Submission No 33

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

Organisation: Brown Wright Stein Lawyers

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Our ref: **MXD/MPM**

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The Director, Portfolio Committee no. 1
Premier and Finance,
Parliament House, Macquarie Street,
Sydney NSW 2000.

By email: **portfoliocommittee1@parliament.nsw.gov.au**

Dear Director

Inquiry into the application of the contractor and employment agent provisions in the Payroll Tax Act 2007 (Inquiry)
Submission

1. We refer to your invitation for submissions to the Inquiry being conducted by the NSW Legislative Council's Portfolio Committee No. 1 (**Committee**).

2. We thank you for the opportunity to make submissions for the Inquiry.

INTRODUCTION

3. We confirm that we have approached these submissions consistent with the Terms of Reference dated 27 November 2024.

4. In that respect our submissions do not address broad policy considerations concerning payroll tax. Our submissions start from the assumption that payroll tax remains an appropriate tax for the New South Wales government to impose.

5. Instead, our submissions focus on the design and application of the contractor and employment agent provisions.

6. We address this issue from the perspective of a law firm that:

   (a) advises employers (primarily small to medium businesses) in New South Wales on the application of the *Payroll Tax Act 1997* (NSW) (**PTA**) and its administration by Revenue NSW; and

   (b) acts on behalf of employers (primarily small to medium businesses) in payroll tax investigations by Revenue NSW and administrative review proceedings commenced in the New South Civil and Administrative Tribunal and the Supreme Court of New South Wales.

7. We consider that it is important when assessing the design and application of the contractor and employment agent provisions to identify the objective of the PTA.

8. Perhaps inelegantly, we consider this to be the raising of revenue to enable the New South Wales to government to fund essential services from the community through the imposition of a tax on wages paid to employees or persons in a relationship with the

payor that is akin to employment. Having regard to this objective is important and the legislative provisions should be consistent with this objective. Payroll tax is a tax on wages, or payments that are akin to wages, and is not simply a tax on payments made by businesses in their commercial operations.

9. Consistent with our comments in paragraph [4] above, it is appropriate that our submissions address the Terms of reference by accepting the validity of the objective set out in the preceding paragraph. It is also appropriate that our submissions accept the validity of the payroll tax laws extending beyond employment relationships to include arrangements that seek to disguise an employer-employee relationship by contractual arrangements or through the interposition of agents. The question is whether the contractors and employment agent provisions are, in their current form, properly and appropriately adapted to achieve this.

10. We have approached these submissions on the basis that the key criterions in assessing the current legislative provisions are simplicity and efficiency. In this respect, we note as follows:

    (a) simplicity is the notion that a tax system, whilst inevitably complex, should strive to avoid complexity. Greater simplicity reduces compliances for taxpayers and the tax system generally. Further, greater complexity will nearly always lead to greater non-compliance; and

    (b) efficiency is the notion that a tax system should not operate in a way that causes undue interference with the market. Taxes should aim to allow 'the decisions of individuals to remain as they would in the absence of the tax'[1]; that is taxes should aim to be neutral.

11. Payroll tax is a practical business tax that requires employers to lodge on a monthly basis with penalty tax of between 25% to 75% imposed for the underreporting of wages ***or*** for late payment.[2] In this respect, the complexity of the laws creates additional concerns for the costs of compliance as compared with a tax that is reported on an annual basis, such as income tax or land tax or a tax that is imposed on particular transactions, usually extraordinary, such as duty. This burden is particularly high for small and medium sized businesses.

12. The impact of complexity in payroll tax is magnified by the fact that there is considerable doubt that non-legal professionals can advise on payroll tax and other NSW State taxes by operation of section 10 of the *Legal Profession Uniform Law* (NSW). This legal uncertainty has a wider impact. Unlike Commonwealth taxes, there is very limited education on payroll tax. To our understanding, payroll tax is not currently part of the compulsory education requirements for Chartered Accountants or CPA Australia. That many accountants lack specialist knowledge in payroll tax is not well known by business owners who simply expect that accountants are qualified to manage any matter concerning a taxation obligation.

13. We note that the Terms of Reference extend beyond the design and operation of the contractor and employment agent provisions to the practices adopted by Revenue NSW to those provisions as evinced by relevant rulings and practice notes. Our submissions do not make extensive comment on the practices of Revenue NSW, other

[1] J Waincymer, *Australian Income Tax: Principles and Policy* (2nd ed.) 27.

[2] That penalty tax may be imposed for *late* payment and not merely interest charges is worth noting as it may result in a penalty for between 25% to 75% of the tax for payment that is late by days or weeks. It is then up to the exercise of the discretion of the Chief Commissioner to remit. In our experience, it is not unusual for the Chief Commissioner to not exercise the discretion to remit in such circumstances resulting in a penalty that is often disproportionate to the culpability of the employer.

than to extent that the practices demonstrate design failings or uncertainties in the contractor or employment agent provisions. We consider that it is a matter for Revenue NSW to determine what practices to adopt and whether a practice in administering the the PTA correctly applies the relevant provisions is best addressed through administrative review of the particular decision. However, it is fair to observe that the approach of Revenue NSW to the contractor and employment agency provisions has evolved over the years, as the understanding of the provisions has developed due to judicial consideration, and there is a question of whether the expectations for the compliances standard for small businesses has been too high given that the owners of such business have not been, and could not expect to be, aware of these the changes in practices. This is particularly the case with respect to the decisions made by Revenue NSW on imposition of penalty tax and interest.

14. We have avoided making submissions about aspects of the PTA that, while potentially having an adverse impact in the context of the contractor and employment agency provisions, are not limited to the contractor and employment agent arrangements. For example, that the grouping provisions, in effect, treat members of a payroll tax group as a single entity for threshold and liability purposes, but do not provide for intra group payments to be ignored as taxable wages, is particularly onerous in a contractor or employment agent provisions context. However, we consider that this is a broader issue for the PTA and not one limited to the contractor and employment agency provisions, albeit it is an area worthy of further consideration by Parliament.

