**Submission No 30**

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

**Organisation:** Payroll Tax Solutions Pty Ltd

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**By email**

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For the attention of: The Hon. Jeremy Buckingham, Committee Chair for Portfolio Committee no. 1.

Dear Honourable Member and Director,

**Payroll Tax Act 2007 – Contractor and Employment Agent Provisions Inquiry**

**Introduction**

Thank you for initiating the instant Parliamentary inquiry into the application of the contractor and employment agent provisions in the *Payroll Tax Act 2007* (NSW) (**PTA**).

These submissions were jointly prepared by Andrew Fricot of Payroll Tax Solutions and Richard Ung of Stratos Lawyers.

We welcome the opportunity to provide Parliament with detailed submissions addressing current issues in the construction and application of the relevant PTA provisions. We highlight select matters for further consideration and suggest potential approaches for future legislative amendment concerning both the Contractor and Employment Agent (**EA**) provisions of the PTA.

Contracting (and subcontracting) has and continues to be an increasingly popular means by which entities participate in the Australian economy. There are many reasons why subcontracting has increased in popularity beyond State/Territory payroll tax considerations.

In our experience, businesses are increasingly preferring to contract certain functions because they lack the in-house resources, expertise and are unable or unwilling to internalise those functions on a more permanent basis. They also take on contracting models for service delivery because they can transfer some of their operational challenges and insurance risks to their contractors.

An example of an industry or sector responding to skill and goods shortages in the face of adverse operating conditions by contracting was the Aged Care sector and public transport settings in the midst of the COVID pandemic when vaccines were being developed but were not widely available.

It may be recalled that outbreaks of COVID in Aged Care sites were likely to, and did result in, multiple COVID fatalities. Under such vulnerable patient settings, Aged Care operators urgently outsourced hygiene and infection control functions to external contractors who could recommend the most effective cleaning chemicals, techniques and systems; by doing so, the Aged Care sector succeeded in externalising COVID-related operational risks to cleaning specialists. This extended beyond the outsourcing of "labour" to cover the supply of PPE and industrial grade cleaning and disinfection chemicals. In a similar manner, operators of public transport also rapidly outsourced specialist cleaning and infection control services to contractors.

An example of legislative and regulatory considerations weighing against the development and retention of in-house functions by way of traditional employment is in the field of security, as explored by Ward CJ in Eq (as Her Honour then was) in the first instance decision of *E Group Security Pty Ltd v Chief Commissioner of State Revenue* [2021] NSWSC 1190. Whilst that decision was overturned in *E Group Security Appeal No. 2* on different grounds (focusing on the intercompany employment agent contracts), that decision examined the duties and obligations of licensed security personnel under the *Security Industry Act 1997* (NSW) and associated Regulations. It is self-explanatory as to why businesses do not develop in-house security functions (recruitment, arming, training and licensing) in circumstances where the regulatory framework is onerous.

The loan / mortgage brokering industry is an example of the intersection of industry practice preferring contractor arrangements for service which has its own unique licensing regulatory framework was the subject matter of judicial consideration in *Loan Market Group Pty Ltd v Chief Commissioner of State Revenue; Loan Market Pty Ltd v Chief Commissioner of State Revenue* [2024] NSWSC 390 (**Loan Market**).

More recently, the NSW Government will also be acutely aware of the trend in medical practitioners (whether general practitioners or specialists such as psychiatrists) increasingly preferring private practice as contractors in lieu of more traditional employment arrangements, in part due to more attractive hourly rates available in the private sector and the desire for flexible working arrangements and personal preferences in seeking professional opportunities in geographically diverse locations.

Of course, in a contracting environment, it may not always be commercially viable or possible for any single contractor to be in a position to deliver the goods and/or services to the client. In such instances, obligations are subcontracted in part or whole to other contractors.

The increasing prevalence of contracting arrangements and the inherent uncertainties in the application of the Contractor and EA provisions justify a close scrutiny of these provisions and their administration in practice. It is unfair and harsh for taxpayers to be charged with substantial penalties particularly when the case law on these provisions remains unsettled. The unfairness is further magnified as many taxpayers elect to pursue an administrative review in the NSW Civil and Administrative Tribunal in lieu of the Supreme Court of NSW on account of the costs regime differences across the two jurisdictions.

It is against this economic and realistic context that our submissions are developed for the assistance of Parliament.

**Harmonisation of interjurisdictional State/Territory legislation**

For the most part, Contractor and EA provisions are meant to be harmonised between the majority of jurisdictions. Currently, WA Contractor provisions are not harmonised with the other states and territories and the both WA and ACT have non-harmonised EA provisions.

Therefore, any changes in NSW's provisions should be suggested as a potential road map for change across the other jurisdictions in favour of promoting harmonisation across the nation, as this in itself reduces legislative and administrative red tape and compliance burdens for taxpayers. However, should the other jurisdictions not follow suit, I would strongly encourage NSW to lead the way forward in making the compliance simpler through its rules and administration of Contractor and EA rules.

