Submission No 23

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

Organisation: The Tax Institute

Date Received: 7 February 2025

The Tax Institute

7 February 2025

The Hon Jeremy Buckingham, MLC
Chair and Member of the Legislative Council
Parliament House
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SYDNEY NSW 2000

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Dear Chair and Member of the Legislative Council,

Inquiry into the application of the contractor and employment agency provisions in the *Payroll Tax Act 2007* (NSW)

The Tax Institute welcomes the opportunity to make a submission in response to the NSW Legislative Council's inquiry into the application of the contractor and employment agency provisions in the *Payroll Tax Act 2007* (NSW) (**Payroll Tax Act**).

In developing this submission, we have closely consulted with our members with specialist expertise in this area, including our National FBT and Employment taxes Technical Committee, and our NSW State Taxes Committee, to prepare a considered response that represents the views of The Tax Institute's broader membership.

We commend the NSW Legislative Council for this inquiry, particularly considering recent legal disputes regarding provisions of the Payroll Tax Act. The Tax Institute strongly advocates for reform of the Payroll Tax Act. The existing ambiguity and inconsistent application of the law, stemming from the broad nature and drafting of its provisions, combined with member experiences of the current approaches of the regulator in testing the boundaries of the literal wording of provisions without necessarily affording full consideration to anti-avoidance intent, necessitate legislative amendments to align the regime more closely with Parliament's intent.

Our detailed response and recommendations to improve deficiencies in the Payroll Tax Act, as well as our views on the need for reform are contained in **Appendix A**.

Our submission is intended to be a starting point for further discussion and consultation. We consider it essential to ensure an ongoing dialogue between the NSW Treasury, Revenue NSW, and the tax profession, on the matters considered in our submission, and ways in which the Payroll Tax Act and its interpretation may be improved. Such an open and collaborative process will help to ensure the Payroll Tax Act is appropriate in the current environment and fit for future use.

To this end, we would be pleased to continue to work with you, and the NSW Treasury and Revenue NSW on any proposed reforms to the Payroll Tax Act. Please contact our Head of Tax & Legal, Julie Abdalla, at (02) 8223 0058 to arrange a time to workshop the issues further or discuss any aspect of our submission.

The Tax Institute is the leading forum for the tax community in Australia. We are committed to shaping the future of the tax profession and the continuous improvement of the tax system for the benefit of all. In this regard, The Tax Institute seeks to influence tax and revenue policy at the highest level with a view to achieving a better Australian tax system for all. Please refer to **Appendix B** for more information about The Tax Institute.

Yours faithfully,

Scott Treatt
Chief Executive Officer

Tim Sandow
President

APPENDIX A

We have set out below our detailed comments and observations for your consideration.

Preliminary comments

Overview

The Long Title to the Payroll Tax Act reads as:

> An Act to provide for a tax on employers in respect of certain wages….

The objective of the Payroll Tax Bill 2007, which introduced the current Payroll Tax Act, was to repeal and reenact the Payroll Tax Act 1971 (**1971 Act**), incorporating changes to align the Act with Victoria's corresponding payroll tax regime.

Importantly, the revisions to the 1971 Act did not substantially alter the contractor provisions (contained in Division 7) or the employment agency provisions (contained in Division 8), which have faced several legal challenges in recent years. These provisions have remained static for over a decade, raising concerns about their relevance in today's on-demand and gig economy landscape. Further, in recent years, the Courts have adopted a broad interpretation of these provisions that is arguably inconsistent with what was intended by Parliament and has led to, among other things, the classification of general practitioners (**GPs**) and optometrists as contractors, and the classification of cleaners and security guards as subject to the employment agency provisions, necessitating payroll tax payments (as explained further below).

Compliance issues add to the complexity, primarily due to the significant administrative burdens on taxpayers, including the need to keep detailed records of contractors and their working days. Further, the broadened interpretation of the contractor and employment agency rules has exposed taxpayers (often unknowingly) to substantial and unexpected payroll tax and interest liabilities, even where they have taken reasonable care and relied on Court decisions that were current at the time of preparing their payroll tax returns. See, for example, the recent case of *XL Retail Services Pty Ltd v Chief Commissioner of State Revenue* [2025] NSWCATAD 22 (**XL Retail**), where the decision by Revenue NSW to impose penalties was deemed inappropriate and overturned by the Tribunal.

Although strong advocacy from the Royal Australian College of General Practitioners (**RACGP**) and other stakeholders has resulted in the introduction of amnesties in most Australian states to protect some GPs from payroll tax for public policy reasons, similar protections are not available to non-bulk billing GPs and other specialist medical practitioners who operate on a similar basis. Nor have similar concessions been made available for other sectors.

The lack of clear guidance and the inconsistent application of the law, exacerbated by inconsistent judicial interpretations of the legislative provisions and the regulator's approach, highlight the need for legislative amendments to resolve ambiguity, and better align the provisions with Parliament's original intent of identifying contractors who functionally resemble employees.

Recommendation 1

Accordingly, The Tax Institute recommends the following:

- simplify and clarify the legislative language of the Payroll Tax Act so the objectives of the Act are applied to address today's on-demand and gig economy landscape appropriately;
- review these provisions and the other provisions of the Payroll Tax Act in light of stakeholder feedback through consultation;
- implement necessary amendments following adequate consultation; and
- conduct a post-implementation review of the amendments similar to section 317 of the *Duties Act 1997* (NSW), which requires a review by the Minister within two years of Royal Assent.

Harmonisation of payroll tax

On 29 March 2007, State and Territory Treasurers announced a plan to reform payroll tax regimes across Australia, to enhance legislative and administrative consistency. Subsequently, on 11 July 2008, the Commissioners from all State and Territory Revenue Offices reaffirmed their dedication to uniformity in payroll tax administration. On 28 July 2010, multiple states and territories signed a joint harmonisation protocol aimed at standardising legislation across eight specific areas. New South Wales, Victoria, Tasmania, Northern Territory, and South Australia have implemented similar payroll tax legislations, with only minor variations in their schedules, while Queensland has also passed legislation to support harmonisation. Western Australia (**WA**) has yet to align its contractor provisions with those of other jurisdictions. This harmonisation has yielded some advantages for payroll tax practitioners and businesses by lowering administrative expenses and enhancing operational efficiency. However, feedback from our members indicates ongoing concerns regarding continuing discrepancies in payroll tax laws, and their interpretation and administration across different states and territories.

