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1 Introduction

1.1 Both taxpayers and tax administrators would be assisted by a 'root and branch' review of the payroll tax grouping provisions, undertaken with the object of furnishing rulings and guidelines that deliver clarity and certainty as to:

(a) what arrangements fall outside grouping;

(b) what arrangements qualify for exclusion, and

(c) what arrangements properly attract the consequences of grouping.

1.2 Unfortunately there have been very few payroll tax grouping matters that have been heard in a Court. Consequently much of the guidance in the application of the provisions arises out of review processes in administrative tribunals. Decisions from such tribunals do not have the standing of judicial authority.

1.3 In addition, the matters that are before a tribunal or a court are necessarily heard and determined based only on the facts and issues that are presented in the immediate case. The cases will often identify the matters that fall for grouping, or are denied exclusion, but may not assist in explaining what arrangements fall outside the grouping provisions, or qualify for exclusion orders.

1.4 There has seldom, if ever, been an opportunity for the full gamut of legal, statutory and administrative issues encountered in the operation of the grouping provisions (and the issue of exclusion orders) to be considered, enunciated and collated in one compilation.

2 A Short Outline of the Grouping Provisions' History

2.1 Payroll tax was transitioned from a Federal tax to a State tax in 1971. There were comments made in Queensland Hansard at the time, describing the known (but as yet not outlawed) minimisation structure of splitting employer entities.

2.2 Existing Victorian grouping reforms were subsequently adopted in 1975.

2.3 The grouping provisions, originally in ss.16A – 16I, were subsequently renumbered as ss.66 - 75.

2.4 The provisions were 'harmonised' with those in Victoria and NSW in 2008.

3 The Purpose of the Grouping Provisions

3.1 The cases describe an anti-avoidance purpose: to overcome the strategy of accessing the exemption threshold on multiple occasions, by splitting a payroll amongst separate entities carrying on purportedly separate businesses [see the often cited case of *Commissioner of Pay-Roll Tax v RG Elsegood & Co Pty Ltd* [1983] 1 NSWLR 223 at 229-230].

3.2 That 'anti-avoidance' purpose has been confirmed on numerous occasions: *Plummers Border Valley Orchids v Commissioner of Taxes (NT)* 2002 ATC 4530 at 4537; *Baxter & Anor v Chief Commissioner of Pay-roll Tax (NSW)* 1986 ATC 4816 at 4817; *Artistic Pty Ltd v Commissioner of State Revenue* [2006] WASAT 39 at [98]; *Tasty Chicks Pty Ltd & Ors v Chief Commissioner of State Revenue* [2009] NSWSC 1007 at [99].

3.3 The cases have also recognised the very broad scope of the grouping provisions, said to be alleviated by the operation of the exclusion provisions (again, see *Commissioner of Pay-Roll Tax v RG Elsegood & Co Pty Ltd*), although that mechanism for relief from grouping has itself been criticised - see *Muir Electrical Co Pty Ltd & Ors v Commissioner of State Revenue (Vic)* 2001 ATC 4386 at [14].

3.4 Ultimately the grouping provisions have been allowed to aggregate businesses that were never operated as one integrated payroll, and despite which remedial exclusion orders are often denied. See the analysis by Bond J in *Scott and Bird and Ors v Commissioner of State Revenue.*[1] The provisions do this independently of any decision or determination of the Commissioner. No notice is required to a group member who then automatically becomes liable to pay – even though the assessment may only have been served on the "Designated Group Employer". While the group member would qualify as a 'taxpayer' who can object, in most cases the time limit to lodge an objection in respect of previous periods will have expired.

[1] [2016] QSC 132 at [27] – [28]

4 The Scope of the Grouping Provisions

4.1 Many of the scenarios that incur grouping squarely fulfil the perceived purpose as an anti-avoidance measure to aggregate payrolls amongst businesses that are purported to operate separately.

4.2 The provisions start to overreach when they deem grouping when there is nothing more than a mere common discretionary beneficiary amongst separate discretionary trusts.

4.3 In other scenarios, simple common elements will combine two seemingly separate groups, for example through common sets of directors, or shareholdings.