There is a harmonisation protocol that was agreed to and documented between the states and territories since 2010. The joint government website www.payrolltax.gov.au hosts this protocol amongst other documents. This website serves as a host of joint initiatives, education and rulings. Although, both Contractor and EA provisions were not listed as specific areas of harmonisation, the general scope and move has been to align the payroll tax rules including the both Contractor and EA rules. This is demonstrated by the intentional listing/tabulating of vastly harmonised rulings that can be seen under the 'Resources – Revenue rulings' tab.

**Harmonisation with the Commonwealth related authorities of the High Court**

On 9 February 2022, the High Court of Australia published two decisions (heard together) concerning the *Fair Work Act 2009* (Cth) in relation to "employee vs independent contractor" issues:

> *Construction, Forestry, Maritime, Mining and Energy Union v Personnel Contracting Pty Ltd* [2022] HCA 1; 275 CLR 165 (***Personnel Contracting***)
>
> *ZG Operations Australia Pty Ltd v Jamsek* [2022] HCA 2; 275 CLR 254 (***Jamsek***)

It is submitted taxpayers and the Crown alike have been and continue to be bound by the principles set out in *Personnel Contracting* and *Jamsek* in payroll tax matters unless and until the legislative branch of the NSW Government enacts legislative reform to overcome those authorities.

Whilst the above authorities have been applied on numerous occasions in the intervening time, there has been very limited consideration and application of either *Personnel Contracting* or *Jamsek* in the superior courts of any State/Territory in the context of the PTA and its other State/Territory counterparts.

An apt summary of the high-level impact of the above High Court authorities may be found in *Agrigrain Pty Ltd v Rindfleish* [2024] NSWCA 295 (a negligence and industrial law/employment law case) per Kirk JA (with whom Ward P and Stern JA agreed) at [31]:

> *A majority in Personnel Contracting rejected a multi-factorial approach to the issue of characterising a person as an employee or independent contractor, indicating that at least for*

> *written contracts the issue was to be determined by reference to the terms of the contract: at [59] (Kiefel CJ, Keane and Edelman JJ), [187]-[189] (Gordon J), [203] (Steward J).*

At [222] in *Personnel Contracting*, in dissent, perhaps prophetically, Steward J said (citations omitted):

> *Whilst this is not a criminal law case, overturning the Full Court's decision in Odco would expose the respondent to significant penalties on a retrospective basis. That is unfair. It will also, as Lee J observed, greatly damage the respondent's business and the businesses of many others. That is undesirable. It will also potentially deny to workers a choice they may wish to make to supply their labour as independent contractors, thus possibly undermining one of the objects of the Independent Contractors Act.* ***Given the severity of these potential consequences, which will apply retrospectively, the fate of the Full Court's decision in Odco should be a matter left for the legislative branch of government to consider.*** *The decision, and those that have followed it, are not plainly wrong. The cogency of the reasons of the learned primary judge in this case is a sufficient basis for that conclusion.*
>
> (our bolded and underlined emphasis)

As it happens, the Commonwealth Government did consider the impact of the *Personnel Contracting* decision and specifically enacted section 15AA of the *Fair Work Act 2009* (Cth) to overcome that decision. However, Commonwealth legislative reform has not extended to other areas (for example, superannuation having regard to the application of *Personnel Contracting* in the matter of *JMC Pty Ltd v Commissioner of Taxation* [2023] FCAFC 76; 297 FCR 600). Consequently, in Federal matters, there is a divergence of approach in different contexts.

*Personnel Contracting* was first the subject matter of submissions in the Court of Appeal decision of *Chief Commissioner of State Revenue v E Group Security Pty Ltd* (No 2) [2022] NSWCA 259 (***E Group Security Appeal No. 2***)[1], however the Court of Appeal did not expressly comment on the High Court authorities.

*Personnel Contracting* was applied by Hammerschlag CJ in Eq in *Uber Australia Pty Ltd v Chief Commissioner of State Revenue* [2024] NSWSC 1124 (***Uber Australia***) at [172]:

> *Characterisation of the payments made by Uber must proceed by reference to the Contracts which reflect and govern the legal relationship between the contracting parties and by reference to the rights and obligations to which the Contracts give rise: see* CFMEU v Personnel Contracting Pty Ltd *(2022) 275 CLR 165.*

*Personnel Contracting* was not considered by the Court in *Loan Market* which preceded the decision in *Uber Australia*.

*Personnel Contracting* is also the subject matter of very limited consideration and application by the Chief Commissioner of State Revenue in NSW. By way of example, Commissioner's Practice Note *CPN*

[1] *E Group Security Appeal No. 2* at [53] and [63].

*036v2: Relief to Medical Centres PTA 041 Payroll Tax Act- Relevant Contracts - Medical Centres* only refers to paragraphs [63]-[66] in *Personnel Contracting*.

Those passages were directed to the principle of contractual interpretation that a contract's own description of its character is not determinative of its character, best encapsulated by Gageler and Gleeson JJ in *Personnel Contracting* at [127]:

> "*the parties cannot create something which has every feature of a rooster, but call it a duck and insist that everybody else recognise it as a duck*".