In its capacity as the Ministerial Advisory Council for tax issues and as part of its general mandate to contribute to the improvement of the general integrity and functioning of the tax system, the Board of Taxation formed a Working Group to examine inconsistencies in fundamental definitions and concepts among state, territory, and federal tax laws. The Working Group presented its final report in August 2017, identifying potential discrepancies in core definitions and concepts within State and Territory payroll tax laws and aspects of relevant federal tax laws.

Recommendation 2

The Tax Institute recommends a comprehensive harmonisation of payroll tax laws, extending to rates, thresholds, and other legislative aspects, to facilitate simpler compliance for businesses operating across various states and territories.

History and intent of the contractor and employment agency provisions

Both sets of provisions were first introduced in the 1980s, predominantly to prevent tax avoidance. The explanatory note accompanying the Pay-Roll Tax (Amendment) Bill 1985 (**EM to the 1985 Bill**), which introduced the contractor provisions and employment agency provisions, states that these provisions were introduced to prevent tax avoidance by addressing relationships that exhibit similarities to employer/employee dynamics.

A relevant excerpt from the EM to the 1985 Bill is reproduced below:

> Schedule I (2) inserts new sections 3A and 3B into the Principal Act to provide for the taxation of payments to contractors under certain contractual arrangements.
>
> The arrangements within the scope of section 3A are set out in the definition of "relevant contract" in subsection (1). The terms of this definition are directed to capture several means of disguising the employer-employee relationship by contractual arrangements which have been increasingly resorted to in recent years by persons seeking to defeat the objects of the Principal Act. The definition contains appropriate exclusions, so that the parties to genuine service contracts will not be prejudiced.

The State Revenue Legislation (Miscellaneous Amendments) Bill 1998 (**1998 Act**) introduced the employment agency provisions that continue to apply today. The relevant excerpt from the Explanatory Note to the 1998 Act reads as follows:

> The Pay-roll Tax Act 1971 is amended by Schedule 6 [2] and [3] to make employment agents, instead of the end-user, liable for pay-roll tax in respect of employment agency contracts, not being contracts of employment. An employment agent is not liable for pay-roll tax if:
>
> - the contract worker is liable for pay-roll tax in respect of the wages paid for provision of the services, or
> - the wages paid to the contract worker would be exempt from pay-roll tax if they had been paid to the contract worker by the end-user of the services, or
> - the end-user of the services is not liable to pay pay-roll tax.

On the basis that these measures were to be anti-avoidance provisions, the drafting thereof was deliberately broad to capture various arrangements that might be used to circumvent payroll tax liabilities. However, over time, the interpretation of these provisions has broadened even further, and they now affect a wider range of business arrangements than what was intended (and include arrangements established for specific and genuine commercial purposes, rather than only those directed at avoiding payroll tax). This has led to confusion and increased compliance costs for taxpayers. The scope of these provisions have continually expanded (without any legislative amendments to the wording), based on a literal interpretation of the statutory wording and the regulator's reduced focus on the anti-avoidance purpose of the provisions. This is the crux of why so many disputes are arising, with the regulator and taxpayers taking opposing views.

In recent years, the emergence, and now proliferation, of non-traditional working arrangements has resulted in an increased level of scrutiny with regard to the application of these provisions. Without seeking to restate the facts of these landmark cases, we have outlined the impact of some key decisions below to illustrate the shift from purposive to literal interpretation:

- *UNSW Global Pty Ltd v Chief Commissioner of State Revenue* [2016] NSWSC 1852 (**UNSW Global**): The Court observed that the legislation intended to cover indirect employment arrangements, and therefore suggested a purposive interpretative approach, noting at paragraph [49]:

  > "the provisions should be construed so as not to apply to all arrangements that could fall within their literal terms, but should be construed in accordance with the legislative intent as ascertained from the statutory context, including the juxtaposition of the employment agency contract provisions with the relevant contract provisions, the legislative history, and the extrinsic materials. This may mean that the legal meaning to be given to the provisions differs from their literal meaning".

  This case also clarified that the scope of the employment agency provision requires services to be performed 'in and for the purpose of, and ordinary conduct of the client's businesses'. This 'in and for' test has since been applied broadly, despite this exact terminology being absent from the legislation.

- *Winday International Pty Ltd v Chief Commissioner of State Revenue* [2016] NSWCATAD 270: in this case, the Tribunal sought to apply the employment agency provisions widely through a literal construct, rather than through a purposive lens. The Tribunal's broad application of these provisions did not align with the practical realities or legislative purpose, resulting in outcomes that seemed disconnected from the intended framework.

- *Commissioner of State Revenue v The Optical Superstore Pty Ltd* [2018] VSC 524 and *Commissioner of State Revenue v The Optical Superstore Pty Ltd* [2019] VSCA 197 (**Optical Superstore**): This case broadened the scope of the contractor provisions (despite the fact that the Victorian law is harmonised with the NSW law) to include different payment structures (such as tenancy and facility fee structures), that are common in the medical sector and were previously thought to be outside the purview of the contractor provisions. Croft J concluded that the phrase 'in relation to' for the purposes of section 32 of the *Payroll Tax Act 2007* (Vic) did not require a relationship that is 'direct and immediate,' nor did it require that payments must be in the nature of consideration for the performance of work'.

- *Thomas and Naaz Pty Ltd v Chief Commissioner of State Revenue* [2023] NSWCA 40 (**Thomas and Naaz**): This decision examined the inclusion of doctors' payments within the payroll tax net, specifically focusing on GPs and other medical services. It has sparked widespread discussion on whether GPs and other doctor services should be subject to payroll tax, subsequently influencing various relief measures like amnesties across different Australian jurisdictions. Leeming JA seemingly cautioned against a perspective that only tax avoidance arrangements came within the scope of the contractor provisions, noting:

  > "I do not accept this submission. It amounts to the assertion that the scope of the Division is confined to "tax avoidance". Even assuming that concept had some precise legal meaning, to accept the applicant's submission amounts to placing a gloss on the statutory text."