4.4 An alarming provision is found in s.72, which causes individuals (directors or shareholders) to be branded as "relevant entities", and to thereby become part of a payroll tax group by operation of the definitions in ss.74A-74G.

4.5 Some contended applications of the grouping provisions have thrown up absurd results that are unlikely to have been intended by the legislature. This is a basis to reject the absurd interpretation for a more reasonable one. The case that is most frequently cited in support of the proposition that Courts are entitled to approach the interpretation of legislation by taking into account the consequences of giving a particular meaning, is *Cooper Brookes (Wollongong) Pty Ltd v FCT* (1981) 147 CLR 297, at 320-321.

5 Discussion Point – The Grouping Provisions

The existence of a "business" is a pre-requisite

5.1 Sections 70 and 71 address entities that operate a "business". In the absence of a business, grouping should not arise under those sections.

5.2 The sections should go further and consider whether the business is an employer. The object of the provisions is only achieved if businesses that have employees are the subject of grouping.

5.3 In the Can Barz litigation the grouping of a superannuation fund with other active entities created tension between the provisions of the *Superannuation Industry (Supervision) Act* 1993 (Cth) (notably ss 62 and 67A as well as regulation 5.08) and the *Payroll Tax Act* (Qld) (which imposes joint and several liability on group members). Hence the superannuation fund (which had never had a business or indeed 'employees') was sought to be made liable for a liability which hadn't been incurred for the specific purpose of providing retirement benefits for its members.

5.4 On the other hand, if there are three 'associated' (to use a neutral term) entities, only one of which has any employees, then there is no mischief if that employer/business is registered and pays its payroll tax liability, and in that case no grouping need occur.

5.5 The rationale for the provisions were summarised in the submission made by the appellant in *Commissioner of Payroll Tax v R G Elsegood and Co Pty Ltd* (and accepted by Mahoney JA:

> *"Tax relief was given by the Act to businesses employing less than a specified number of employees. Attempts have been made, or could be, made by larger businesses to obtain that relief by splitting their businesses into a number of smaller or separate businesses, employing no more than the specified number of employees. The remedy adopted by the statute to avoid that mischief was: to deny such relief to members of a 'group'; to provide for the employees of 'commonly controlled' businesses to be deemed to constitute a group to define 'group' for this purpose in wide terms so as hopefully to include all who might be involved in the avoidance of the purpose of the legislation; and to deal with such anomalies as might arise because of the wide terms of the definition of 'group' partly by specific provisions: s 16E is perhaps directed to this, at least in part; and partly by committing the Commissioner a discretion which he may exercise so as to remove such anomalies."*

What is the purpose of s.72 and ss.74A-74G?

5.6 Section 72 does not confine its operation to entities that operate a business. Why is that the case, and by what means does the provision operate to ensure that employees of "associated" businesses are all aggregated and treated as one payroll?

5.7 Properly understood, s.72 operates only to impose liability by association. In doing so, it arguably offends the principle of legality [while perhaps not directed at s.72, but in an analysis that must be of universal relevance, see the discussion of Philippides JA in *Commissioner of State Revenue v Can Barz Pty Ltd & Anor* [2016] QCA 323].

5.8 That principle is so dominant that it operates without regard for the usual rule requiring some effect to be given to the offending provision.

5.9 To the contrary, in order to overcome the prohibitions imposed by the principle of legality, the words used in the legislation must be sufficient to show an intention to expressly override the principle. Query if s.72 meets that threshold. Otherwise the scope of operation of s.72 should be read down by reference to the purpose of the provision and its context.

Additional Context

5.10 Because the test for exclusion orders is whether a 'business' has a relevant connection or dependency with another business, any entity that does not conduct a business (save for those expressly included by the legislation, such as 'the carrying on of a trust...') should be automatically entitled to exclusion. Although it is considered that there ought be further guidance given specifically in relation to trusts (particularly self-managed superannuation funds) – which are not carrying on a business and have never had employees.

5.11 That aspect of the exclusion provisions is relevant context that also supports the conclusion that entities that do not operate a business do not fall into the grouping net in the first place.