However, those passages were not generally directed on the abandonment of the multifactorial approach in favour of determination by reference to the terms of a contract.

PTA 041 also refers to an earlier decision of the High Court in *Accident Compensation Commission v Odco Pty Ltd* [1990] HCA 43; (1990) 95 ALR 641 at 652 (***Odco***). *Odco* was overturned by *Personnel Contracting* and as such PTA 041 does not, to the extent reliance is placed on *Odco*, reflect the correct position at law. Such an approach runs contrary to *Personnel Contracting* and *Uber Australia*.

We anticipate other persons making submissions to Parliament will address the decision in *Uber Australia* in the context of the gig economy in greater detail. For the present purposes, we draw attention to the passage extracted from *Uber Australia* in support of our views that unless and until overturned on appeal (and we understand an appeal is on foot) of *Uber Australia* or Parliament otherwise enacts legislation overcoming it, the High Court authority in *Personnel Contracting* is binding in NSW.

We observe substantial passages in existing publications, such as Revenue Ruling PTA 038 *Determining whether a person is an employee* continue to apply a multifactorial approach which was, as we have set out above, overturned by the High Court in *Personnel Contracting* in 2022.

Further, the existence of three superior court revenue law decisions, with only one decision citing and applying *Personnel Contracting* (i.e. *Uber Australia*) emphasises the importance of Parliament clarifying its views on the application of *Personnel Contracting* in NSW.

In our view, harsh and capricious results have arisen in cases where taxpayers are assessed on principal tax, interest and penalties where decision makers have failed to apply and take into account the principles in *Personnel Contracting* and instead followed the former *Odco* approach, and are the precise outcomes Justice Steward was mindful of in His Honour's dissent in *Personnel Contracting*.

Public confidence in the administration of taxation laws is undermined by the uncertainties arising from the limited judicial guidance on the application of *Personnel Contracting* in payroll tax cases, combined with the lack of guidance available in any revenue ruling or Commissioner's Practice Notes.

If Parliament is minded to overcome the decision *Personnel Contracting* (and restore the position in *Odco*), we submit the Commonwealth Government's approach in enacting section 15AA of the *Fair Work Act 2009* (Cth) provides a working example of how to address this issue with clarity.

Alternatively, if Parliament is not intent on overcoming the decision in *Personnel Contracting* (which, as we have observed above, remains in force in some areas of law in the Federal jurisdiction), then it would also promote the rule of law by inserting a corresponding section in the PTA to confirm the intention of Parliament.

Whilst fairness public confidence may also be promoted by way of media release and/or updating existing revenue rulings and Commissioner's Practice Notes etc, we consider the better approach is to enact legislative amendments to the PTA as the authority in *Personnel Contracting* continues to be applied by the Courts in other non-taxation related matters. Our concern with the incorporation of clarifications in revenue rulings or Commissioner's Practice Notes is that the Court and Tribunal are not bound by what is expressed in such publications. Moreover, the legislative practice of including explanatory notes or memoranda to legislation provides a further opportunity to address issues of uncertainty so that recourse may be had to such extrinsic material on questions of construction of the PTA.

**Contractor provisions**

The contractor provisions are by far the 'greyest' area of payroll tax legislative compliance. Industry has for many years since the introduction of the Contractor provisions been confused and bewildered by a number of issues in its legacy. Firstly, deeming provisions of Division 7 and what is a relevant contract; and secondly, evidence required to substantiate any claims for what is not deemed to be a relevant contract.

It is acknowledged legislation must have, to some degree, a level of generality so as to facilitate the administration of taxation laws without creating exploitable 'loopholes'. However, excess generality results, as it is submitted, in legislation which could result in manifestly absurd results.
In order to prevent such outcomes, Parliament may consider legislative reform to introduce 'bright line' tests for taxation or alternatively enact 'bright line' / safe harbour exemptions to ensure the provisions are effectively targeting the economic activity intended to be captured under the Contractor provisions.

**Issue 1 – Sole traders**
The first issue is the application of what is regarded as the 'totality of the relationship' test, it has traditionally required the taxpayer to apply their own discretion, considering a number of factors weighing up the characteristics that differentiate between an employee and a contractor as an independent business. The consequences of the self-determination results in the taxpayer eligibility to consider if one of the contractor exemptions are applicable. The validity of the traditional approach, following *Odco*, is in serious doubt following the decisions of the High Court in *Personnel Contracting* and *Jamsek*: supra.

Many contractors typically operate a business as ABN holder - sole traders and must face this first hurdle of scrutiny before they can be possibly afforded one of the seven payroll tax contractor exemptions available. Contractors that are established as separate legal entities, such corporations,

partnerships or trusts; do not need to have the 'totality of the relationship' test applied prior to having access to the seven exemptions.

Therefore, businesses that engage sole traders have added compliance burdens and uncertainty in their application of the rules, regarding whether their sole traders should be treated as employees at common law or contractors that may be afforded one of the seven exemptions.

