractor Rules, for a subcontractor to issue a written statement in approved form that, amongst other things, attests that payroll tax has been paid, relieving the principal contractor from payroll tax.[35] The provision of this statement, which is routinely required by a principal contractor as a condition for contractual engagement of a subcontractor, promotes voluntary compliance with the Act and provides Revenue NSW an audit trail for the payment of payroll tax.

99. We consider that the extension of this provision to the Employment Agent Rules would produce an immediate simplification of compliance and cost saving for taxpayers and Revenue NSW.

[35] Subsection 18(4) of Schedule 2 Part 5 of the *Payroll Tax Act 2007* (NSW).

Modernise the Rules where a subcontractor fails to supply a valid written statement

100. *Second*, in those cases where there is no valid written statement then the current imposition of payroll tax on the employment agent would continue but in our view the Rules should be amended to address the practical problems discussed earlier. Hopefully the majority of cases would however never get this far because a valid written statement is obtained.

101. Noting that the current Rules are intended to be anti-avoidance rules, as noted by the Minister's Second Reading Speech in 1998 (quoted above), the Rules should be redrafted with more particularity as to bright-lines practical factors as to what is not caught.

102. For example:

(a) traditional labour hire arrangements would be caught, such as in the building and construction sector or the supply of drivers in the transport sector. The sectors would be the subject of legislation or Ministerial determination. A definition of "labour hire" would be required but would in conceptual terms involve the supply of labour of workers who work under the complete control and direction of the client when on the client site (or in the client vehicle) and are otherwise indistinguishable from the client's workforce. The legislation may need to be amended to ensure that the decision of the Minister would be reviewable by an aggrieved taxpayer;

(b) arrangements in which the service provider provides services in respect of functions that are not part of the client's traditional or normal functions are not caught;

(c) assuming that the case is not determined by either of the tests in (a) or (b) then a revised version of the *UNSW Global* test would apply. That is, a multi-factorial approach would be taken to the *UNSW Global* test, directed to the question of whether the workers are integrated with the workforce of the client and work as if they were employees of the client - for example:

(i) documented contractual provisions would be especially significant;

(ii) whether the service provider is providing a total system or turnkey solution;

(iii) the traditional or normal functions of the client, as against those of the services provided by the service provider;

(iv) control and direction of the workers;

(v) the distinguishability of the workers between those procured by the service provider and the client - for example, uniforms, location;

(vi) recruitment;

(vii) training;

(viii) setting of standards for work; and

(ix) responsibility for compliance with regulatory requirements (for example, workplace health and safety, industry specific compliance regulations).

(d) The Rules would define:

(i) the contract in subsection 37(1) as between the service provider and the client;

(ii) who is the client in subsection 37(1); and

(iii) what is a service (as distinct from the provision of equipment or goods, such as consumables) in subsection 40(1) so that payroll tax only applies to wages paid to a worker for a service.

103. The proposed reforms would require a legislative rewrite by the NSW Parliamentary Counsel's Office and presumably consultation on exposure draft legislation.

104. In our view, the proposed reforms should improve the integrity of the Employment Agent Rules and bring these Rules into the 21st century. There should be no loss to the Revenue because in most cases subcontractors will pay the applicable payroll tax and issue a valid written statement as they do now under the Contractor Rules.

Retrospective Reform

105. In our view, the approach to relief for medical practices (discussed in the section on Contractor Rules) provides a template for how to provide relief in the Employment Agent cases.

106. That is, where taxpayers have not paid payroll tax under the Employment Agent Rules they should be retrospectively relieved of paying payroll tax provided that they would not be liable to payroll tax under the amended rules. Refunds would not be available if payroll tax has already been paid.

107. There would however be no need for a rebate as in the case of GPs as the Employment Agent Rules would not apply prospectively in inappropriate circumstances.