- *Loan Market Pty Ltd v Chief Commissioner of State Revenue* [2024] NSWSC 390 (**Loan Market**): The potential expansion of the contractor provisions was further explored through the lens of the financial services industry. It noted by Richmond J at paragraph [207]:

> "the conclusion that the Broker Agreements constitute a relevant contract under s 32 may be seen as a harsh outcome for LML because the contractor provisions now found in s 32 were originally introduced as an anti-avoidance measure which was not intended to catch "bona fide independent contractors". But the way the legislature approached the implementation of that purpose was to cast the net of 'relevant contract' very widely and then to give exclusions which were intended to catch the bona fide independent contractor relationships."

This observation goes to the heart of the issue in our view – the inconsistency between Parliamentary intent, the provisions as drafted, and the regulator taking a literal approach to the provisions without due consideration of anti-avoidance intent.

- *Uber Australia Pty Ltd v Chief Commissioner of State Revenue* [2024] NSWSC 1124 (**Uber**): One of the key guiding principles in Hammerschlag CJ's approach was to have regard to the intended objective of the contractor provisions; seemingly, being to ensure disguised employer-employee relationships are brought into the tax net. His Honour considered that the amount taken to be wages for purposes of the contractor provisions requires a reciprocation between the payment and the work performed under the 'relevant contract' (seemingly taking a purposive lens). That is, the contractor provisions focus on the contractual terms of the written agreement between both parties.

In our view, it is evident that the contractor provisions and employment agency provisions were drafted broadly on the basis that they are specific anti-avoidance measures. This breadth has meant that the application of the provisions is beholden to their interpretation within the judicial system, coupled with the interpretation by Revenue NSW.

As evidenced by the cases above, the judiciary has not always been consistent in its approach to interpretation of these provisions and, at times, there has been a literal interpretation which has then arguably captured arrangements that were never contemplated as being within scope, and which were created for specific commercial purposes (rather than with the avoidance of payroll tax as a consideration). This has created a snowball effect to broaden the net, capturing modern arrangements and industries beyond the original intent of the legislation, with some judgments even acknowledging this as being a harsh outcome given the commercial context.

With this background in mind, we have outlined below specific issues and recommendations for reform.

Interpretation of the contractor provisions and employment agency provisions

As demonstrated by the judicial extracts above, the ever-evolving nature of the Courts' interpretation of these provisions has posed a major challenge for businesses to remain compliant. A literal interpretation of the provisions often fails to align with the legislative intent, creating anomalies and unintended tax liabilities for genuine independent contractors. A purposive approach has its own challenges, including in the context of framing what may or may not constitute 'tax avoidance'.

As previously noted, the anti-avoidance provisions were deliberately broadly drafted to capture a wide range of arrangements. In our view, narrowing the provisions is unlikely to result in a better outcome, as this could erroneously exclude certain appropriately taxable arrangements. By the same token, relying on or expecting the Courts to shift to a purposive lens is now too difficult, given the volume of judgements that would need to be unwound (and creating difficulty in relation to the doctrine of precedent).

Recommendation 3

To effectively address the dichotomy of applying literal and purposive interpretations, we recommend:

- Introducing new legislation that explicitly directs a purposive approach. Similar to the proposed Superannuation (Objective) Bill 2024 (Cth), this legislation could help enshrine the core goal of addressing anti-avoidance measures rather than widening the net as to which the provisions apply. For example, it may be the case that each application of the provisions would be required to conform to an objective (and which frames a purposive approach). This would need to be carefully designed (and would benefit from consultation), but would provide the necessary clarity and guidance for taxpayers, the regulator, and the Courts, aligning the application of the law with its intended protective role; and
- Revenue NSW should issue guidance (again, benefitting from consultation) on interpreting these provisions in line with their purpose. Such guidance would provide greater transparency and clarity for taxpayers, promoting a more consistent and purposive application of the law, rather than adhering strictly to a literal interpretation that can capture arrangements set up for legitimate commercial purposes. By doing so, Revenue NSW can improve the predictability of the payroll tax regime, reduce compliance burdens, and ensure the provisions fulfil their intended role. This would have the added benefit of instilling greater public confidence in the regulator and the system as a whole.

The broad scope of Division 7 contractor provisions

In NSW, payments to independent contractors are subject to payroll tax on the basis that such workers operate under 'relevant contracts' under section 32 of the Payroll Tax Act. Payments to contractors are exempt from payroll tax only where an exemption from the contractor provisions exists.

For completeness, the seven exemptions contained in subsection 32(2) of the Payroll Tax Act are summarised below:

- the supply of services is ancillary to the supply of goods (**goods exemption**);
- services are not ordinarily required by the principal and the contractor provides the same or similar services to the public (**Services Not Ordinarily Required exemption**);
- services performed by the contractor for the principal are services required by the principal for less than 180 days in a financial year (**180-day exemption**);
- the contractor provides their service for no more than 90 days in a financial year (**90-day exemption**);
- services approved by the Commissioner as exempt;
- services are performed by two or more people (**Two or More People exemption**); and
- the services are provided by an owner-driver (**Owner-Driver exemption**).

Complexities of contractor provisions

Feedback from our members indicates that the current exemption criteria under the Payroll Tax Act are often considered overly stringent and not reflective of modern business practices. The use of contractors as a preferred labour force is becoming more prevalent, leading to an administratively burdensome process for employers to identify and accurately apply one of the seven contractor exemptions, as well as ensure record keeping requirements are met.

For example, the Services Not Ordinarily Required exemption requires the Commissioner's approval, which can be impractical to obtain in each case, especially in industries with many contractor engagements. Our members often see employers outsourcing consulting, legal and accounting services to large multinational organisations that service a number of clients. The intent of the law has never been for these companies to attract payroll tax, as they are not single-person companies, notwithstanding that in some instances, a business may only obtain services from one of the employees of those businesses (which therefore limits the application of the two or more people exemption).

While Revenue NSW has provided some guidance on when no approval from the Commissioner is required (including where the employer engages the contractor for an average of 10 days or fewer per month), this remains burdensome for employers to track. We consider that more precise and practical guidance is required. Similarly, the requirement for 'pre-approval' for businesses exceeding 10-days is also impractical, particularly when dealing with large cohorts of contractors. This imposes an additional administrative burden that could be streamlined.