EXECUTIVE SUMMARY

15. A summary of our submissions is as follows:

    (a) the contractor employment agent provisions were introduced to address arrangements where parties disguised what was in substance an employee-employer relationship through contractual arrangements and, thereby, avoiding payroll tax on the payments made for the labour of the worker;

    (b) the provisions, as currently interpreted and applied by the courts, extend well beyond the purpose for which they were introduced and now capture commercial arrangements that are not in substance an employer-employee relationship or akin to an employer-employee relationship;

    (c) the provisions are extremely complex, due to a combination of the following:

        (i) the provisions contain imprecise terms that require difficult evaluative judgment to be made by businesses;

        (ii) the provisions are, in many instances, counter-intuitive, particularly for small business owners, having regard to the labels used and what those terms commonly mean;

    (d) the provisions result in artificial outcomes, where a payment is treated as taxable wages merely due to structuring choices made by business owners for legitimate commercial purposes. This has the undesirable outcome of requiring business owners to make a choice between foregoing ordinary commercial protections or benefits or face a tax risk;

    (e) the provisions result in inconsistent outcomes such that there may be a greater level of taxable wages, for example, under a contractor arrangement than there would be if there was an employment relationship. Further, the contractor provisions contain certain exclusions and reductions that the employment agent contract provisions do not. There is no policy justification for these differences.

16. We make the following recommendations for the Committee's consideration:

(a) that consideration be given to amending section 32(2)(iv) of the PTA so that it better ensures that bona fide independent contractor arrangements are excluded from being relevant contracts and to provide greater certainty as to when the exclusions apply;

(b) that consideration be given to how the contractor provisions could be modified to ensure that they do not create a bias for businesses to engage larger business to provide services;

(c) that consideration be given to providing legislative clarification as to the interaction between section 35 and section 46 of the PTA to arrangements where the payments are made to a deemed employee by a person who is genuinely a client of the deemed employee and not by the deemed employer;

(d) that consideration be given to amending section 35(2) of the PTA to ensure that the PTA operates in an equivalent economic manner for contractor arrangements as it does for employment relationships;

(e) that consideration be given to amending the employment agent provisions to ensure that they more appropriately align with the original intent and do not capture genuine commercial arrangements that do not involve the interposition of an agent to disguise an employee/employer relationship;

(f) that consideration be given to amending the employment agent provisions to ensure that the kind of control exercised or capable of being exercised by the client of a putative employment agent that causes the arrangement to be an employment agency contract is the kind of control over the person performing the work that would ordinarily be present if the client was the employer of the person performing the work;

(g) that consideration be given introducing exclusions to the employment agent provisions that are equivalent to the exclusions to the contractor provisions found in section 32(2) of the PTA;

(h) consideration be given to "turning off" the employment agent provisions between entities that are members of the same payroll tax group;

(i) that consideration be given to amending section 40 of the PTA to provide an equivalent reduction for non-labour as that provided by section 35 of the PTA for relevant contracts; and

(j) that consideration be given to amending section 41 of the PTA to provide certainty as to who payroll tax is imposed on under a chain on hire arrangement.

RELEVANT CONTRACT PROVISIONS

History of the relevant contract provisions

17. The contractor provisions are contained in Division 7 of Part 3 of the PTA.

18. It is acknowledged that the contractor provisions are intended to apply to circumstances where payments for services are not ordinary wages. The very intent of the provisions was to bring into the payroll tax net labour arrangements that severed the employee-employer relationship. We do not question or criticise that intent.

19. In the Second Reading speech for the introduction of the Bill that was to become the *Pay-Roll Tax (Amendment) Act 1985* (NSW), the then Minister for Employment and Minister for Finance stated as follows:

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

20. It is clear that relevant contractor provisions were designed to ensure that payments made under artificial arrangements entered into in order to sever an employee-employer relationship or to prevent one from arising are still subject to payroll tax. It is also clear that contractor provisions were not intended to capture payments made to bona fide independent contractors.

21. Whilst it must be accepted that the contractor provisions were intended to extend beyond payments that are ordinary wages, as acknowledged in paragraph [18] above, it must also be accepted that the provisions were intended to capture labour arrangements that are, for all intents and purposes, employment relationships. This is consistent with the objective set out in paragraph [8] of this letter.

The operation of the contractor provisions

22. The contractor provisions operate where there is a 'relevant contract' as defined in section 32 of the PTA. That definition contains a positive limb and negative exclusory limb.

23. The positive limb is as follows:

> ***Section 32***
>
> *(1) In this Division, a* ***relevant contract*** *in relation to a financial year is a contract under which a person (the* ***designated person*** *) during that financial year, in the course of a business carried on by the designated person—*
>
> *(a) supplies to another person services for or in relation to the performance of work; or*
>
> *(b) has* ***supplied to the designated person*** *the services of persons* ***for or in relation to the performance of work****; or*
>
> *(c) gives out goods to natural persons for work to be performed by those persons in respect of those goods and for re-supply of the goods to the designated person or, where the designated person is a member of a group, to another member of that group.*

24. In most cases, it is sub-section (b) that brings an arrangement into the PTA.

25. The exclusory limb then seeks to exclude certain arrangements that, using the wording in the Minister's Second Reading speech, equate to the service provider being a 'bona fide independent contractor'. The exclusory limb includes the following:

    (a) the services are of kind that the recipient does not ordinarily require and are provided by a person who ordinarily provides such services to the public generally;[3]

    (b) a contract for services of a kind ordinarily required by the service recipient for less than 180 days in a financial year (**180 Day Test**);[4]