To minimise uncertainty on behalf of the taxpayer, a possible remedy is for all ABN holders with the status of sole trader, to be automatically classified as contractors for the purposes of payroll tax. Anti-avoidance provisions could be enlivened in cases where principals and the designated persons/sole traders enter arrangements/schemes deliberately to avoid the tax. Alternatively, applying what is commonly known as the 80/20 rule, as applied by the ATO in assessing contractor legitimacy could be a practical and already widely understood method for deeming sole trader workers as contractors. In this regard, harmonisation of existing and familiar rules across jurisdictions should be promoted wherever possible.

**Issue 2 – Contractor Deductions**

Sec. 35(1&2) of the PTA prescribes what part of a contractor payment is subject to payroll tax as deemed liable wages. This distinction between what is labour or capital is important, as payroll tax should only be levied on remuneration (I.e. reward for services performed) not on the cost of goods, materials or equipment associated and factored into the cost of a contract.

The careful distinction and exclusion of goods from taxation in NSW is comparable to the Commonwealth Government's paramount powers of taxation under the Australian Constitution under section 51(ii); see also, section 31 of the *Interpretation Act 1987* (NSW).

In our experience, auditors of the Chief Commissioner of State Revenue (CCSR) [NSW] have generally allowed for the cost of goods supplied to be excluded from any payroll tax liability generated from contractor payments but subject to an existing revenue ruling. Sec 35(2) of the Act, specifically allows for the CCSR to determine and therefore prescribe an amount for the excision of the cost of goods associated with a contract. This practice is evident in the publication of the harmonised Revenue Ruling PTA 018- Contractor deductions, which prescribes deduction percentages for various industry types based on capital versus labour intensive aspects of contracts.

As experienced by many taxpayers the percentage deductions in PTA 018 do not substantially reflect the actual cost of goods provided under a contract. Additionally, the relevant industry type for a particular contract may not be represented in the list of prescribed industries noted the ruling. It is our understanding that this list of percentage deductions has not been updated since 2008 and may not represent current industry rates and lacks in its listing of types.

The legislation does not actually allow for taxpayers to simply deduct costs of goods supplied, rather relies on the Commissioner's outdated determination.

The mischief which this creates is the excessive taxation of deemed taxable wages under the Contractor provisions which are in part a taxation on the provision of goods in contravention of section 51(ii) of the Australian Constitution; s 18 of the *Interpretation Act*, supra.

Accordingly, it is recommended that the legislation allow various options to accommodate an election by taxpayers to either deduct in full costs of goods or apply the prescribed deductions with an expanded scope of industry types formulated in consultation with industry peak bodies and associations. The existing PTA 018 approach is a welcome "bright line" or "shortcut" approach but in our submission should not be discriminatory or unconstitutional (by inadvertent omission). Thus, section 35(2) together with PTA 018 are both in urgent need of substantial revision to avoid capricious and harsh results which represent the imposition of State taxation on goods, however unintended.

Parliament may wish to consider the language adopted by the Commonwealth Government in section 8-1 of the *Income Tax Assessment Act 1997* (Cth) [consider adopting the expression "incurred", the meaning of which is reasonably settled] which, together with other evidentiary requirements in other provisions, facilitate the claiming of allowable deductions to the extent they are incurred in gaining or producing assessable income. Evidentiary / record-keeping requirements may also be imposed concurrently and is consistent with taxpayers bearing the onus of proof in State taxation matters: see ss 88 and 100 of the *Taxation Administration Act 1996* (NSW). The point here is that a taxpayer is entitled to relief from excessive State taxation but subject to discharging its onus of proof.

Also, in relation to the liable component of a contract, the current legislation and rulings associated leave do not provide clarity as to whether other deductions afforded to employee wages, such as motor vehicle allowances (such as rates per KM), accommodation allowances or various fringe benefits provided to contractors are given the same treatment as prescribed for employees dealt with outside of Division 7 of the PTA. It is suggested that a redrafted Division 7 address and clarify the above concerns.

**Issue 3 – Labour ancillary to goods supplied - Sec. 32 (2)(a)**

Although this exemption goes to the heart of what the contractor provisions aim to preclude, businesses claiming this exemption have experienced a lack of clarity about the value of the supplied goods of a contract that are deemed as acceptable for its granting.

As the legislation does not prescribe the criterion of what is considered the acceptable overall value of goods versus labour, businesses need to look outside the legislation for a determination of the CCSR, for which the legislation gives the CCSR the ultimate authority to determine causing disagreement, uncertainty and added red-tape administration for the taxpayer.

It is recommended that the legislation be more definitive in its criterion of the value of goods/equipment. Currently the CCSR's Revenue Ruling PTA033 - Contractors: services ancillary to the supply of goods prescribes a minimum 50 percent value criterion of goods. A prescribed value in the

legislation would be beneficial, while also providing definition or avoidance of words like 'ancillary' would lead to less ambiguity for businesses when applying this exemption.

