Review of Payroll Tax

Submission

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Request for submissions

How can payroll tax administration processes in NSW be streamlined, noting that thresholds and rates are outside the scope of this Review?
More than 95% of the payroll tax returned by business in NSW involves almost no effort by Revenue NSW. Revenue NSW has systems in place to assist businesses, but the businesses tabulate their taxable wages for all jurisdictions in which they employ and send Revenue NSW the money. This implies that for most businesses that pay payroll tax they find that their liability is simple and easy to administer. Reports have shown that about 97% of payroll tax revenue in NSW is paid accurately and on time. The errors that do exist only relate to a very small value of wages compared to the total wages declared by all clients, and errors where too little is paid are balanced to a large degree by errors where too much is paid. It is my belief that if compliance was 100% perfect the revenue collected would hardly change. It should be kept in mind that if compliance was 100% perfect the revenue yield from penalties and interest would be nil. There are 2 parts of the Payroll Tax Act 2007 that regularly generate significant penalty tax and interest. In the first, grouping, this is not easily addressed by changes in administrative practices or legislative change because the people in a business who are responsible for paying pay the tax may not be aware of the structure of the businesses. Even the directors may not understand how the grouping provisions apply to their business. The NSW grouping provisions have been regarded by at least one Supreme Court judge as less comprehensible than the General Theory of Relativity. The second , the 2 deeming provisions in Part 3 Wages**,** Division 7 Contractor provisions, and Division 8 Employment agency provisions are now 33 years old and 18 years old respectively. Despite the time businesses have had to

understand them they still generate most of the revenue discovered by audit. It is from these 2 provisions that most additional taxes; penalty tax and the resulting objections emanate.

There are 2 clear areas in which the administration of payroll tax can be improved.

(1) Processes that enhance the correct payments of the tax, and
(2) Legislative change, on a basically revenue neutral basis, that enhances the return of payments made for the labour of person other than employee as wages.

For point (1) changed administrative processes might include:

(1) Improved software that best meets the needs of all businesses and which ideally should be superior to all commercial products. In particular it should calculate the liability in all other jurisdictions even if it does not lead to a payments system for them.
(2) Inbuilt rewards for "***good payers"*** such that they are shielded from tax defaults and premium interest if their prior payments were 95% accurate or better for a period such as 3 years.
(3) "***try before you commit***" calculators with positive feedback messages for all of the correct parts and suggestions for enhanced compliance for incorrect or incomplete areas.
(4) If by the time the last chance to lodge an additional annual reconciliation has expired there is only the original annual return a personalised thank you letter from the Chief Commissioner, as a mail merge, for taking the time to lodge an accurate return.
(5) Asking clients to identify areas of compliance they have difficulty with. They may make suggestions if they wish. When software was first introduced clients were consulted and many improvements came from the clients and were incorporated in later versions.
(6) The liable employer is nearly always a corporation, but the administration of payroll tax is primarily in the hands of individuals, usually women, who administer the employer's payroll. They can be a conduit of information to those in the business aware of contractor use, director businesses and potential grouping issues and they need to be supplied with clear information they can take to those who are responsible for those issues.

For point (2) review the *Contractor provisions* and *Employment agency provisions*. Not only are the contractor provisions a relic of a bygone mind set, (that almost all contractors are disguised employees) they operate on an annual basis while taxable wages operate on a monthly basis. It is only significant non- compliance in relation to the returning of taxable wages paid to contractors that has masked this inconsistency.

For the employment agency provisions those businesses are at common law the employers of the workers if they procure the services of employees. Their liability would in that case be covered by the general provisions. Only when they procure the services of contractors for businesses are the employment agency provisions required.

Once enlivened the two provisions have very different effects on what could be the same contractor working for the same business under 2 separate contracts. This

effect stems from the different basis for each provision, but such discrepancies reveal bad legislation especially in a tax base so heavily reliant on the understanding of the legislation by the persons who pay the tax for each liable employer.

Understandably, from the point of view of a business engaging contracts to perform tasks for their businesses, the payroll tax liability, if any, on those payments should not have a significantly different result just because they contracted with another business to get the tasks done.