    (c) a contract for services by a person providing the same or similar services to the service recipient under the contract for no more than 90 days in a financial year;[5]

    (d) a contract for which the Chief Commissioner is satisfied that the services are performed by a person who provides services of that kind to the public generally.[6] This final exclusion only applies if the exclusions in (a) to (c) do not apply. Absurdly, this has led to one case being decided on the basis that the taxpayer had not satisfied its onus in respect of this exclusion as it had not established that none of the exclusions in (a) to (c) applies, despite the fact that if, one of those exclusions had applied, the contract would not have been a relevant contract; and[7]

    (e) a contract under which 2 or more persons perform the work in a business carried on by the service provider.[8]

26. The application of the contractor provisions has been widened beyond the original intent, as evinced by the Minister's Second Reading speech, by a broad construction of the positive limb and a number of factors that have narrowed the availability of the exclusory limb. This is demonstrated by a recent case before the Queensland Civil and Administrative Tribunal, which considered the equivalent provisions in the *Payroll Tax Act 1971* (Qld), where the Queensland Commissioner of State Revenue accepted that the contractors in issue were independent contractors carrying on their own businesses but still considered that the payments to those contractors were taxable wages.[9] This approach by the Queensland Commissioner is entirely orthodox given the current understanding of the scope of the contractor provisions.

Broad construction of the positive limb

27. The positive limb is enlivened, in relation to sub-section 32(1)(b) of the PTA, where a person who is carrying on a business has services provided to them by another person, whether or not a natural person, for or in relation to the performance of work. That is, it merely requires that there be a services arrangement that involves the performance of work. The positive limb extends to virtually any arrangement for the provision of services.

28. The breadth of the positive limb has been remarked upon in a number of recent cases, including the case of *Thomas and Naaz Pty Ltd v Chief Commissioner of State Revenue* [2023] NSWCA 40 (**Thomas and Naaz**), in which medical practitioners were

[3] *Payroll Tax Act 2007* (NSW), s 32(2)(b)(i).
[4] *Payroll Tax Act 2007* (NSW), s 32(2)(b)(ii).
[5] *Payroll Tax Act 2007* (NSW), s 32(2)(b)(iii).
[6] *Payroll Tax Act 2007* (NSW), s 32(2)(b)(iv).
[7] *Thomas and Naaz Pty Ltd v Chief Commissioner of State Revenue* [2021] NSWCATAD 259 at [54].
[8] *Payroll Tax Act 2007* (NSW), s 32(2)(c).
[9] *Roofing Services Queensland Pty Ltd ATF Roofing Services Qld Trust v The Commissioner of State Revenue t/as Office of State Revenue* [2025] QCAT 604

held, when providing medical services to patients, to also be supplying services to the operator of the medical centre from which such services were provided. The key reasons for this finding were as follows:

(a) the operator was running a business at which people would attend its centres to receive medical treatment and required the medical practitioner's attendance at its centres for this purpose;[10]

(b) the centre operator shared in the patient billings of the medical practitioner, which were only obtained through the medical practitioner's attendance at the centre;[11]

(c) the medical practitioner's contractual obligations to the operator were valuable rights that would also enure for the benefit of a purchaser of the centre operator's business;[12] and

(d) those valuable contractual promises, which were ancillary to the services being provided to patients, such as attending the medical centres, maintaining records and adhering to certain protocols, involved the provision of services.[13]

29. Importantly, the Court of Appeal made it clear in *Thomas and Naaz* that this conclusion was not predicated on the patients who attended the medical centre being patients of the operator. They were not. They were patients of the medical practitioner.[14] It is also not in question that the medical centre operator had no right to direct the practitioners in the performance of the medical services to patients. That is, the conclusion of the Court of Appeal was not affected by whether or not the medical practitioners have complete independence in the manner which the medical services were performed.

30. There are a number of ordinary commercial arrangements that would fall within such a broad construction of the positive limb, including the following:

(a) a tenant could be regarded as providing services to a landlord. This is particularly the case if the arrangement involves rent calculated based on turnover which is not uncommon with retail shops; and

(b) a barrister could be regarded as providing services to the chambers from which the barrister operates.

31. It is then left to the exclusory limb to prevent the arrangement being a relevant contract.

Problems with exclusory limb

32. The exclusory limb does not adequately or appropriately exclude all bona fide independent contractor relationships from being a relevant contract for a number of reasons as follows:

(a) the operation of the exclusory limb does not appropriately accommodate a bona fide independent contractor in professional roles where the work will nearly always only be performed by 1 person, either because of regulatory requirements or custom and practice;

[10] T*homas and Naaz Pty Ltd v Chief Commissioner of State Revenue* [2023] NSWCA 40 at [42] to [43].
[11] Ibid at [43].
[12] Ibid at [44].
[13] Ibid at [45].
[14] Ibid at [46].

(b) the availability of the exclusory limb requires satisfactory evidence to establish that the conditions for a particular exclusion are satisfied. In many, if not most cases, this will require the business to obtain evidence that it does not have and could not be expected to have, such as whether or not a contractor is providing services to others and to what extent. This is compounded by the fact that such evidence is often not required until many years after the services have been provided by the contractor when an investigation is commenced by Revenue NSW. In our experience, this results in many arrangements a being treated as not been excluded by the contractor provisions due to lack of evidence, despite it being clear as a matter of common sense that one or more of the exclusions apply;

(c) there is considerable ambiguity and uncertainty as to the application of the exclusory limbs. For example, if a business engages a strategic human resources advisor (**HR**) to provide it with strategic HR advice, will that be treated as services of a kind that the business already requires, on the basis that it requires general HR services for all of the year, or is it a service that is not of a kind. This is relevant to the 180 Day Test and working our whether the days worked by the strategic HR advisor need to be aggregated with the days worked in the business by any person providing general HR services;[15]

(d) the narrowness of the exclusory limb results in arrangements being deemed to be one of employer and employee for the purpose of the PTA despite such arrangement not being employer-employee in any other regulatory context. This leads to confusion for small businesses that must grapple with a multitude of definitions of employer and employee across various regulatory landscapes. Unsurprisingly, the understanding of a small business as to who is an 'employee' for payroll tax is often affected by the understanding of that term in a different regulatory context.