6 Discussion Point – Exclusion Orders

Some general principles about the exclusion discretion

The test for exclusion

6.1 The factors listed in s.74(3) cannot be elevated to the status where they replace the statutory test set out in in s.74(2) - see *Boston Sales and Marketing Pty Limited v Chief Commissioner of State Revenue* [2014] NSWCATAD 139 at [23].

6.2 The scheme for making exclusion orders was considered by Bond J in *Scott and Bird and Ors v Commissioner of State Revenue.*[2] In some respects it represents 'fresh eyes' looking at what practitioners may have thought was a settled scheme. What Bond J identifies is:

(a) the discretion to issue an exclusion order is conferred in s.74(1);

(b) the discretion is only enlivened if the Commissioner is satisfied as to the matters in s.74(2), namely independence and no connection between businesses;

(c) if the discretion is enlivened, then the Commissioner must have regard to the matters in s.74(3); and

(d) there will be some 'crossover' between the factors that must be considered in forming the 'evaluative judgment' as to whether the discretion in s.74(1) is enlivened, and then deciding whether the discretion in s.74(1) should be exercised.

6.3 Bond J rejects the taxpayer's submission in *Scott and Bird,* that s.74(2) confers a discretion, and that s.74(3) comprises mandatory considerations for the exercise of that discretion. This rejection is said to follow the NSW Court of Appeal's decision in *Seovic Engineering Pty Ltd v Chief Commissioner of State Revenue.*[3]

6.4 What is confusing about that rejection is that the submission exactly aligns with the legislative scheme in NSW, where the exclusion order provisions bear a different formulation in the *Payroll Tax Act* 2007 (NSW). Section 79 provides:

> Section 79 Exclusion of persons from groups
>
> (1) The Chief Commissioner may, by order in writing, determine that a person who would, but for the determination, be a member of a group is not a member of the group.
>
> (2) The Chief Commissioner may only make such a determination if satisfied, having regard to the nature and degree of ownership and control of the businesses, the nature of the businesses and any other matters the Chief Commissioner considers relevant, that a business carried on by the person, is carried on independently of, and is not connected with the carrying on of, a business carried on by any other member of that group.
>
> ...

[2] [2016] QSC 132 at [39] – [42]
[3] [2015] NSWCA 242

6.5 Effectively, the provisions in ss.74(2) and 74(3) of the Queensland *Payroll Tax Act* are found combined in s.79(2) of the NSW Act. By that formulation, the factors from s.74(3) are expressly integrated into the precondition for the enlivening of the discretion in NSW.

6.6 In that respect the Queensland provisions/formulation should be contrasted (and perhaps distinguished) with the one that was analysed in *Seovic*. On that basis *Seovic* is not 'binding' on the Queensland court. However it is that distinction, and the fragmentation of the factors from the evaluative decision in Queensland, that arguably supports and permits the formulation advanced by Bond J in *Scott and Bird.*

6.7 Some commentators are critical of the analysis of the exclusion provisions in *Scott and Bird.* Irrespective, the case offers a construction of the provisions that must now be reconciled with the existing rulings and practices, reconciled or distinguished from *Seovic*, or the position should be clarified by legislative harmonisation/reform.

What if there is no business?

6.8 If there is no business then, reasonably, the submission can be made that exclusion cannot be denied - i.e. there can be no business with which to evaluate the existence of a connection or interdependence with another business. Support for this proposition may be found in the judgment of Bond J in *Scott and Bird*[4] - although in that case the existence of a deemed business, by operation of s.66, prevailed against the submission.

6.9 Although the trustee of a trust might be deemed to carry on a business [see s.66(d)], when it comes to evaluation under s.74 it is necessary to identify and evaluate a connection or interdependence that arises in the carrying on of that business (deemed or otherwise).