In a similar vein, the 90-day exemption includes partial days of work towards the 90-day threshold, which may include limited work (for example, where only one hour is performed). Organisations generally do not often require timesheets from contractors, and equally, the contractor will not always monitor the number of days worked across the year (particularly when given the flexibility to work partial days). This means that even for sophisticated organisations who have an annual process to obtain declarations from contractors on the number of days worked, there is an inherent risk that this data is not accurate.

Moreover, exemptions based on days worked may not sensibly apply to gig economy and on-demand workers. In this respect, it would be more appropriate to apply the exemption on an hours-worked basis (i.e., a gig worker who works 1 hour a day in addition to their primary job arguably should not be considered to have worked 1 full day for the purpose of applying these exemptions).

Also, exemptions from the relevant contractor provisions frequently depend on data or factual information that is typically only accessible by the contractor, or in some cases to Revenue NSW, which is able to obtain information from the Australian Taxation Office (**ATO**) and WorkCover databases. Taxpayers generally do not have access to such information as the person (**principal**) engaging that contractor. For example:

- the *Services Not Ordinarily Required exemption* requires the principal's assessment of whether the contractor offers similar services to the general public. To meet this requirement, the principal must determine whether the contractor derived less than 40 percent of their gross trading income from the principal during the relevant financial year (Revenue Ruling PTA 022);

- The *Two or More People exemption* requires the principal to ascertain whether two or more people perform the services and, if so, whether the involvement of other personnel is in respect of the subject matter of the contract or whether it is merely administrative (Revenue Ruling PTA 023); and
- the *Owner-Driver exemption* is contingent upon the principal determining the contractor's status as an owner-driver (Revenue Ruling PTA 006).

The Payroll Tax Act lacks a structured framework for the granting of exemptions, requiring the Commissioner to establish evidentiary standards and criteria for such exemptions. This compels principals to make substantial assumptions regarding contractors' work beyond their direct engagement, often resulting in discrepancies during audits by Revenue NSW.

Audit processes also require more transparency and consistency. Businesses often face uncertainty due to contradictory information – the information that Revenue NSW can access from sources such as the ATO often differs to that which the principal can access from a contractor (assuming the contractor agrees to provide such information) (e.g., a statement from the contractor that they perform services for multiple organisations). This lack of transparency creates compliance challenges for taxpayers, leading to inconsistencies and potentially avoidable disputes during audits.

Recommendation 4

To address these challenges, we recommended that the contractor exemption criteria be revised to better align with contemporary business practices. Doing so will help businesses manage their payroll tax obligations more effectively and reduce administrative complexities. This could be achieved by:

- amending the legislation to allow entities registered for GST and sole traders who are contractors and satisfy the criteria of personal services business (a federal tax concept) to self-assess their liability as exempt from payroll tax;
- removing the requirement for Commissioner approval for the 'Services Not Ordinarily Required' exemption, given this is often applied in very clear and straightforward non-taxable scenarios. Alternatively, Revenue NSW should provide further 'carve-outs' where Commissioner approval is not required. For example, if the contractor has a public website where it is advertised that they service multiple clients or have multiple workers, consideration should also be given to whether the average number of days should increase from 10 days per month and/or whether the pre-approval should be removed altogether, with the exemption status being evaluated during audits;
- introducing automatic exclusions for annual contractor payments that are below or above a certain threshold, to simplify the compliance burden without undermining the overall intent of the provisions. For example, establishing a minimum contractor payment amount (i.e. less than $35k), where contractors that fall below this threshold would automatically be excluded for payroll tax purposes. This would be on the basis that it would be reasonably expected that the contractor would qualify for the 90-day exemption. Revenue NSW currently has an approach allowing a 'replacement method' calculation (to ascertain if the contractor was paid for more than 90 days); however, a threshold would arguably achieve the same intent but would be administratively simpler. Similarly, introducing a contractor ceiling (i.e. more than $350k), where contractors that fall above this amount would automatically be excluded for payroll tax purposes, would be founded on the basis that two or more

people would be expected to have provided the services given the high value. In any case, any such threshold would be subject to integrity measures;

- redefining the 90-day rule as 90 full working days. While we acknowledge this would allow for a greater number of contractors to be excluded, such a change would provide a more practical and straightforward approach, aligning the rules with typical business operations, and reduce complexity for taxpayers, making compliance more straightforward. This amendment would also ensure the exemption sensibly applies to modern working arrangements (i.e., gig economy and on-demand workers, and hybrid and flexible working arrangements generally);
- improving clarity, transparency, and consistency in the Revenue NSW audit processes. This could involve providing detailed guidelines on the audit process, ensuring that information accessed and taken into account by Revenue NSW is consistent with that which taxpayers can access, and offering training or resources to help businesses understand and navigate the audit process; and
- allowing contractors to qualify for an exemption where an approved declaration is completed by the contractor and provided to the principal, rather than requiring more detailed evidence (such as records of days attended) to support exemptions.

Expansive interpretation of contractor provisions

Recent court interpretations of the current wording of contractor provisions have resulted in a broad interpretation encompassing arrangements that, in our view, should not be subject to these provisions. Significant cases include:

- *Optical Superstore*, where optometrists were classified as 'relevant contractors' without exemptions, making their payments liable for payroll tax;
- *Thomas and Naaz*, where GPs were similarly categorised as 'relevant contractors' for the first time, resulting in their payments also being taxable;
- *Uber,* which revealed that payments to ride-share drivers were not considered taxable wages, as they did not relate to work performance, despite the relevant contract provisions; and
- *Loan Market*, which determined that mortgage brokers, previously exempt from payroll tax, were now classified as 'relevant contractors,' subjecting their payments to taxation.

Although these cases concern the same harmonised legislative provisions, they have produced inconsistent outcomes due to an expansive and conflicting interpretation of the contractor provisions. The uncertainty arising from the inconsistent application of the provisions is not confined to specific industries and is pervasive across various sectors.

In the absence of clarification on the scope and application of these provisions, the implications of these decisions are likely to have a significant impact on businesses that are, in reality, service providers to business operators such as medical practitioners and gig economy operators, and who are genuinely engaged as independent contractors for payroll tax purposes, including:

- medical and health practitioners that provide services to medical centres (including dental, physiotherapy, radiology, and other healthcare providers);
- gig-economy and digital platform workers that provide services to various platforms (including rideshare, delivery, and social media platforms); and

- mortgage aggregators that engage authorised mortgage brokers as independent contractors.