33. The limits to the exclusory limb can be demonstrated by the fact that it is difficult to see how a contract between a barrister and the chambers entity for the chambers in which the barrister operates would fall within any of the exclusions.

34. A qualification to the above is the operation of the exclusion in section 32(2)(b)(iv) of the PTA, which could potentially be construed to ensure that the relevant contract provisions operate as originally intended in some circumstances. Section 32(2)(b)(iv) provides as follows:

> *(iv) those services are supplied under a contract to which subparagraphs (i)-(iii) do not apply and the Chief Commissioner is satisfied that those services are performed by a person who ordinarily performs services of that kind to the public generally in that financial year, or*

35. The question is whether, in the context of the medical practitioner and barrister arrangements noted above, the mere fact that the medical practitioner, as an example, is in the business of supplying medical services to patients generally, irrespective of whether the business is limited to providing those services from particular premises, means that the exclusion is satisfied. There is judicial support for the exclusion potentially applying in such circumstances, although it would still have considerable limitations.[16]

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[15] This is based on an actual case for which our firm was involved in which the Chief Commissioner of State Revenue concluded that the services were "of a kind" such that the days needed to be aggregated.

[16] *Loan Market Group Pty Ltd v Chief Commissioner of State Revenue* [2024] NSWSC 390.

36. Appropriate amendments to the exclusion in section 32(2)(iv) of the PTA would ensure that the contractor provisions are better suited to achieve the ends sought and do not capture bona fide independent contractor arrangements.

> **Recommendation 1:**
>
> We recommend that consideration be given to amending section 32(2)(iv) of the PTA so that it better ensures that bona fide independent contractor arrangements are excluded from being relevant contracts and to provide greater certainty as to when the exclusions apply.

37. The design of the contractor provisions, and particularly the exclusory limb, inevitably results in a bias for businesses to engage larger businesses for which it will more easily be able to prove that one of the exclusions in the exclusory limb applies. We query whether such an outcome is desired from a policy perspective.

> **Recommendation 2:**
>
> We recommend that consideration be given to how the contractor provisions could be modified to ensure that they do not create a bias for businesses to engage larger business to provide services.

Taxable wages under the contractor provisions

38. Section 35 of the PTA is the provision that operates to include an amount paid under a relevant contract as taxable wages. It relevantly provides 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.*
>
> *(2) If an amount referred to in subsection (1) is included in a larger amount paid or payable by an employer under a relevant contract during a financial year, that part of the larger amount which is not attributable to the performance of work relating to the relevant contract or the re-supply of goods by an employee under the relevant contract is as determined by the Chief Commissioner.*

39. The concept of a payment for or in relation to the performance of work has been given a broad construction,[17] albeit with some recent judicial reservation at a non-appellate level.[18]

40. The requirements of section 35 of the PTA have led to judicial observations in the *Thomas and Naaz* case that the potentially draconian operation of the relevant contract provisions can simply be overcome by the means of money flow.[19] For example, in medical practice arrangements, instead of patients paying fees into an account managed by the centre operator, the fees would be paid directly into the medical practitioner's account and the medical practitioner would then pay a fee back to the centre operator for its services.

41. There are two concerns with this possible "way out" of the contractor provisions as follows:

[17] *Commissioner of State Revenue v The Optical Superstore Pty Ltd* [2019] VSCA 19.
[18] *Uber Australia Pty Ltd v Chief Commissioner of State Revenue* [2024] NSWSC 1124.
[19] *Thomas and Naaz Pty Ltd v Chief Commissioner of State Revenue* [2023] NSWCA 40 at [67].

(a) Revenue NSW has not provided any public endorsement of the view that, if the practitioners collect the fees directly from patients, section 35 of the PTA does not operate to treat any amount as taxable wages, and during matters which our firm has been involved, has expressed the view that section 46 of the PTA would apply to still capture the fees retained by the practitioner. Importantly, section 46 of the PTA does not appear to have been considered by the Court of Appeal in *Thomas and Naaz*; and

(b) it results in an artificial distinction as to when the provisions apply and potentially results in commercial arrangements being altered for tax reasons, despite there being genuine commercial reasons for the parties to those arrangements having ordered their affairs they way that they had.

Recommendation 3:

We recommend that consideration be given to providing legislative clarification as to the interaction between section 35 and section 46 of the PTA to arrangements where the payments are made to a deemed employee by a person who is genuinely a client of the deemed employee and not by the deemed employer.

42. Section 35(2) of the PTA does provide a reduction or apportionment for an amount paid under a relevant contract where that amount is not attributable to the performance of work. The operation and ambit of this provision can be somewhat unclear and difficult to apply in practice.[20]

43. For example, it is unclear whether section 35(2) of the PTA would provide for a deduction of costs incurred by the service provider that are necessary for the performance of work and that would ordinarily be paid by an employer, such as license of professional association fees, and which would not be included in 'taxable wages' of the employer as they are exempt a fringe benefit . If such costs are not deducted, this results in a different economic outcome for employment relationships to arrangements captured by the relevant contract arrangements.

Recommendation 4:

We recommend that consideration be given to amending section 35(2) of the PTA to ensure that the PTA operates in an equivalent economic manner for contractor arrangements as it does for employment relationships. Specifically, the PTA could allow for a reduction in taxable wages for costs incurred by the contractor that are customarily paid by an employer on behalf of employees in the relevant industry.