It is this last effect which was so clearly seen in UNSW Global. That through varies means the judicial decision created no discrepancy between the direct hire of the businesses of the expects or the indirect hire of the businesses of the experts was a result based on an understanding of the law unavailable to the payroll officers and directors of NSW employers.

What is the single change to the way payroll tax is administered in NSW which would be of greatest benefit.

Defining which payments made by businesses, for or in connection with, the performance of work by a person ***other than an employee*** should be taxed as wages in an ***inclusive provision.*** Reversing the onus of proof in taxation law should apply only in extreme situations.

The contractor workforce is at least 4 time larger than it was when the contractor provisions were drafted so they clearly have not discouraged the use of contractors. That some, or all, of the payments made to contractors for the labour services they provide should be wages restores equity between businesses with similar labour costs but different workforce composition and removes a bias towards using contractors when employees could be used. Businesses choose to use contractors for various reasons. That in many cases there is less payroll tax if they choose a contractor than there would be if they used employees does not need to be an extra bonus stemming from that choice nor does it need to be based on some political bias in favour of the self-employed.

The harmonised legislation agreement did not cover the contractor provisions, but they are identical or very similar in 7 of the 8 jurisdictions. Queensland was the last jurisdiction to adopt them on 1/7/2008.

Although the culture in Revenue NSW is to regard many contractors as thinly disguised employees this is at odds with the legislation. Employees, including sham employees, are covered by the general provisions and further supported by the Commissions ability to determine that, if under a contract an employee is performing the work, any part of the contract including the existence of any intervening party, including a corporation, can be disregarded by that determination. Then there is also the third- party provisions where if an employee has their wages paid to a person other than themselves the wage is still liable for the business for which the service is supplied.

The result of this is a division that taxes what its title reflects. It taxes payments made for the labour of persons operating as a business rather than as an

employee. It would greatly clarify the administration of the contract provisions if the person performing the work was referred to in the definition of a ***relevant contract*** as a "***contract worker***" a term previously used in the employment agency provisions. Following the Drake case that title was changed to "***service providers***" as it was found in that case that most of the workers were the common law employees of the employment agency involved.

A ***contract worker*** would be any person, other than an employee, contracted to performs services for, or in relation to the performance of work. This could be used for both deeming provisions for all non- employees as most workers secured from an agency would return to the general provisions as the employees of the agency in line with the decision in the Drake case.

Division 6 Contractor provisions and Division 7 Employment agencies exist to tax payments made to non- employees. That only the labour component ***should be*** taxed is consistent with the legislation as a whole and if the labour component is 50% or less then the contract does not have the securing of the labour of an individual as its sole or dominant character, and so it should not be a ***relevant contract***.

Under the current contractor provisions the business carried on by the contract worker is the primary basis for an exclusion from the provision while for the employment agency provision it has no effect even on the amounts taken to be wages as there is no allowance for materials or even the use of a backhoe, grader or other goods to perform the tasks required under the contract.

This difference is an aberration. The liability of a contract for the performance of work for payroll tax between a ***principal business*** and a ***contract worker*** should not have 2 very different outcomes based solely on the decision of a ***contract worker*** to secure work through an intervening business.

All contracts for the performance of work emanate from the business that requires the work to be done. As the decision in Drake showed only the business that offers the work and promises to pay can be a party to a work contract. This is the case even if the offer is to a business carried on by a contractor or consultant.

It is the payment for labour attached to that offer of work that should be the basis of liability. The business carried on by the contract worker should only make a difference in limited situations based on information readily available to the business paying for the work that they offered.

Problems with Part 2 Taxable wages

All jurisdictions came together in 2008 to solve the **Taxable wages** issue because employers had difficulty administering the old legislation because of change in the way employees were paid. While it took some time for the Parliaments to agree, the resulting legislation is clear and simple in its application for employers and in unusual situations has a set of provisions that lead to the ideal situation that the months wages paid or payable for the work performed by any person, are wholly liable in only one jurisdiction.