The relevant contract provisions are anti-avoidance in nature and therefore could have been applied in the *Optical Superstore* case - where the formulas in that case arguably suggested that the optometrists were paid on an hourly basis, without the need to contort the interpretation of the contractor provisions to apply more generally, and which has subsequently led to the distortions discussed above.

Instead, the application of the *Optical Superstore* case, as well as subsequent decisions, has led to an outcome that many GPs and other medical specialists who clearly operate as genuine independent personal businesses are now classed as contractors. This applies notwithstanding that in most cases, patients are attracted by the particular GP/medical specialist, not the branding of the medical centre operator, of which the patient is frequently not aware, and that goodwill arises from the actions of, and relationship with, the doctor not the medical centre operator.

These developments also pose a considerable threat to gig economy workers. If these workers are classified as employees under common law, their earnings may become subject to payroll tax unless an exception is invoked. This could have adverse effects on both society and the economy[1]. The *Uber* decision is particularly significant regarding the application of payroll tax within the gig economy[2]. It provides much needed legal clarity for platform operators and businesses reliant on contractor workforces, especially in light of the previous cases involving GPs and mortgage brokers[3]. However, the Court's observations in the *Uber* case highlight the inherent complexities of applying payroll tax legislation to gig economy platforms, which were not in existence at the time the legislation was enacted,[4] as well as creating considerable confusion as to how the Court's conclusions reconcile, if at all, with the earlier cases. There is now considerable uncertainty regarding how these provisions apply to genuine contractor arrangements across all industries.

In this regard, it is important to note that the explanatory note to the Payroll Tax Bill 2007, provides minimal insight into Parliament's intention, and this complicates the accurate interpretation of the contractor provisions.

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[1] Celeste Black, 'The Future of Work: The Gig Economy and Pressures on the Tax System' (2020) 68(1) *Canadian Tax Journal* 69, 95.

[2] Greg Protektor, Jerome Tse and Judith Taylor, '"Five-Stars": Uber's victory in Court puts brakes on payroll tax assessments', King & Wood Mallesons (Web Page, 9 September 2024) <https://www.kwm.com/global/en/insights/latest-thinking/ubers-victory-in-court-puts-brakes-on-payroll-tax-assessments.html>; Uber Australia Pty Ltd v Chief Commissioner of State Revenue [2024] NSWSC 1124.

[3] *Thomas and Naaz Pty Ltd v Chief Commissioner of State Revenue* [2023] NSWCA 40; *Commissioner of State Revenue v The Optical Superstore Pty Ltd* [2019] VSCA 197; *Loan Market Group Pty Ltd v Chief Commissioner of State Revenue* [2024] NSWSC 390; *Uber Australia Pty Ltd v Chief Commissioner of State Revenue* [2024] NSWSC 1124.

[4] *Uber Australia Pty Ltd v Chief Commissioner of State Revenue* [2024] NSWSC 1124, [17].

Contractor provisions in WA

As mentioned earlier, the contractor provisions in WA diverge significantly, as the payroll tax legislation distinctly differentiates between employees and contractors. The WA Commissioner of Taxation has broad powers to determine if payments made to an individual are considered a 'tax reducing arrangement'. If this determination is affirmative, those payments become subject to payroll tax. Unlike NSW, the provision in WA requires consideration of the common law test to determine whether a worker is an employee or an independent contractor.

Recommendation 5

The Tax Institute recommends that the 'relevant contract' definition, including exemptions from that definition, should be revised and amended to ensure the contractor provisions do not apply to genuine independent contractor arrangements (including, independent contractor arrangements for medical practitioners, gig and digital platform workers, and mortgage brokers, among others). Further, revisiting the common law definition of an employee, or adopting a framework similar to that of WA, may help to realign the law with its original purpose and ensure coherence with other tax and employment regulations.

Goods Exemption

Paragraph 32(2)(a) of the Payroll Tax Act provides broadly that a contract of service does not fall under the definition of a relevant contract if the services provided are ancillary to the supply of goods. The Payroll Tax Act does not define the term 'ancillary' nor grant the Commissioner the authority to do so. However, the Commissioner's interpretation of what constitutes ancillary services is outlined in Revenue Ruling PTA 033, which states that if the costs associated with materials and/or equipment exceed 50% of the total contract value, the labour provided is deemed ancillary. Conversely, the Ruling provides that if the 50% threshold is not met, the principal may be eligible for a deduction based on the contractor's profession, as noted in Revenue Ruling PTA 018. It is our view that the Commissioner's interpretation is an overreach as it defines the term ancillary without adhering to the general understanding of the term when it is not explicitly defined. While this approach may stem from a desire for good governance and effective administration, it is inappropriate and has resulted in an arbitrary outcome. The Courts may not necessarily accept the Commissioner's interpretation of the term 'ancillary', and this causes uncertainty for taxpayers.

Recommendation 6

Therefore, The Tax Institute considers that a review of, and potentially an amendment to the provision is necessary to define the term 'ancillary' and to establish a clear framework for granting the Goods exemption, within which the Commissioner should administer the law.

Amounts under relevant contracts taken to be wages

Section 35 of the Payroll Tax Act deals with determining wages that are liable to tax under the Payroll Tax Act in relation to a contract. Subsection 35(1) of the Payroll Tax Act reads as follows:

> (1) For the purposes of this Act, amounts paid or payable by an employer during a financial year for or in relation to the performance of work relating to a relevant contract or the re-supply of goods by an employee under a relevant contract are taken to be wages paid or payable during that financial year.