Splitting groups

6.10 Exclusion orders should be available to split a larger group into two separate smaller groups, if the relevant connection that caused them to be subsumed (see s.73) can be removed by a favourable application for exclusion. The NSW Supreme Court in *Baxter & Anor v Chief Commissioner of Pay-roll Tax (NSW)* 86 ATC 4816 at 4823 confirmed that, in applying similar provisions in the NSW legislation, the Commissioner's discretion to confer exclusion orders could operate to dissolve a larger group (formed by smaller subsumed groups) back into its smaller constituent groups. It is understood that the Queensland Commissioner follows that authority.

6.11 Note however that McPherson J in *John French Motors* appears to set the higher test, although there were only three members of the group being evaluated in that case.

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[4] [2016] QSC 132 at [45], [52] and [53]

Discretions must be exercised reasonably

6.12 The High Court has observed that where a statutory power is conferred the legislature is taken to intend that the discretion is to be exercised reasonably and justly [see, e.g., *Minister for Immigration and Citizenship v SZIAI* (2009) 83 ALJR 1123 at 1127 [15] and fn 16; *Kruger v The Commonwealth* (1997) 190 CLR 1 of 36].

6.13 In *Minister for Immigration and Citizenship v Li* (2013) 249 CLR 332 at [63] – [76], the High Court had occasion to discuss the concept of unreasonableness as a ground of review. Unreasonableness will be found where, by reference to the scope and purpose of the statute, a decision maker has committed a particular error in reasoning, given disproportionate weight to some factor, or reasoned illogically or irrationally – such that the decision may be ultra vires and void.

Prohibition for corporate groups

6.14 What is the policy reason for denying exclusion orders for members of a corporate group? See s.74(4).

6.15 If corporations otherwise meet the test of their businesses not being connected and being carried on independently, then why can't they also apply for exclusion from a group?

A logical methodology

6.16 The administration of the Commissioner's discretion to issue exclusion orders should follow a logical approach that lends itself to objective evaluation (for advisers) and implementation (for the Commissioner).

6.17 A suggested logical approach is as follows:

(a) The first question should be: what is the incident/factor that is alleged to reflect the disqualifying connection or interdependence between the businesses?

(b) The next question should be: is the incident/factor that is alleged to reflect the disqualifying connection or interdependence between the businesses insignificant, or is it 'substantial';

(c) The next question should be: is the existence of that incident/factor attributable to:

(i) the nature and degree of ownership AND control;

(ii) the nature of the businesses;

(iii) other matters (reasonably) considered relevant.

What is 'substantial'

6.18 Although the word "substantial" was removed in the latest version of the exclusion provisions, the cases have always required a degree of materiality, which has been read as amounting to the

requirement for a *substantial* connection or interdependence - see Pagone J in *GTS Industries Pty Limited v Commissioner of State Revenue* [2004] VCAT 21, and *Lombard Farms Pty Ltd v Chief Commissioner of State Revenue* [2013] NSWADTAP 42 at [50] to [51].

6.19 The cases have also supported that the materiality should be measured by examining the effect that the connection or interdependence has on the business, or more precisely the effect that removing the connection or interdependence would have [see *Lombard*].

6.20 For example, an analysis would look at the effect on the viability of the business if:

(a) an inter-entity loan was called up, determined not by reference to the scale of the loan, but to the capacity of the debtor to repay [see *Crusher Holdings Pty Ltd v Commissioner of Taxes (NT)* (1994) 29 ATR 156, and *Lombard Farms* (on remission back) [2014] NSWCATAD 132].

(b) if there is a particular connection of custom or supply, then whether it is at arm's length, or whether it is readily interchangeable and that supply can readily be obtained from someone else without affecting the viability of the business.

7 Discussion Point - The Factor of Ownership 'and' Control

7.1 First and foremost, the mere existence of any common ownership element cannot itself be invoked to deny exclusion. In other words, the factor that caused grouping in the first place cannot later, of itself, be relied upon to deny exclusion.

7.2 The degree of ownership and control must not be insignificant – if a mere fifty-one percent co-ownership causes grouping to arise, then something more substantive must exist to qualify as a relevant degree of ownership and control to deny exclusion – provided the logical methodology outlined above is also applied.