Despite this ideal effect for a month's wages paid for the work of an individual it is not the case for amounts taken to be contractor wages. It also has the capacity to not be the case for contractors whose services are procured by an employment agent.

An amount taken to be a wage for contractors and for agencies can involve the work of partners, it can relate to a year's worth of work. It can be paid in one financial year for work done last financial year that for accrual accounting is a last financial year expense and for the next financial year a taxable wage.

In considering the interaction of **Part 2 Taxable Wages** with the two deeming provisions I considered the effect on only using the work performed in one calendar month as a basis for both provisions. It greatly simplifies and clarifies the liability for the employer. If this was combined with a proviso that a business conducted as a personal service business was the non-employee whose wages were to be taxed it would:

- Remove contracts where the labour content is 50% or less, and
- Remove contracts where an asset of the business generates the payment, and
- Remove contracts where two or more persons fulfil the tasks in the contract.

Such a change requires a new policy position to be agreed on by all Treasurers and Parliaments in Australia except the Commonwealth. As the tax base would be wider there would be more Commonwealth tax deductions for the businesses affected.

That process would take some time.

Is there a simple, short term change that should be considered to make an immediate improvement to tax administration?

All tax defaults in payroll tax stem from errors made by one or more persons employed by, or who provide payroll services to, an employer. If a tax default in payroll tax was treated as considerately as a tax default in land tax, there would be a number of benefits to the administration of payroll tax. A tax default should not have different outcomes based on its tax base. A more sensitive approach for tax defaults in payroll tax would lessen the pressure on objections and review and encourage businesses to assist in the audit process.

Attempts to change the behaviour of payroll officers by hitting them with penalties fail because the person whose behaviour you wish to change is an employee, but the penalty is paid by the business. Emails to all clients on the 1st of each month asking them to please lodge by the 7th would have a better effect.

Putting a minimum 20% penalty on all payroll tax defaults minimises any incentive for a timely response to assist the Commissioner once an audit commences. A reduction from 25% penalty tax to 20% penalty tax is not much of an incentive.

To use the donkey, carrot and stick analogy Revenue NSW wants the donkey to try harder but provides no carrot and use the stick to hit the donkeys' owner.

A removal, or significant reduction, of penalty tax for a reply within 30 days would speed up client responses. Incomplete responses would have a lesser reduction.

Revenue NSW has access to Workcover Data. It could send out advice annually to businesses approaching the threshold. This would be a good practice for a self-administered tax base.

A “good payer” policy could be assumed for businesses unless there is some evidence of international disregard of the law. Having spoken to thousands of people whose job it was to lodge payroll tax returns, almost all of them were very motivated to get them correct. They should be assisted in that aim.

Contractor provisions a temporary measure to assist in future administration
The Chief Commissioner has the power in section 32(2)(iv) that any contract between a person and a designated person is not a relevant contract if satisfied that the “***contractor”*** within a financial year, provides services of that kind to the public generally. That information is not usually available to the business of the client but only to the business of the contractor. While the Commissioners satisfaction is fairly unrestricted by legislation when it comes to the administration of that satisfaction its use is minimal.

If the contractor was to provide to the business of the designated person a declaration similar in concept to the subcontractor declaration such a declaration could be used to trigger the revenue ruling about that discretion unless the Chief Commissioner determined otherwise, or the declaration was found to be false.

The declaration would include:

1. The name and trading name of the business of the contractor.
2. The Australian business number of the contractor
3. A statement that the business of the contractor is registered for and paying GST on the value of the contracts claimed to be included in the declaration.
4. A statement that the contractor meets the requirements for the alienation of personal services income.

This declaration would be available for the 2018/2019 and 2019/2020 tax year only and would complement the other contractor exemptions which would remain intact for those years. Any business that used such declarations for its contractor workforce would be able to rely on it unless the Chief Commissioner determined that the business relying on it knew it was false.

NOTE: Potentially both the business using the contractor labour and the business of the contractor are exposed to penalties and offences in relation to this declaration, so it should be taken seriously by both businesses.