Payroll tax applies to wages paid for the services performed or labour rather than the cost of goods. However, from a reading of subsection 35(1), one can understand that amounts paid or payable in relation to the resupply of goods are also covered in the calculation of wages. To remedy this outcome and to align with the Parliament's intention to levy payroll tax on wages for services performed, subsection 35(2) of the Payroll Tax Act grants power and discretion to the Chief Commissioner to determine that portion of the amount that is not attributable to the performance of work. The Chief Commissioner's discretion in this regard is informed by Revenue Ruling PTA 018, which provides the Chief Commissioner's view on contractor deductions for the non-labour components where the contractor provides equipment and/or materials. This Ruling allows percentage-based deductions for specific industries listed therein, without taking into account the contractor's actual cost of goods incurred. Reissued on 11 January 2008 based on its predecessor Ruling, it is understood that this Ruling has not been revised to account for diverse categories of industries present in the contemporary landscape. Additionally, the Ruling indicates that if a profession or trade is not included in the list, a principal may request a determination from the Chief Commissioner, supplying information about the costs associated with materials and equipment supplied by the contractor. However, feedback from our members indicates that obtaining such a determination from the Chief Commissioner can be a time-consuming process, and often in practice, taxpayers are expected to rely on the Chief Commissioner's determination of the value of goods.

Recommendation 7

We recommend that Revenue Ruling PTA018 is reviewed and the range of industries covered is broadened. Further, the legislation should be amended to allow for the following options:

- the option to apply the Ruling;
- the provision for businesses to automatically deduct costs of goods when they can be identified from an invoice; and/or
- the opportunity for taxpayers to seek a ruling from the Chief Commissioner regarding deductions.

The broad scope of Division 8 employment agency provisions

The term 'employment agency contract' is defined in subsection 37(1) of the Payroll Tax Act as 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. In recent years, the interpretation of the employment agency provisions has expanded to include various employment arrangements that go beyond traditional labour-hire models, such as contracts in the cleaning and security sectors.

Under such contracts, the employment agent is recognised as the employer of the worker providing services to the client, thereby making the worker an employee of the agent. Consequently, the agent is responsible for payroll tax on all payments made to the worker. The provisions are designed to apply when an agent arranges for a worker to perform tasks akin to those of an employee, without the worker becoming an employee of the client.

The current provisions under the Payroll Tax Act concerning employment agency provisions are complex and often misunderstood by businesses. There has historically been a misconception that the provisions only apply to traditional 'employment agency' or 'labour-

hire' arrangements, or that it requires the relationship between the worker and the client to be one of common law employment (i.e. more in the vein of recruitment rather than labour-hire).

Due to the recent increase in litigation on these provisions, a range of industries (including IT, cleaning, medical services, financial services and security) have been required to closely monitor the outcomes of decisions, with many decisions having been overturned on appeal. This has made it difficult for businesses to remain compliant and ensure their internal payroll tax position is reflective of the current jurisprudence.

An example of judicial contention is with respect to the 'in and for' test. While this is not explicitly mentioned in the Payroll Tax Act, this test has been developed through case law such as *UNSW Global* and examines whether the services provided by the worker are 'in and for' the conduct of the client's business, which would ultimately indicate the relationship between the two parties is one of an employment agent relationship.

As noted in the most recent decision on these provisions, *Chief Commissioner of State Revenue v Integrated Trolley Management Pty Ltd* [2023] NSWCA 302 (**Integrated Trolley**), this requires a fact-specific analysis which first identifies the work to be done by the workers, and then the nature and structure of the client's business. This results in analysis being required on a case-by-case basis, which can be overly technical and subjective, leading to compliance challenges for businesses.

Another example of this confusion involves one-person companies and their classification under the employment agency provisions. The broad judicial interpretation of these provisions has led to uncertainty about whether contracts involving a 'Key Person' or 'Nominated Person', are considered 'employment agency contracts'. Specifically, if a one-person company is working 'in and for the conduct of the client's business', it could be argued that the payroll tax liability sits with that company (rather than the client end-user of services). This may lead to inconsistent payroll tax outcomes if the client views the arrangement as falling within the employment agency provisions but the one-person company views themselves as falling within the contractor provisions (and where the client has the liability).

Additionally, when an arrangement potentially falls under both the employment agency and relevant contractor provisions, the employment agency provisions take precedence, rendering the contractor provisions and their exemptions inapplicable. This broad interpretation means that numerous subcontractor arrangements will be subject to the employment agency provisions, and unlike those governed by the contractor provisions, no exemptions are available. It is unlikely that Parliament intended to levy payroll tax on relevant contracts that meet the exemption criteria merely because such arrangements also fall within the employment agency provisions.

Furthermore, the employment agency provisions appear to apply to arrangements between an 'employment agent' and 'client' where both of these entities are in the same group. This outcome is not appropriate, particularly where such entities are in the same payroll tax group. The provisions also apply even if a contract of employment exists between the service provider and the employment agent, as the current exception only applies to a contract of employment between the service provider and the client.

We also note that the decision of *UNSW Global* has not been adequately addressed in later legal precedents. The 'in and for' test was originally developed in *UNSW Global* because the Court in that case decided that the definition of an 'employment agency contract' in the Payroll Tax Act should not be read literally, as a literal reading would lead to absurd

outcomes that were certainly not intended by Parliament. However, subsequent cases seem to have mostly undermined this approach.

The NSW Court of Appeal in *Chief Commissioner of State Revenue v E Group Security Pty Ltd* [2022] NSWCA 115 affirmed the employment agency contract test in *UNSW Global*. However, the recent decision in *Bonner v Chief Commissioner of State Revenue* [2022] NSWSC 441 (**Bonner**) cast doubt over the reasoning set out in *UNSW Global*. In *Bonner*, Basten J criticised the 'in and for test' set out in *UNSW Global* noting the 'words are a gloss on the statute'.

The potential implications of this line of reasoning have been exacerbated by subsequent decisions in *Integrated Trolley* and, most recently, in *XL Retail*, creating the potential for almost any commercial outsourcing arrangement to fall within the employment agency provisions. The employment agency provisions are intended to operate as an anti-avoidance provision directed toward the use of an agent to give the appearance of an independent contractor relationship which does not in substance exist. The provisions should not apply to genuine independent contractor arrangements between the employment agent and client. Rather they should be limited to circumstances where the work performed by the service provider forms part of the client's core business in substitution of employees. The contractor provisions should not be enlivened merely because the services provide a benefit to the client's business. A narrower interpretation of the 'in and for' test consistent with the construction adopted in *UNSW Global* is consistent with the purpose of the provision.