**Issue 4 – Services not ordinarily required and are services performed for the public generally**
Ambiguity and interpretation are both wide and uncertain when determining "those services are of a kind not ordinarily required". For example, a carpentry business whose core work is building and installing staircases. The principal carpentry business receives a job where the customer requests intricate and artistic carvings of the wooden posts and rails. The principal carpentry business does not have the internal specialist skills to do this aspect of the work, therefore engages a sub-contractor carpentry business to perform this aspect of the job, which takes over a year for the sub-contractor to complete amongst their other work for other clients. As the kind/type of service of the principal and the sub-contractor businesses are of the same industry ambiguity arise as to whether this exemption can be applied due to the interpretation and implication of the word "ordinarily".

A more general example, a business may have a dedicated IT department, but requires a specialist IT programmer to develop and implement a customised piece of software. This is a year-long project exceeding both 90 and 180-days, where no other contractor exemption can apply. The specialist IT programmer contractor also provides same or similar services to the public throughout the year. There is therefore uncertainty, in applying this exemption in such cases and the business would have the added red-tape of addressing the issue by seeking a ruling from the CCSR.

This exemption has a two-pronged satisfaction approach, where besides the issue addressed above also needs to be considered with whether the contractor "…ordinarily performs services of that kind to the public generally" raises other concerns that will be addressed as a separate issue below.

**Issue 5 – Services performed for the public generally**
A contractor who has other clients besides the principal contractor within a financial year, seems to be a logical path to determining whether a contractor is truly independent and should not be deemed an employee of a business.

Significant uncertainty arises in the application of this particular Contractor exemption.

Take for example a general practitioner (GP) who has their own patients which consult with them at a medical centre. There is on the one hand a service the GP is providing to the patient (the provision of health services which generate for example an entitlement to bulk billing / mixed billing fees) and also at another level a provision of a service to the medical centre.

This seems to have been considered in the *Loan Market* decision in the context of mortgage brokers, whose clientele are immediately receiving a service (the brokering of a mortgage to buy a home or investment property etc) and at another level a service between the broker and an "aggregator" platform: *Loan Market* at [233].

In our respectful submission, the answer in both scenarios is that the contractor is providing a service to the public generally. This is because the goodwill associated with their clientele lies with the contractor whose fee is derived from their contractual relationship with the patient / customer and to whom they owe duties of care; there are careful delineations of risk assumption which coincide with insurance arrangements which should be taken into account and which point away from a contract falling within the intended scope of the Contractor provisions. In our view, where there are services being provided to the public generally, the exemption ought to be applied beneficially for taxpayers given Parliament's intention that such services should be exempt from payroll tax. If a contrary view is taken, then the intended scope of operation this exemption should be clarified in the public interest and to promote confidence in the administration of payroll tax laws.

This exemption criteria, is relative to a number of the exemptions currently available. The logic being if you work for one principal for less than 90/180 days, or if your contractor services more clients than just the principal in a financial year, then the contractor payments can be excluded. However, the mischief in applying these exemptions for the taxpayer is both overly administratively burdensome and requires the principal to be aware of aspects of their contractor's business that are understandably private and secretive to the sub-contractor.

It is a reasonable requirement of the CCSR, that any exemption claimed to be supported by evidence produced by the taxpayer. However, it is unreasonable for businesses to monitor the business activities of its contractors.

**Issue 6 – the two or more persons exemption**

In our view, the language of the text of the chapeau in section 32(2)(c) and subsection (i) are certain and unambiguous i.e. two or more persons employed or provide services for the contractor in the course of the business carried on by the contractor is sufficient to attract the application of this exemption.

The words "in relation to" in the chapeau of this exemption should be construed in accordance with well settled common law authorities; they do not admit the introduction of words of limitation except as expressly provided for by Parliament; to do otherwise, in our view, is to put a gloss on the words of the statute and runs contrary to principles of statutory construction perhaps best articulated by the High Court unanimously in *Commissioner of Taxation v Consolidated Media Holdings Ltd* [2012] HCA 55 at [39] (footnotes omitted):

> "***This Court has stated on many occasions that the task of statutory construction must begin with a consideration of the [statutory] text". So must the task of statutory construction end.*** *The statutory text must be considered in its context. That context includes legislative history and extrinsic materials. Understanding context has utility if, and in so far as, it assists in fixing the meaning of the statutory text. Legislative history and extrinsic materials cannot displace the meaning of the statutory text. Nor is their examination an end in itself.*"

(our bolded and underlined emphasis)

Anecdotally, as a matter of statutory construction, in *Nationwide Towing & Transport Pty Ltd v Commissioner of State Revenue* (No 2) [2018] VSC 609, the Supreme Court of Victoria held it was erroneous to construe, as part of the exemption for providing services to the public generally, an additional criterion that a taxpayer carry on a genuinely independent business. As was said powerfully at [54]:

> *"**Thus the Delegate imported, apparently through the application of Revenue Ruling PTA021, a criterion that was not required or justified by the statutory text**; as discussed previously in these Reasons. This is not a process whereby, in determining whether or not the Delegate made a legal error of the kind identified in Avon Downs, the statement of reasons is being "construed minutely and finely with an eye keenly attuned to the perception of error", nor "... scrutinised upon over-zealous judicial review by seeking to discern whether some inadequacy may be gleaned from the way in which the reasons are expressed". **The error on the part of the Delegate is, as I have indicated, very clear.**"*
>
> (our bolded and underlined emphasis)

Against these considerations, we are surprised that *CPN 016 Commissioner's Practice Note: Payroll Tax Act – Relevant Contracts - Australian Financial Services Licences and Australian Credit Licences* appears to articulate limitations with respect to what type of work qualifies for this exemption.