This might lower the tax collected from contractor payments but would add certainty, collect useful information and the consequences for false or misleading declarations should minimise its potential for abuse.

Future contractor and agency provisions
As part of the launch of this 1 to 2 year declaration the Government would state its intention to rewrite the contractor provisions and agency provisions after consultation with businesses and the other jurisdictions. That many contracts might be liable should not be all that contentious. If a person is working for the benefit of their own businesses it should make little difference if they are a bricklayer or a barrister as it is not their business that is exposed to the tax. As a business expense the payroll tax will be passed on.

It is on that basis that certainty is so important. Businesses hit with large payroll tax assessments under audit often fail to pay or cease to trade or are crippled. If their tax default stems from a wilful act of the business, then that result may be unfortunate, but it has justification. If on the other hand is stems from ignorance of two deeming provisions whose application if often unclear, then that result reflects badly on the Act.

As a client education officer, I explained the contractor provisions to thousands of persons working for businesses. These people understand personal service businesses, workers compensation and superannuation but when they have to prove their contractors are not taken to be employees under the Payroll Tax Act 2007 for every contract they often cannot comply as they do not have the information required. There is no certainty in a taxing provision that works on that basis.

A single deeming provision for all non-employees
It might be possible to blend the contractor and agency provisions. The wording in the ***agency provisions*** is much clearer in its 3 deeming provisions than the contractor provisions.

Deeming provisions for the purposes of the Act would apply. There is no reason an employment agency cannot be a "***designated person***" except for the proviso that an employment agency contract cannot be a relevant contract. It was in the past and it could be again. Only the exclusions available to contracts that are not relevant preclude this. A "***relevant contract***" can be rewritten in a manner similar to 37(1) so that it is a definition of a relevant contract that includes the designated person and the contract worker as identified entities.

In both NSW Payroll Tax Acts since their inception is the inclusion in wages of:
"***an amount paid or payable under any prescribed class of contracts to the extent to which that payment is attributable to labour".*** That there has never been a *prescribed class of contracts* does not negate the existence of a part of the Act put in by Parliament to tax the labour content of contracts.

The contractor provisions tax all of the payments made to the business carried on by the contractor except for the materials costs. There is no such provision for the service providers in the agency provisions. This discrepancy has never been rectified.

Payroll tax taxes the payments made by businesses for the labour supplied to them by employees, directors, consultants and contractors. That not all payments

for labour are a wage does not negate this simple basis any more than having exemptions in land tax negate the fact that land tax is a tax on all land owned in NSW.

Employees provide only labour. Some contractors and consultants have contracts where the provision of labour is the sole or dominant purpose of the contract. Dominant is a word Revenue NSW has experience with explaining the provision to businesses should be fairly simple.

If new contractor/agency provision(s) taxed only the labour value as for the *"prescribed class of contracts"* then this would be consistent with the intent of the legislation. As the States cannot tax goods for constitutional reasons, contracts in which the non- labour content is:

(a) 50% or more, or
(b) More than 50%,

as per whatever policy position is agreed on should not be relevant contracts.

Non- labour content could be determined as for Commonwealth legislation. A statement by the business of a contractor seconded by an approved person such as an accountant could be held by the business of the principal. Non-labour business expenses would include rent, wages or other costs. If the non-labour content does not meet the policy setting it determines the value of the labour to be returned by the business of the principal for payroll tax.

Are there practices that NSW should adapt from other jurisdictions, and what would their impact be if taken up in NSW.

Despite the exclusion of threshold and rate changes from the scope of this review a reducing threshold as wages exceed the threshold has many benefits for the administration, both from a Revenue office and an employer perspective. A 1 in 4 reduction applies in Queensland.

If the value of the NSW threshold disappeared at an annual Australian group wages total of $5 000 000 then all NSW employers in that group would pay a flat percentage. A similar effect would apply in Queensland and the Northern Territory.

- For a large business the increased revenue is to some degree offset by the simplicity of the flat payments.
- For a business with a partial threshold the monthly threshold varies anyway. As long as they use good software or a Revenue Office calculator the calculation is done by the software. The wage values do not alter.