Recommendation 8

To address the complexities and subjectivity in applying the provisions, we recommend that:

- the Payroll Tax Act should be revised to provide greater clarity for taxpayers in determining what constitutes the application of Divisions 7 and 8. This should include considering formally introducing the 'in and for' test as a statutory test and clarifying whether one-person companies can meet the definition;
- further thought should be given as to whether the intended purpose of the provisions is to capture the diverse range of industries (such as property management). The legislation should be amended to limit the employment agency provisions to businesses with the Australian and New Zealand Standard Industrial Classification (**ANZSIC**) code for employment agencies or labour-hire firms to appropriately confine the scope of the provision;
- where it can be established that a service provider under an arrangement also supplies goods/equipment along with their services, such arrangements should be exempted under Division 8. This would push such arrangements more appropriately back within the scope of the contractor provisions contained in Division 7;
- the Payroll Tax Act should be revised to prevent the inadvertent exclusion of employment agents from section 32 of the Payroll Tax Act, which pertains to relevant contractor exemptions. The provisions should also be amended to resolve technical issues resulting in the application of the employment agency provisions to entities within the same group, and to arrangements where the service provider and employment agent are parties to a contract of employment;
- comprehensive guidelines should be developed to clearly outline criteria for classifying contracts as 'employment agent' or 'relevant' contracts', including practical examples and scenarios to support taxpayers to better understand one-person

company scenarios. The language and structure of the provisions should be simplified to reduce technical complexity and improve clarity for more appropriate interpretation; and

- industry-specific circumstances should be considered, tailoring guidance to the needs of sectors such as IT, property management, and the medical industry, to prevent unintended compliance burdens and, where applicable, to take into account broader public policy considerations.

Liable entity for payroll tax

The 2019 cases of *Southern Cross Group Services Pty Ltd v Chief Commissioner of State Revenue* [2019] NSWSC 666 and *Securecorp (NSW) Pty Ltd v Chief Commissioner of State Revenue* [2019] NSWSC 744 confirmed that where there are multiple employment agents in a chain of employment agents, the Chief Commissioner retains his discretion in determining where the payroll tax liability will fall.

Section 41 of the Payroll Tax Act deals with liability provisions. It provides broadly that if an employment agent, under an employment agency contract, procures the services of a service provider for a client of the employment agent, and pays payroll tax on amounts taken for the purposes of section 40 to be wages paid or payable by the employment agent in respect of the provision of those services in connection with that contract, then 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. The section merely clarifies that when an employment agent engaged directly by the client pays payroll tax on behalf of the worker, no other entities in the chain are obligated to do so. The section does not specifically or necessarily assign the payroll tax liability to the employment agent engaged by the client.

However, Revenue Ruling PTA 027 states that the employment agent closest to the ultimate client will be regarded by the Chief Commissioner as the agent who is liable for payroll tax. Section 41 of the Payroll Tax Act, as a liability provision, does not specifically prescribe this outcome. Instead, it is only through enlivening the 'anti-avoidance' provision under section 42 that the Chief Commissioner has the discretion to impose the liability on any agency in the chain. This results in uncertainty for taxpayers, and the tax incidence outcome under section 41 becomes redundant.

Amount taken to be wages

Section 40 of the Payroll Tax Act defines wages in relation to employment agency provisions, specifying that wages paid or payable by the employment agent under an employment agency contract include:

- any amount paid or payable to or in relation to the service provider (worker) in respect of the provision of services in connection with the employment agency contract;
- the value of any benefit provided for or in relation to the provision of services in connection with the employment agency contract that would be a fringe benefit if provided to the person in the capacity of an employee; and
- any payment made in relation to the service provider that would be a superannuation contribution if made in relation to a person in the capacity of an employee.

Noting, the Commissioner's view in Revenue Ruling PTA 027 that the employment agent closest to the ultimate client is the entity liable for the payroll tax, the amount on which payroll tax is levied will include any amount paid towards the agency fee. Example 4 from the Revenue NSW website provides that a client business is seeking labour and pays $120,000 to Agent 2 (which includes an agency fee of $10,000), which pays $110,000 to Agent 1 (which also includes an agency fee of $10,000), which pays $100,000 to the worker.

The Commissioner's view is that Agent 2, being the employment agent closest to the ultimate client, is liable for payroll tax levied on the amount of $110,000 (inclusive of the agency fees) paid to Agent 1, rather than the $100,000 in wages paid to the worker. This appears to be contrary to the express terms of section 40 of the Payroll Tax Act which refer to the amount paid to the worker. The levy of payroll tax on the agency fee is arguably unconstitutional on the grounds that the States do not have the constitutional right to tax the income of the employment agency (being in this case, the agency fees). Therefore, it is our view that this could not have been intended by Parliament.

Moreover, we consider that Division 8 should only apply to the employment agent who is directly paying the service provider, not only would this achieve the appropriate outcome that the amount subject to tax is the amount paid to the service provider, but it would also prevent the current need to trace through multiple arrangements (which can be practically difficult, particularly given commercial sensitives and confidentiality requirements that can exist around such arrangements).

Recommendation 9

We consider it necessary for Revenue NSW to review and update its Revenue Rulings to align with Parliament's intent.

Industry-specific considerations

As discussed above, the Payroll Tax Act was designed to ensure that businesses contribute fairly to state revenue through payroll taxes. However, the evolving nature of employment structures and industries has introduced complexities that the original legislation did not anticipate. Industries such as medical and health, financial services, security, and the gig and on-demand economy have unique contractor arrangements, each of which has clear and discrete commercial drivers (unconnected to payroll tax) that may not fit neatly into the traditional employer-employee framework. This has led to ambiguities and unfairness in the application of the payroll tax regime and particularly the employment agency provisions and contractor provisions.

While currently under appeal, the *Uber decision* highlighted the complexities and nuances of gig economy arrangements, with the Court struggling to balance the literal interpretation of the law with its intended purpose. Hammerschlag J noted in paragraph [17] that these arrangements were not designed to avoid payroll tax or disguise employment, illustrating the need for legislative clarity.

Similarly, certain industries (such as the medical, security, cleaning and mortgage brokerage industries) often engage contractors for genuine commercial reasons (for example, due to licensing arrangements or otherwise), rather than being designed to disguise employment relationships or avoid tax. If the policy intent of the original contractor and employment agency provisions was not to capture genuine commercial arrangements, as we consider is the case, these sectors may warrant tailored exemptions or other carve outs due to the unique nature of their arrangements and industry practices. This will ensure that the

legislative intent, directed at combatting tax avoidance, is maintained and that industries are treated fairly.