We recommend any existing publications which propound an interpretation of the two or more persons exemption which derogate from its plain and ordinary meaning be reviewed and revised to align with the text of the legislation.

**Employment Agent (EA) provisions**

The EA provisions are rapidly approaching the level of complexity of the Contractor provisions, similarly by virtue of the generality in which the provisions were drafted.

In *UNSW Global Pty Ltd v Chief Commissioner of State Revenue* [2016] NSWSC 1852; 104 ATR 577 (**UNSW**) (upheld in *Chief Commissioner of State Revenue v E Group Security Pty Ltd* [2022] NSWCA 115; 109 NSWLR 123 (**E Group Security Appeal No. 1**), White J held at [63]:

> *The mischief apprehended by the legislature following the first instance decision in Drake Personnel was that the supply of temporary personnel by a labour hire company resulted in the avoidance of payroll tax because it muddied the waters as to whether the individuals concerned might be classified as independent contractors, although they would be serving the same function for the client as its employees.*

Thus, it might be thought apparent from the above passage that the mischief which EA provisions address are labour hire arrangements.

In practice however, the EA provisions have been applied beyond the "traditional" labour hire industry, targeting a broad range of subcontracting activities which fall short of the *Drake Personnel* mischief which the EA provisions were enacted to overcome.

**Issue 7: *Personnel Contracting* and harmonisation (supra)**

It is submitted the uncertainty arising from the implications of the principles in *Personnel Contracting* in particular are not confined to Division 7 of Part 3 of the PTA on contractors.

This is because Division 8 of Part 3 of the PTA is directed towards employment agent contracts and at its core the authority in *Personnel Contracting* are principles concerning contractual interpretation.

It may also be surprising to know the above High Court authorities, of such magnitude in the sphere of employment law and independent contracting, are not considered whatsoever in *CPN 005v2 Commissioner's practice note: Employment Agency Contracts Guidelines*.

**Issue 8: identifying the proper and intended scope of the EA provisions**

For the present purposes of advocacy in favour of national harmonisation of employment and independent contracting adjacent legislation (such as the PTA), we pause here to make an observation regarding Parliament's intention in enacting the EA provisions.

The Legislative Council's Media Release dated 16 December 2024 for the instant Parliamentary inquiry states in its second paragraph:

> *The employment agent provisions relate to arrangements in which a third-party employment agent obtains a worker to provide services to a client for a fee, **where the worker remains an employee of the agent**.*
>
> (our bolded and underlined emphasis)

Conformably with the passage cited from *UNSW Global* (supra), it appears Portfolio Committee 1 - Premier and Finance is also under the belief that the EA provisions are directed towards the imposition of payroll tax on labour hire companies (where the on-supplied workers remain the employee of the agent, being the mischief identified at first instance in *Drake Personnel*).

However, the Courts and the Chief Commissioner of State Revenue have not construed and applied the EA provisions in such a limited manner; rather, in practice, the provisions have been held to apply to what may be described as "chain of hire" subcontracting arrangements i.e. where there is a head contractor, who may engage one or more subcontractors, who in turn may also engage one or more subcontractors and so on.

Given the significant disparity between the two approaches to the interpretation of the EA provisions (i.e. targeting traditional labour hire arrangements vs targeting all chain of hire subcontracting arrangements), we believe this is a critical issue which is best clarified by Parliament to promote public confidence in the administration of taxation laws.

**Issue 9: the EA provisions may inadvertently impose State taxation on goods and income**

Given our earlier observations regarding the contractor deductions for goods or materials supplied by a contractor in performing a service, it may be surprising that there is no mechanism in the EA provisions to address the equivalent issue found in section 35(2) of the PTA for the Contractor provisions.

That is to say, by targeting the **gross** contractor payments, the EA provisions are effectively capturing and imposing taxation on the value of any ancillary goods and materials supplied under a contract for service. By doing so, we believe that contracts for service involving ancillary supply of materials and/or goods are being excessively brought to taxation in NSW contrary to section 51(ii) of the Australian Constitution.

The remedy for this issue would be to adopt an actual material deduction or a "shortcut" method (as suggested regarding existing section 35(2) of the PTA and the companion revenue ruling).

Another difficult aspect of the EA provisions to completely overhaul arises from the manner in which deemed taxable wages are calculated and assessed.

In "chain of hire" subcontracting arrangements, there is what is colloquially referred to as a "head contract" (the contract for service immediately between the client and the contractor) and potentially multiple layers of subcontractors in the chain of hire. The CCSR's revenue rulings and Commissioner's Practice Notes about this matter, commonly refer to the "head-contract" entity as the "agency closest to the end-user client", terminology that is foreign to the PTA.