EMPLOYMENT AGENCY PROVISIONS

History of the employment agency provisions

44. The employment agency provisions are contained in Division 8 of Part 3 of the PTA.

45. In *UNSW Global Pty Ltd v Chief Commissioner of State Revenue* [2016] NSWSC 1852 (**UNSW Global**) at [32] to [42] White J set out the legislative history of the employment agent provisions.

46. The first predecessor to the employment agency provisions was introduced by the *Payroll Tax (Amendment) Act 1985* (NSW) (**1985 Amendment Act**). The 1985 Amendment Act amended the definition of 'wages' in section 3 of the *Pay-roll Tax Act*

[20] See *Smith's Snackfood Company Ltd v Chief Commissioner of State Revenue* (NSW) [2013] NSWCA 470 and *Bridges Financial Services Pty Ltd v Chief Commissioner of State Revenue* [2005] NSWSC 788 as compared with *Brisbane Bears – Fitzroy Football Club Ltd v Commissioner of State Revenue* [2017] QCA 223.

1971 (NSW) (**1971 Act**) to include "any amount paid or payable by way of remuneration by an employment agent…"

47. An employment agent was defined in subsection 3(4) of the 1971 Act as follows:

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

48. The Minister for Employment and Minister for Finance stated as follows in introducing the provisions regarding employment agents in the 1985 Amendment Act:[21]

> *A second are of avoidance that is dealt with by this bill is the use of employment agents. Such agents are being used increasingly by employers, particularly in the recruitment of professional people and also for temporary staff. In some cases it has been claimed, by virtue of the arrangements entered into, that the person whose services are provided is employed by neither the contract agent nor the client. The arrangements entered into have sometimes also involved the use of trusts, partnerships or companies. The legislation will confirm that payments by an employment agent made in respect of the provision of services to a client of the agent are liable for payroll tax.*

49. The *Payroll Tax (Amendment) Act 1987* further amended 1971 Act with the effect that the payroll tax liability under the employment agent provisions was shifted from the employment agent to the client.

50. In 1998, the Victorian Supreme Court handed down its decision in *Drake Personnel Limited v Commissioner of State Revenue* (1998) 40 ATR 304 (**Drake Personnel**). *Drake Personnel* involved an arrangement where the principal (i.e. Drake) engaged nurses to perform work for its clients on a temporary basis. The Supreme Court held that the nurses were not employees of Drake and that the nurses would fall within the exclusions under the relevant contract provisions.[22]

51. In response to *Drake Personnel*, the 1971 Act was amended in New South Wales to introduce section 3C in the 1971 Act which is the predecessor to the current employment agent provisions in the PTA. The Second Reading Speech on the introduction of section 3C stated as follows:

> *To secure the traditional tax base and make taxpayers obligations and point of liability absolutely clear, the bill introduces specific provisions relating to payments to workers engaged through employment agents. The agent will now be liable for payroll tax, bringing New South Wales into line with Victoria, Western Australia, South Australia and Queensland. The other jurisdictions do not have specific agency provisions.*

52. In *UNSW Global*, White J at [41] accepted that:

> *…the mischief against which the employment agency contract provisions was directed was the avoidance of payroll tax through the interposition of an agent to give the appearance of a contractor relationship where one did not exist in substance. The mischief to which the provisions were directed was not where the service provider was a genuine independent contractor whose services were provided to a client through an intermediary.*

[21] Extracted from *Freelance Global Ltd v Chief Commissioner of State Revenue* [2014] NSWSC 127 at [146].
[22] *Drake Personnel Limited v Commissioner of State Revenue* (1998) 40 ATR 304 at [43].

53. Importantly, section 3C of the 1971 Act removed the reference to the workers carrying out "duties of a similar nature to those of an employee" which was present in subsection 3(4) of the 1971 Act. In *Chief Commissioner of State Revenue v E Group Security Pty Ltd* [2022] NSWCA 115 (**E Group Appeal**), the Court of Appeal recognised the haste in which section 3C was introduced stating at [25] to [26]:

> *The timing suggests that the bill was drafted hastily. There is nothing explicit in the extrinsic materials to suggest that regard was had to the legislation which had been in force in 1986 and 1987, still less that a conscious decision was made to depart from it. However, it is not unlikely in the scheme of things that some of the instructing officers would have recalled that short-lived measure.*
>
> *But telling against that inference is a different aspect of the legislative history, namely, that the Act can be readily amended in response to the decisions of courts. Indeed, the Act has been amended no fewer than 15 times since UNSW Global was decided. The amendments include amendments to Division 8, although not to the definition in s 37 itself. The provisions of Division 8 broadly speaking have equivalent counterparts in all other Australian jurisdictions save for Western Australia.*

54. In the current employment agent provisions, an employment agency contract is defined in section 37 of the PTA as follows:

> *(1) For the purposes of this Act, an "employment agency contract" is a contract, whether formal or informal and whether express or implied, under which a person (an "employment agent") procures the services of another person (a "service provider") for a client of the employment agent.*
>
> *(2) However, a contract is not an employment agency contract for the purposes of this Act if it is, or results in the creation of, a contract of employment between the service provider and the client.*
>
> *(3) In this section–*
>
> *"contract" includes agreement, arrangement and undertaking.*

55. In *UNSW Global*, White J at [62] confirmed that the definition of 'employment agency contract' directs attention to whether there is a contract (agreement, arrangement or undertaking) under which *"a person procures the services of another person in and for the conduct of the business of the employment agent's client"*. Relevantly, White J stated at [63] that "… the employment agency contract provisions were intended to apply to cases where the employment agent provided individuals who would comprise, or who would be added to, the workforce of the client for the conduct of the client's business."

56. In effect, White J was reviving the interpretation which was, to some extent, in the original definition of employment agent contained in subsection 3(4) of the 1971 Act where the worker was carrying our similar duties as an employee of the client.