A reducing threshold in NSW might encourage other jurisdictions to follow. For any large business or groups that exceeded the reducing threshold deduction in all jurisdictions all of their payroll tax payments would become very simple. Just wages times rate equals tax to be paid.

If all jurisdictions had such as system it would reduce the number of refunds paid to business confused by getting a partial threshold in NSW when they have no threshold in Queensland.

Are there additional guidance /materials/tools that could be provided by Revenue NSW to improve an employer's user experience
A self-audit tool would be a useful addition to the Revenue NSW website. It would be full of prompts and spoken and written imbedded pop ups. As previously noted positive guidance embedded in feedback would enhance the experience people have with their interaction with Revenue NSW. I feel there is a tendency, especially in payroll tax, to dehumanise the client. While almost all NSW payroll tax is paid by corporations, it is returned by natural persons. Revenue NSW has a number of staff who specialise in enhancing the ability of these people to increase their compliance with payroll tax. Even an overpayment results in an increased workload for the staff of Revenue NSW. Tabulating all of the discrepancies and designing remedies could be the focus of a special task force. Any reduction in penalty tax resulting from changes is a sign of success.
Burden on my business?
Not applicable to me but the Payroll Tax Act, in the main, has to prove that any remuneration for the performance of work is a wage and that an employer is obliged to pay tax on it. Reversing that basis for contractors and making employers prove that they don't have to pay is not a provision that should be found in a modern taxation Act.
Are there any areas where further harmonisation or co-ordination with other jurisdictions would be beneficial?
All jurisdictions have the same grouping provisions including the same exclusion provisions as drafted by Victoria in 1976. All jurisdiction use Revenue Ruling PTA031 for guidance despite the fact the Supreme Court of Western Australia stated it could only be relied upon by businesses. It is also a direct copy of PT2 issued in 1982. A lot has happened since 1982 including new grouping provisions and lots of seminal Supreme court cases including ones that deal with the change in wording in the exclusion provision itself. The decision to issue an exclusion determination rests with the Commissioner or any Court or Tribunal that can take the place of the Commissioner based in a ***satisfaction*** as to certain facts and matters of regard. An opinion is to be formed. The Taxation Administration Act is now being used to call into question those facts and matters that in the past were part of that "*satisfaction*". That the TAA exists must be acknowledged but section 79(2) in its design does not need the TAA to add an extra layer of satisfaction in its administration. A version 2 for exclusion determinations is long overdue and it would be good if it addressed the burden of proof issue.
How might the performance of the NSW payroll tax administration process be measured to keep track of the efficiency and effectiveness of the system, and to benchmark with other tax administration systems.

Send a survey to the 2000 largest private sector clients who pay payroll tax in 2 or more jurisdictions. Ask them a version of the above question.

Taxing payments to non- employees a personal perspective.

For the harmonised exclusion provision there were 3 potential policy settings to consider. For the 2009 taxable wage provision consultation and consensus resulted in good legislation. I feel that for payments made for the performance of work to persons other than employees and directors there are 3 broad policy settings:

(1) Do not tax payments to non-employees other than directors, or
(2) Tax the payments made to some non-employees based on an agreed set of criteria within an inclusive provision, or
(3) Tax the payments made to all non-employees except when constitutional issues interfere or the business performing the work is clearly an employer in its own right.

I am sure other setting exist. Retaining Divisions 7 and 8 is one option but not a credible one. Neither of them reflects the purpose for which they were created.

- Division 7 does not tax many "*employee like contractors*" while taxing lots of "*genuine independent contractors*", and
- Division 8 was not enacted to take, as an employment agency, every business that uses contractors to supply services to other businesses.

The business that use non-employees as a workforce and the people in those businesses whose work it is to pay any statutory imposts on the payments to those people can administer any inclusive provision for non-employees. It would assist them if that provision was based on familiar concepts like personal service businesses.

A new basis for taxing the labour of non-employees that can be readily understood and administered by the employers of Australia is needed to lower the heavy compliance burden involved in proving that a business does not have a contractor liability.

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