The commercial reality is that frequently head contractors will have the reputation or market capitalisation, equipment, proprietary knowledge or skills to fulfil a head contract and in turn subcontract their obligations to other contractors. In doing so, the contract fee paid or payable by a client to a head contractor is in effect represented by the "cost base" (its subcontracting fees) and the difference being the profit margin retained by the head contractor, and so on along each link in a chain of hire arrangement.

In our submission, by bringing the gross sum of contractor payments of an "employment agent" (as so defined in the PTA), both the "cost base" and the profit margin is taxed in NSW. By subjecting the profit margin to payroll tax, we apprehend NSW (and other States/Territories with equivalent or similar EA provisions) have effectively imposed income tax on such amounts assessed pursuant to the EA provisions.

Further, we believe the Court and Tribunal may have, albeit inadvertently, in affirming assessments under the EA provisions for contracts involving supply of materials and/or goods and which implicitly involve the taxation of the profit margin in a chain of hire arrangement, have not had regard to section 31 of the *Interpretation Act 1987* (NSW).

We anticipate Parliament did not intend to enact the EA provisions to impose taxation on profit margins. One possible solution to address the unconstitutional element of the EA provisions may be for the Chief Commissioner of State Revenue to engage in extensive commercial in confidence industry

and profession consultations to identify what may be a reasonable benchmark percentage by which, in a manner analogous to the s 35(2) contractor deductions mechanism, the deemed taxable wages are reduced to eliminate the incidence of State taxation on the profit margin.

In this regard, a shortcut method may be the least administratively burdensome approach to addressing the elimination of what we believe amounts to taxation of the profit margin.

Unfortunately, an "actual profit margin" adjustment mechanism is likely to impose an onerous record keeping and compliance burden on taxpayers particularly when the inadvertent incidence of an unconstitutional tax should be a matter best addressed by Parliament in devising taxation provisions which were principally directed at overcoming the decision of *Drake Personnel* at first instance in the context of traditional labour hire firms.

In the interim, until the inadvertent incidence of taxation on materials/goods and/or profit margins is ameliorated, given there is, in our experience, a practice of the Chief Commissioner of State Revenue to impose substantial penalties when raising EA provision assessments or reassessments, we believe it may be just and equitable for Parliament to impose a moratorium on enforcement of the EA provisions pending further consultations and enactment of legislative reform to address the shortfalls inherent in the provisions as presently in force.

**Issue 10: the hypothetical "employer" client may not be grounded in commercial and economic reality**

As presently propounded in *UNSW Global*, the EA provisions seek to impose taxation on the on-supply of workers who are an additional workforce of a client.

Inherent in this approach is an assumption or identification of the hypothetical client which is ready willing and able to have incorporated the additional workforce as common law employees, and an assumption the hypothetical client also had the necessary equipment and materials to fulfil what was effectively outsourced by way of a contract for service.

It could not reasonably be assumed in all cases that a client *could* employ such workforce because under particular contracts for service often entail requirements for contractors to supply their own equipment and materials, to give valuable contractual indemnities in favour of clients, licensing and other insurance requirements etc. Such matters are not a feature of common law employment but rather the ordinary features of an arms-length contract for service.

In contrast, common law employees are not generally expected to supply their own equipment or materials, nor are they required to expressly indemnify their employer or obtain independent insurance (rather, the rules of vicarious liability are in place).

We are unable to formulate a pragmatic solution to provisions requiring the postulation of what a hypothetical client might do when it has instead negotiated a contract for service bearing elements which militate against any resemblance of a hypothetical employment scenario.

Given there are many other fundamental and structural problems with the EA provisions (supra), we believe this issue is another cogent basis upon which a moratorium on the enforcement of the EA provisions should enter effect so that all material considerations may be reconsidered and addressed.

**Issue 11: economic double taxation**

The EA provisions may create unintentional incidences of economic double taxation by NSW in circumstances where taxation is assessed in chain of hire arrangements firstly on the putative employment agent and subsequently on a subcontractor further down the chain of hire who is liable to payroll tax on the same worker(s) ultimately supplied to a client.

As presently drafted, section 41 & 42 of the PTA do not provide relief from double taxation in such cases; rather, it only seeks to eliminate double taxation if another person within the same chain of hire has already been subject to taxation under the EA provisions.

In our experience, the CCSR has, in such instances, exercised a discretion by way of administrative fiat not to impose taxation under the EA provisions. This should not be a matter of discretion; there is no proper or rational basis for imposition of economic double taxation on the labour of workers within a chain of hire arrangement. Strong consideration should be given to legislative reform to address harsh and oppressive outcomes involving economic double taxation under the EA provisions.

**Issue 12: ad hoc services and the need for consistency in the administration of taxation law**

A recent case decided in the NSW Civil & Administrative Tribunal, *XL Retail Services Pty Ltd v Chief Commissioner of State Revenue* [2025] NSWCATAD 22 provides a relevant example where, at [16], the Tribunal noted:

> *The Respondent accepted that the ad hoc services were not liable to payroll tax.*

There is force in this approach – ad hoc services are not targeted under the Contractor provisions (as one may expect it falls within the rubric of services to the public generally) and nor should they be brought to taxation under the EA provisions (because a contractor who supplies ad hoc services cannot be said to be additional to the workforce of the client). However, in our experience, this approach has not been consistently applied by the CCSR.