As an example, we have outlined the inconsistent payroll tax outcomes in the medical industry below:

- There is currently a rebate available for medical centres making payment to contracted GPs. However, this is generally only available for bulk billing arrangements, with a different rebate percentage depending on the suburb the services are carried out. This is likely to result in unfairness for businesses across metropolitan Sydney and regional NSW. Further, the rate of bulk billing GP practices continues to decline, limiting the application and value of this rebate.
- Only bulk-billed GPs have access to the payroll tax rebate. Other medical practitioners, such as non-bulk billed GPs, dentists, optometrists and allied health professionals, are treated as taxable unless an exemption applies. Each of the operators in the medical sector generally operates on a similar model. However, the rebate is limited to some. One unintended impact but likely reality is that the additional payroll tax cost will be ultimately passed on to the patient. This has broader public policy implications and adds greater pressure on our public health system.
- The historical rules favour higher risk tolerance by taxpayers. Before 4 September 2024, GP wages were exempt, but only if no payroll tax had already been paid historically. This effectively penalised employers who had conservatively complied with the payroll tax guidance (e.g. those who when faced with uncertainty chose to take the option of apparently least risk).

There is also a lack of harmonisation in the guidance and relief afforded to certain GPs compared with other industries (for example, mortgage brokers). These disparities highlight the need for a more uniform approach to ensuring that no industry is unfairly disadvantaged compared to others, and all businesses can understand and comply with their payroll tax obligations more easily, while also ensuring that the Payroll Tax Act remains relevant and adaptable for future needs.

Recommendation 10

To address the potential for unintended consequences and unfairness in the application of the provisions across different sectors, we recommend that, to the extent that it aligns with the intent of the provisions, consideration should be given to introducing specific provisions within the Payroll Tax Act for evolving working arrangements and specific industries (such as those considered as examples above). These provisions should also recognise the pivotal role of digital platforms in facilitating modern work arrangements and offer clear compliance guidance to prevent ambiguities so that businesses better understand their obligations under the law.

Revenue NSW Rulings and other guidance

Revenue NSW has often adopted a strict and literal approach in their guidance and rulings concerning the provisions. This strict interpretation, primarily aimed at ensuring the breadth of the tax net, generally sacrifices commercial reality and practicality. For example, in the context of the exemptions to the contractor provisions, feedback from our members indicates

that businesses are finding it increasingly difficult to adhere to guidance that does not adequately contemplate the complexities and realities of their day-to-day operations.

We note that NSW is the only Australian jurisdiction that issues Commissioner Practice Notes (**CPNs**). We commended this practice and consider that it positions NSW ahead of other jurisdictions in terms of providing detailed guidance and transparency for taxpayers. We commend Revenue NSW for regularly engaging with The Tax Institute and other stakeholders in consultation, and we welcome continued collaboration. We also consider that expanding consultation practices, particularly on a more public scale, and specifically including affected industries, would be beneficial for the system as a whole. In this regard, we consider the timely release (and where relevant, updating) of CPNs is crucial to enhance their utility and effectiveness.

A specific example of this can be seen in the *CPN 016: Payroll Tax Act – Relevant Contracts - Australian Financial Services Licences and Australian Credit Licences,* which was released in 2022 and has not yet been updated to reflect the recent decision in the *Loan Market* cases. Similarly, guidance has not been updated following the *Uber* decision and its impact on evolving working arrangements (such as for gig economy workers). Without timely updates to guidance, businesses operate under outdated guidance, leading to uncertainty and higher cases of inadvertent non-compliance.

Recommendation 11

We recommend that Revenue NSW provide more timely and balanced guidance that considers real-world business scenarios. This should be prioritised over strict and literal interpretations of the law. Such guidance should be practical and supportive of genuine business activities, ensuring compliance is achievable and aligned with the original intent of the provisions. To achieve this, our suggestions include:

- Revenue NSW should proactively and regularly engage with industry stakeholders to understand the commercial application of current and future guidance and rulings. This could include forming additional consultation groups, advisory panels, conducting surveys, and holding consultation sessions. This engagement should occur well ahead of audit cycles and involve discussions with those directly impacted by these provisions. By collaborating with industry stakeholders, regulators can ensure that their guidance is both practical and reflective of the operational realities businesses face, thereby fostering a more cooperative and effective compliance environment;
- where relevant, Revenue NSW should issue guidance promptly to ensure businesses have adequate time to understand and implement necessary changes. Delayed guidance, as seen in the case of certain CPNs for specific industries (e.g. mortgage brokers), can render the guidance less effective and compliance more burdensome for businesses; and
- updated guidance should include detailed examples and scenarios that illustrate how the provisions apply in various real-world situations. These examples can help businesses better relate and understand their obligations and how to comply with the provisions effectively. These documents should be concise, easy to understand, and provide actionable steps businesses can follow to ensure compliance. This means considering the operational challenges and administrative burdens that businesses encounter, and providing solutions that are feasible in commercial settings

APPENDIX B

About The Tax Institute

The Tax Institute is the leading forum for the tax community in Australia. We are committed to representing our members, shaping the future of the tax profession and continuous improvement of the tax system for the benefit of all, through the advancement of knowledge, member support and advocacy.

Our membership of more than 9,000 includes tax professionals from commerce and industry, academia, government and public practice throughout Australia. Our tax community reach extends to over 40,000 Australian business leaders, tax professionals, government employees and students through the provision of specialist, practical and accurate knowledge and learning.

We are committed to propelling members onto the global stage, with over 7,000 of our members holding the Chartered Tax Adviser designation which represents the internationally recognised mark of expertise.

The Tax Institute was established in 1943 with the aim of improving the position of tax agents, tax law and administration. More than seven decades later, our values, friendships and members' unselfish desire to learn from each other are central to our success.

Australia's tax system has evolved, and The Tax Institute has become increasingly respected, dynamic and responsive, having contributed to shaping the changes that benefit our members and taxpayers today. We are known for our committed volunteers and the altruistic sharing of knowledge. Members are actively involved, ensuring that the technical products and services on offer meet the varied needs of Australia's tax professionals