57. Following the decision in *UNSW Global* and immediately before i*t*, there have been numerous cases in New South Wales which have considered the application of the employment agent provisions. Without seeking to be exhaustive, a list of these cases is at **Appendix A**. That there has been such a large number of cases on the application of the employment agent provisions over this relatively short period is worthy of note.

58. The case of *Chief Commissioner of State Revenue v E Group Security Pty Ltd* [2021] NSWSC 1190 (**E Group**) related to the arrangements of E Group Security Pty Ltd in providing security services to clients. In *E Group*, Ward CJ set out what was established on the evidence *"of the factors identified as relevant in considering whether the workers are provided "in and for" the client's business"*, as follows at [318]:

> *Those legislative provisions [(which her Honour had earlier extracted)], and [White J's] construction of the relevant terms have been considered in a number of decisions (to which reference has been made already). It is well-recognised that the analysis is a fact sensitive one and much was made of the indicia identified in cases such as* HRC Hotel Services *when determining whether there is the requisite integration of the service providers into the relevant client's workforce. It is not disputed (though the emphasis placed on each varies in the respective parties' submissions) that those indicia include, as the Chief Commissioner has submitted, matters such as the location at which the services are provided by the workers; the regularity with which the workers provide the services to the client; the level of any interaction between the workers and the client's customers on the one hand and the client's employees on the other; the level of any direction or instruction provided by the client to the workers; the workers' access to, and use of, client staff facilities; and the relevance or connection to the client's business of the services provided by the workers to the client. What is not relevant in this context is whether the services performed by the workers are integral or ancillary, as the case may be, to the client's business.*

59. In the *E Group Appeal*, the Chief Commissioner sought to depart from the test propounded in *UNSW Global*.[23] However, the Court of Appeal pointed out that this was inconsistent with the Chief Commissioner's position and the "construction in *UNSW Global* accords with the purpose of the Act".[24]

60. In *Chief Commissioner of State Revenue v E Group Security Pty Ltd (No 2)* [2022] NSWCA 259 (**E Group No 2**), Brereton JA at [7] stated that the focus is on determining whether the arrangements between the putative employment agent and the service providers is an employment agency contract, and it was not the contract between the putative employment agent and the client that was to be examined. Previous cases had not explicitly identified the contract which was to be examined for the purposes of section 37 of the PTA.

61. The case of *Integrated Trolley Management Pty Ltd v Chief Commissioner of State Revenue* [2023] NSWSC 557 (**ITM**) considered the arrangements of Integrated Trolley Management in operating a trolley collection business for supermarkets and, for some supermarkets, providing cleaning services. In *ITM*, Parker J concluded that the arrangement between Integrated Trolley Management, its clients (the supermarkets) and the subcontractors was not an employment agency contract. Justice Parker referred to various indicia that had been developed judicially following *UNSW Global* in reaching this conclusion.

62. However, on appeal in *Chief Commissioner of State Revenue v Integrated Trolley Management Pty Ltd* [2023] NSWCA 302 (**ITM Appeal**), the Court of Appeal rejected the reliance on indicia from previous cases as it "could not replace the statutory test".[25] With the statutory test being "that the individuals who worked for the client should do so in much the same way as would an employee of the client. That meant that the business would involve work having a degree of regularity and continuity, and where the nature of the work was to a significant degree under the control and direction of the client".[26]

63. Following the *ITM Appeal* the current interpretation by the Court of section 37 of the PTA is as follows:

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[23] *Chief Commissioner of State Revenue v E Group Security Pty Ltd* [2022] NSWCA 115 at [44].
[24] Ibid at [46].
[25] *Chief Commissioner of State Revenue v Integrated Trolley Management Pty Ltd* [2023] NSWCA 302 at [2].
[26] Ibid at [86].

(a) in applying the employment agency contract provisions, regard to approaches in prior cases "will rarely be of assistance"[27];

(b) it is the terms of the contract between the putative employment agent and the client that must be considered in determining whether there is a contract under which the putative employment agent has procured the services of a person to work in and for the conduct of the business of the client and not the actual operation of the arrangements. The actual operation of the arrangements will provide little guidance as to the characterisation of the employment agency contract;

(c) the overarching question is whether the individuals who worked for the client should do so in much the same way as would an employee of the client. The focus of this test is on the manner in which the work is performed, with the key considerations being:

(i) whether it involves work having a degree of regularity and continuity (**Regularity Limb**); and

(ii) whether the nature of the work is to a significant degree under the control and direction of the client (**Control Limb**).

64. The above legislative history highlights the shift in the employment agency provisions over time. Namely:

(a) the provisions were initially introduced to address the mischief where the worker was not an employee of the putative employment agent or client, but carried out duties of a similar nature to those of an employee;

(b) section 3C of the 1971 Act was introduced in "haste" to address the issues arising from *Drake Personnel*, and the mischief being addressed was avoidance of payroll tax through the interposition of an agent to give the appearance of a contractor relationship where one did not exist in substance;

(c) *UNSW Global* was the seminal case regarding the interpretation of section 37 of the PTA and the relevant test from that case was whether the worker would comprise, or who would be added to, the workforce of the client for the conduct of the client's business;

(d) following *UNSW Global*, cases developed indicia to determine whether the worker would comprise or was added to the workforce of the client, but this approach was later rejected in the *ITM Appeal*;

(e) the "in and for" test was further expanded in *ITM Appeal* as the Court of Appeal identified that whether a worker was added to the workforce was a two-pronged test: the Control Limb and Regularity Limb;

(f) the *ITM Appeal* confirmed that the contract to consider was the one between the putative employment agent and the client, which was previously not confirmed in the case law, and in fact, was opposite of the view stated by Brereton JA in *E Group No 2*.