A simple remedy to avoid harsh or capricious application of taxation law on this issue would be to update the revenue rulings and Commissioner's Practice Notes to provide practical guidance to both the public and Revenue NSW officers tasked with the administration of payroll tax legislation promoting both fair and consistent application.

**Issue 13: practical application of exemptions and the need for consistency in the administration of taxation law**

In taxation matters, whether State/Territory or Federal, objection and reviews are conducted on the reverse onus position where the taxpayer bears the onus of proving an assessment excessive.

Often, the Chief Commissioner may not have "perfect" information or knowledge when issuing an assessment, thereby resulting in what is ultimately an assessment ***based on estimates***. The abovementioned recent decision in NCAT (refer issue 11) is an example of such an approach.

In our experience, both audit officers and review officers have increasingly taken inflexible and adversarial approaches to their work, not realising the real objective is to arrive at the correct and preferred result of an assessment which is fairly premised on the taxable facts under consideration.

In one particularly egregious objection, a client's accountant had, by clerical error, calculated the proportion of subcontractor payments derived from not-for-profit clients. Once that error was identified, it was notified to the Chief Commissioner's officers together with supporting information to substantiate and demonstrate the mathematical error. Despite this, the assessments were issued at audit on the incorrect calculation and were upheld on objection by a review officer. Surely such an arbitrary result is not what Parliament intended in the administration of taxation laws; the focus should be the collection of the ***correct*** amount of taxation and not the ***maximum*** amount of taxation. The admonition of Gleeson CJ in *Carr v Western Australia* [2007] HCA 47; (2007) 232 CLR 138 (at [6]) is apt:

> *"... [I]t may be said that the underlying purpose of an Income Tax Assessment Act is to raise revenue for government. No one would seriously suggest that s 15AA of the Acts Interpretation Act has the result that all federal income tax legislation is to be construed so as to advance that purpose.* ***Interpretation of income tax legislation commonly raises questions as to how far the legislation goes in pursuit of the purpose of raising revenue. In some cases, there may be found in the text, or in relevant extrinsic materials, an indication of a more specific purpose which helps to answer the question.*** *In other cases, there may be no available indication of a more specific purpose. Ultimately, it is the text, construed according to such principles of interpretation as provide rational assistance in the circumstances of the particular case, that is controlling."*
>
> (bolded and underlined emphasis)

The first problem with such an inflexible and adversarial approach is that it runs contrary to the Parliamentary intention of enacting a not-for-profit exemption for payroll tax purposes. It arrives at the wrong decision which involves imposing indirect taxation on the not-for-profit sector.

Secondly, when the not-for-profit exemption is examined in closer detail, it may be observed there are strict procedural and "prescribed form" requirements which, if the not-for-profit sector is not in full compliance with, operates to deny availability of the exemption to suppliers to the not-for-profit sector.

Thus, returning to the particular case study outlined above – taxpayers may be assessed unfairly on contracts with not-for-profit entities on account of the strictness of the relevant exemption and unfair practices in disallowing exclusions from taxation which runs contrary to the public policy of promoting the not-for-profit sector by not imposing taxation on it. It is observed whether or not a not-for-profit entity is registered for the payroll tax exemption is beyond a subcontractor's control and as such it

should not form the basis for the imposition of taxation on the delivery of their services to the not-for-profit sector.

Similar to issue 12, the harshness and unfairness in the inflexible application of the not-for-profit exemption to EA provision assessments is readily capable of alleviation by updating revenue rulings, Commissioner's Practice Notes and perhaps through continuing professional development programs within Revenue NSW to ensure consistency and fairness in the administration of taxation laws in NSW.

**Conclusion**

The Parliamentary Inquiry into the Contractor and EA provisions is a timely opportunity to examine the operation of the payroll tax legislation in the wake of the threat to the revenue base which the decision of *Drake Personnel* at first instance aimed to combat.

It is acknowledged that it is Parliament's prerogative to impose taxation on employment and employment-like arrangements; however, it is also Parliament's duty to ensure such taxation laws are not unconstitutional, are reasonably clear in interpretation and practical application to promote public confidence.

What our examination of the payroll tax legislation reveals is the existence of two complex payroll tax regimes which are difficult to apply in practice, whether by taxpayers and their advisors or the Chief Commissioner.

With such a high degree of uncertainty in the administration of taxation law, unfair or harsh outcomes are often further magnified with the imposition of administrative penalties.

Unless and until these provisions are amended and/or clarified, it is submitted there should be a moratorium on the imposition of penalties except in anti-avoidance / contrived or artificial arrangements. If this approach is taken, then further care should be exercised in ensuring heed is taken to the remarks of Steward J in *Personnel Contracting* as the vast majority of taxpayers should not be characterised as participating in anti-avoidance activities.

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