

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

Organisation: NSW Treasury

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Application of the contractor and employment agent provisions in the *Payroll Tax Act 2007*

NSW Treasury submission

Treasury welcomes the opportunity to make a submission to the Portfolio Committee No. 1 – Premier and Finance’s inquiry into the application of the contractor and employment agent provisions in the *Payroll Tax Act 2007*.

Treasury’s role in relation to payroll tax is to provide advice to the Treasurer and the Government on matters of a policy nature, rather than its administration (which is the responsibility of Revenue NSW). Treasury’s advice seeks to support strong and sustainable economic and fiscal outcomes, including enhanced productivity and ultimately improved living standards.

Consistent with this, this submission sets out key policy considerations from the broader economic and tax system design perspective, which are essential in assessing both current and future policy settings.

As noted in other submissions, payroll tax is harmonised across most states and territories, to reduce compliance costs on businesses that operate in more than one jurisdiction. Any potential changes to payroll tax will require consultation across states and territories if harmonisation is to be retained.

The importance of payroll tax

Payroll tax plays a crucial role in maintaining state revenues and funding essential services. Understanding its significance is key to evaluating the current provisions and any proposed changes.

The Australian Constitution constrains state governments in the taxes that can be levied. Whilst states are responsible for a significant part of critical expenditure such as hospitals, public schools and roads, state governments have access to limited taxation powers to fund these expenditures. This is known as vertical fiscal imbalance.

Within these limited state taxation powers, payroll tax is one of the largest, most stable, fiscally sustainable, and economically efficient taxes.

- Payroll tax is one of the largest state taxes. As at the 2024-25 Half Yearly Review, payroll tax revenues are expected to raise \$13 billion in 2024-25. This is approximately 10.9 per cent of the State’s revenues. These revenues are vital for supporting essential services and infrastructure such as public hospitals, schools, public transport and roads. This means that if payroll tax were to be reduced or its tax base narrowed, there will need to be a reduction in government services and infrastructure, an increase in other taxes, or an increasing reliance on debt.
- Payroll tax is one of the most stable and fiscally sustainable taxes. The payroll tax growth rate is primarily driven by the labour market (wages and employment). These underlying drivers are relatively stable and predictable compared to other state taxes (such as transaction-based taxes) that can see large variations through the

economic cycle. The *2021 NSW Intergenerational Report* projected payroll tax revenues to be the only State tax to grow in line with government spending and economic growth over the long-term.

- Payroll tax is one of the more economically efficient taxes. Efficiency refers to the extent to which taxes distort economic activity, which can undermine competition and productivity and therefore economic growth. Most taxes result in some costs to the economy — whether that be a reduction in employment, investment, production and/or consumption. Within the range of State taxation powers, payroll tax is considered relatively efficient as it applies to a broad range of businesses. Over time the tax is either absorbed through business production costs or consumers paying higher prices. Therefore, payroll tax has minimal impact on businesses' long-term employment decisions. However, the existing exemptions from payroll tax, including the tax-free threshold and other industry-specific exemptions, create inefficiencies.

Tax policy principles

The contractor and employment agent provisions ensure that remuneration paid in employment-like relationships are captured within the payroll tax system, regardless of the legal nature of the employment.

Treasury agrees with the submission made by the NSW Chief Commissioner of State Revenue in relation to the detail and history of the legislative provisions and will not replicate this information in this submission. As the Chief Commissioner notes, the fundamental policy and legal framework governing payroll tax for contractors and employment agents have not changed for decades. The scope of payroll tax has not been expanded in recent years to target particular industries. The courts have played an important role in confirming and clarifying the payroll tax obligations for specific business models.

Any proposed changes to the contractor and employment agent provisions must be evaluated within a broader economic and systemic framework. While individual businesses or industries may see benefits from narrowing the payroll tax base, these advantages must be weighed against the potential long-term and broader economic consequences — such as reduced government services as a result of lower government revenues, increased tax liabilities elsewhere, or diminished competition and productivity that ultimately undermines living standards. Alternatively, any fundamental change to the scope of payroll tax revenues will need to be pursued as part of broader national tax reform.

Any change to the scope of payroll tax policy should be considered within the framework of tax policy principles, as set out below.

- Sustainability. A sustainable tax system must evolve alongside shifts in business models and workforce structures to ensure that the tax base is maintained. Payroll tax, as a tax on labour, should encompass labour income as broadly as possible to ensure fiscal stability. As economic activity diversifies — particularly with emerging contractor-based industries — it risks increasing the share of labour income that is not captured by payroll tax. The tax base should be sufficiently robust to accommodate these structural changes while maintaining long-term revenue growth.

NSW Treasury

- Efficiency. Tax efficiency refers to the extent to which taxes may distort economic activity, including the choices made by those who are subject to taxes. As employment practices evolve in various industries, tax settings should aim to avoid distorting business decisions and support competitive neutrality between different business models. In the present context, this should involve considering the potential of existing contractor and employment agent provisions to distort choice in business models and the use of labour. This is not suggesting anti-avoidance behaviour, but rather businesses models being influenced by tax policy settings.
- Simplicity. A tax is simple if the administration costs to government and compliance costs to taxpayers are low. Tax simplicity also supports tax efficiency. Lack of clarity can increase compliance costs and distort business decisions.
- Equity. Equity is a notion that applies to individuals, rather than entities. Therefore, it needs to be considered in respect of the economic incidence of payroll tax, as distinct from the legal liability for payroll tax. As indicated above, the costs of payroll tax fall onto employees (in the form of lower wages) or onto consumers (in the form of higher prices) in the long run. Exemptions provided to certain businesses or industries can therefore be said to be inequitable, as it makes distinctions regardless of the circumstances of the individual bearing the cost. For example, the ultimate benefactor of the tax-free threshold is the individual employed by the small business, who may be earning a high wage.

Good tax policy should take into account each of these principles, which may involve balancing or trading-off various considerations, including other Government objectives. For example, the tax-free threshold and exemptions to certain industries, employees (e.g. apprentices) and circumstances (e.g. maternity leave). These exemptions seek to achieve certain policy objectives, however may counteract the tax policy principles described above and should be recognised as a trade-off.