65. It is apparent from the above that the goal posts have significantly shifted and expanded in the application of the employment agency provisions. The broad words used in section 37 of the PTA have resulted in an interpretation which is far removed from the original intent for the introduction of the employment agency provisions, being

[27] *Chief Commissioner of State Revenue v Integrated Trolley Management Pty Ltd* [2023] NSWCA 302 at [113].

to address payroll tax avoidance through the interposition of an agent giving the appearance of a contractor relationship in substance this is an employee/employer relationship.

Recommendation 5:

We recommend that consideration be given to amending the employment agent provisions to ensure that they more appropriately align with the original intent and do not capture genuine commercial arrangements that do not involve the interposition of an agent to disguise an employee/employer relationship.

Control Limb

66. In respect of the Control Limb there is a risk that, having a contract between the putative employment agent and its client that contains contractual terms that requires the putative employment agent to take or not take certain actions, will lead to a conclusion that a significant degree of control is exercised by the client over the person performing the work on behalf of the putative employment agent. For example, the existence of KPI's and service standards for the putative employment agent, appear to be sufficient, in the view of the Chief Commissioner, for a conclusion that substantial control and direction is exerted by the client over the person performing the work.

67. Generally, a commercial relationship of any kind requires instructions to be given by the person requesting the goods or services from the supplier. Usually, in these types of arrangements one party has greater bargaining power or leverage over the other. For example, in a cleaning contract context, the cleaning company is likely to accept the terms and conditions of its client to win the work in a competitive market.

68. The existence of such contractual "controls" rarely results in control being exercised by the client over the person performing the work in the sense of an employer and employee relationship for which the employment agent provisions were introduced. Rather, such contractual controls merely facilitate directions given by the client to the putative employment agent in respect of the work is to be performed, which is nearly always present in any commercial contract for the provision of services.

69. In applying section 37 of the PTA and the Control Limb, there appears to be no delineation between the type of direction and control exerted by the client in an ordinary commercial context and the type of direction and control exerted in an employee/employer context.

70. The Control Limb results in a taxing impost arising for the putative employment agent solely due to existence of ordinary commercial contractual clauses that are included for the protection of the client of the putative employment agent.

Recommendation 6:

We recommend that consideration be given to amending the employment agent provisions to ensure that the kind of control exercised or capable of being exercised by the client of a putative employment agent that causes the arrangement to be an employment agency contract is the kind of control *over the person performing the work* that would ordinarily be present if the client was the employer of the person performing the work.

Regularity Limb

71. In respect of the Regularity Limb, there is no clarity as to what regular and continuous means. Does it mean once every 6 months over a 5-year period? Does it mean Monday to Friday over a one-month period?

72. For example, you may have cleaners who specialise in window cleaning and only clean windows at a building site once every quarter or half yearly. It is not clear in what circumstances the services satisfy the Regulatory Limb.

73. This lack of clarity on the Regularity Limb makes it extremely difficult for businesses to understand their taxation obligations under the employment agent provisions.

Absence of exclusions from employment agency provisions

74. This breadth of the employment agent provisions, and that they can apply to ordinary commercial arrangements that are not akin to labour hire arrangements as commonly understood, is worsened by the absence of any exclusions as contained in the contractor provisions.

75. In contrast to the position in New South Wales, the *Payroll Tax Act 2011* (ACT) does contain exclusions in the employment agent provisions that are broadly equivalent to the exclusions contained in the relevant contract provisions. The existence of such exclusions would go a long way to ensuring that the employment agent provisions do not operate arrangements not initially contemplated as being captured.

> **Recommendation 7:**
>
> We recommend that consideration be given introducing exclusions to the employment agent provisions that are equivalent to the exclusions to the contractor provisions found in section 32(2) of the PTA.

'Internal' employment agency contracts

76. Since the judgment in *E Group No 2*, the Chief Commissioner has applied section 37 of the PTA to internal arrangements between grouped entities. The following example is provided as an illustration:

> *A business group includes a trading company (Trading Co) that enters into contracts with clients and a labour company (**Labour Co**) that enters into contracts with independent contractors*

In *E Group No 2*, the Court of Appeal found that this arrangement involved an internal employment agency contract between Labour Co and Trading Co whereby Labour Co was procuring workers "in and for" the business of Trading Co. This was originally an alternative argument run by the Chief Commissioner in the E Group litigation.

77. The following is stated by the Court of Appeal regarding this 'alternative argument':

> *[31] The secondary nature of this alternative claim is reflected not only in the relatively little attention given to it in the parties' oral closing submissions below, but also in the relative brevity of the primary judge's reasons for rejecting the alternative claim (which for convenience are set out at [41] below).*
>
> *…*
>
> *[40]…It should be noted that only three paragraphs in the Chief Commissioner's 22 page written opening submissions were devoted to that aspect of his alternative claim concerning the alleged "arrangement".*

78. It is important to emphasise that this was an alternative argument of the Chief Commissioner that only needed to be considered after the primary argument failed. The primary argument was that the contractual arrangements between Trading Co, to use the terms adopted in our example above, and its clients was an employment agency contract. The primary argument did not succeed as the Court of Appeal concluded that the contract between Trading Co and its clients did not involve Trading Co procuring workers in and for the business of the client within the meaning

expressed in *UNSW Global*. That is, the wider commercial arrangement was not one in which workers were being procured for the workforce of the clients of Trading Co.

79. To be clear, if Trading Co had engaged the contractors directly, the payments to the contractors would not be taxable wages. It was only the imposition of Labour Co as part of the business group's corporate arrangements, for which there can be a multitude of genuine commercial reasons, that resulted in payroll tax being imposed on the payments.

80. The characterisation of these 'internal arrangements' as employment agency contracts results in payments made to genuine independent contractors being liable for payroll tax, contrary to Parliament's intention in introducing the employment agent provisions.

81. That the 'internal' employment agency contract can be overcome by removing Labour Co and engaging workers by Trading Co also demonstrates that the provisions operate artificially and arbitrarily, without regard to whether the arrangement is in substance, or akin to, an employer-employee relationship, or seeking to interpose an agent in an employer-employee relationship.

Recommendation 8:

We recommend that consideration be given to "turning off" the employment agent provisions between entities that are members of the same payroll tax group.

Non-labour costs

82. As noted above in respect of the contractor provisions of the PTA, under section 35(2) of the PTA, the payment made to the contractor is reduced by the amount that is not attributable to the provision of labour by the contractor.

83. The employment agent provisions do not use the same wording as in the contractor provisions. Section 40(1)(a) of the PTA provides:

> *(1) For the purposes of this Act, the following are taken to be wages paid or payable by the employment agent under an employment agency contract—*
>
> *(a) any amount paid or payable to or in relation to the service provider in respect of the provision of services in connection with the employment agency contract,*

84. It is not clear, where there is a service and non-service component in an employment agency contract, that there can be a reduction for the non-service component.

85. There is no rationale for adopting a different approach for the employment agent provisions to the approach adopted for contractor, particularly where both set of provisions are not intended to capture arrangements with genuine independent contractors.

Recommendation 9:

We recommend that consideration be given to amending section 40 of the PTA to provide an equivalent reduction for non-labour as that provided by section 35 of the PTA for relevant contracts.

Chain of on hire

86. An arrangement for providing services can involve more than one employment agent. This is described in *Revenue Ruling* PTA 017 as a 'chain of on hire'. PTA 017 states as follows:

> *A 'chain of on-hire' occurs when an employment agent on-hires a service provider to another employment agent who in turn on-hires the service provider to its client. A strict application of the employment agency provisions on a 'chain of on-hire' would mean that*

both employment agents are liable for payroll tax on essentially the same employment agency arrangement.

87. Where a chain of on hire arrangement exists, section 41 of the PTA has application. It provides, in effect, a mechanism to avoid double tax by permitting the Chief Commissioner to only assess one employment agent on an amount under the arrangement.

88. The mechanism adopted by section 41 of the PTA to avoid double tax is unsatisfactory in a number of ways as follows:

    (a) it results in uncertainty for businesses as to their obligations. Each employment agent will not be in a position to know whether another employment agent has already paid payroll tax on an amount; and

    (b) it is unclear as to which amounts are precluded from being subject to tax under section 41. This is illustrated by the following simple example:

    Client pays $100 to employment agent 1 for the procurement of workers. Employment agent 1 pays $80 to employment agent 2 $. Employment agent 2 pays $50 to its workers $50 and includes the $50 in its taxable wages.

89. Does section 41 preclude payroll tax on the whole of $80 or just the $50? Further, if the answer is it is only the $50, what is the justification for now imposing the $30 on employment agent 1 given that this amount is not wages in any sense.

90. We are unable to discern any policy justification for not simply imposing payroll tax on one entity to the chain of on hire arrangement with legislative certainty.

Recommendation 10:

We recommend that consideration be given to amending section 41 of the PTA to provide certainty as to who payroll tax is imposed on under a chain on hire arrangement. We consider that the imposition of payroll is most appropriately imposed on the employment agent who pays the natural persons who perform the work as this is the only payment that is akin to wages for the work performed.

CONCLUSION

91. We again thank the Committee for the opportunity to make submissions for the Inquiry.

92. We remain willing to assist the Committee in the continuing conduct of the Inquiry.

Yours faithfully
BROWN WRIGHT STEIN

APPENDIX A

Employment agency contract cases in New South Wales

Case	Case
Freelance Global Ltd v Chief Commissioner of State Revenue [2014] NSWSC 127	*Securecorp (NSW) Pty Ltd v Chief Commissioner of State Revenue* [2019] NSWSC 744
Qualweld Australia Pty Ltd v Chief Commissioner of State Revenue [2015] NSWCATAP 249	*Southern Cross Community Healthcare Pty Ltd v Chief Commissioner of State Revenue* [2021] NSWSC 1317
Winday International Pty Ltd v Chief Commissioner of State Revenue [2016] NSWCATAD 270	*Southern Cross Community Healthcare Pty Ltd v Chief Commissioner of State Revenue (No 2)* [2021] NSWSC 1538
UNSW Global Pty Ltd v Chief Commissioner of State Revenue [2016] NSWSC 1852	*Chief Commissioner of State Revenue v E Group Security Pty Ltd* [2022] NSWCA 115
JP Property Services Pty Ltd v Chief Commissioner of State Revenue [2017] NSWSC 1391	*Chief Commissioner of State Revenue v E Group Security Pty Ltd (No 2)* [2022] NSWCA 259
UNSW Global Pty Ltd v Chief Commissioner of State Revenue (No 2) [2017] NSWSC 26	*Bonner v Chief Commissioner of State Revenue* [2022] NSWSC 441
HRC Hotel Services Pty Ltd v Chief Commissioner of State Revenue [2018] NSWSC 820	*Infinity Security Group Pty Ltd v Chief Commissioner of State Revenue* [2023] NSWCATAD 28
Banfirn Pty Ltd v Chief Commissioner of State Revenue [2019] NSWSC 1058	*Infinity Security Group Pty Ltd v Chief Commissioner of State Revenue (No 2)* [2023] NSWCATAD 61
Bayton Cleaning Co Pty Ltd v Chief Commissioner of State Revenue [2019] NSWSC 657	*Chief Commissioner of State Revenue v Integrated Trolley Management Pty Ltd* [2023] NSWCA 302
Southern Cross Group Services Pty Ltd v Chief Commissioner of State Revenue [2019] NSWSC 666	