7.3 Certainly the deeming provisions found in the grouping provisions should be ignored when considering the *actual* ownership and control of businesses. For example, where there may be a "set of persons" deemed to control numerous entities and businesses, if in fact the *actual* control is exercised by sub-groups or individuals distinct from that entire "set" – then the actual reality must prevail [see *Commissioner of State Taxation (WA) v Scotford Cameron & Middleton Pty Ltd* 81 ATC 4576 at 4578].

7.4 It cannot be ignored that the analysis is as to ownership AND control of the business, not ownership OR control of the business. In addition, applying the logical methodology outlined above, the identified connection or interdependence itself must be explained by the existence and extent of ownership and control.

7.5 Ownership and control must not be a mere potential or theoretical factor, but must be shown to be the actual factor that led to the connection or interdependence between the businesses.

8 Discussion Point - Nature of the Businesses

8.1 This factor looks at the complementary (or otherwise) nature of the activities carried on by the businesses seeking to be excluded from each other.

8.2 Cases have shown that if businesses are disparate in nature, then they are entitled to be excluded, even if they have common ownership and control. Examples include:

(a) a prawn farm and an ice-cream shop [see *Commissioner of Payroll Tax v John French Motors* (1984) 14 ATR 228 at 236].

(b) a hairdresser and an electrician [see *Commissioner of State Revenue (WA) v Artistic Pty Ltd* 2008 ATC 8048 at 8053].

(c) a building contractor and a hotel [see *Shadforth Lythgo* QCAT 12 April 2016].

8.3 Generally, businesses of disparate/non-complimentary nature should be excluded, irrespective of their ownership and control.

8.4 The purpose and object of the payroll tax grouping provisions, and the exclusion provisions, are not to outlaw and discourage the creation of a portfolio of disparate businesses, where those businesses could never have operated in conjunction by one employer.

9 Discussion Point – Joint Liability of Group Entities

Liability to be construed in context

9.1 First, the preceding discussion points are relevant context, and the implementation of those factors should operate to remove numerous entities from alleged groups, for example:

(a) if they have no employees (although this proposition may require overrule of *Scott and Bird*);

(b) if they do not even operate a business (noting however the 'deemed' business that may arise for a trust by operation of s.66);

(c) if there is no substantial connection or interdependence between the businesses;

(d) if the businesses that are carried on are plainly disparate in their nature;

(e) if, irrespective of ownership, the businesses are separately controlled; and

(f) if the degree of common ownership is slim.

9.2 The interpretation and implementation of the grouping provisions and the exclusion provisions consistent with their purpose and object will mean that there are fewer entities found to exist in any group in the first place.

9.3 That will alleviate the jeopardy of joint liability affecting an entity that should not reasonably even be treated as a member of a group.

Joint liability Under s.34(2) and s.42(2)

9.4 Joint liability for grouped entities is primarily imposed by s.34(2) for annual liability, and s.42(2) for final liability.

9.5 Both provisions refer to "every relevant group *employer*" as being made liable.

9.6 Applying basic rules of statutory interpretation, and considering the text, context and purpose, those sub-sections have a pre-condition, namely that the group member be also an "employer".

The scope of s.51A

9.7 Section 51A is expressly made subject to the primary provisions in s.34(2) and s.42(2). As mentioned above, those provisions confine liability to group members who are also employers

and s.51A must be construed in light of the express provision: that it is subject to s.34(2) and s.42(2).

9.8 Section 51A(2) only operates to eliminate the possible argument, that an entity which is now an employer was not an employer during the period to which the liability amount relates.

9.9 Section 51A cannot overcome the fundamental legal principle that a law cannot invoke a punishment upon person for the liability or offence of someone else.

9.10 The principle of legality will not permit the tax liability of one employer to be recovered from someone who has no connection to that liability.

9.11 The provision does not contain wording such as will suffice to repel the principle of legality [see Philippides J A in *Commissioner of State Revenue v Can Barz Pty Ltd & Anor* [2016] QCA 323].

10 Discussion point – proposals for change

Purpose of grouping provisions

10.1 Any proposal for reform of the grouping provisions should start with a consideration of their purpose. As described above, the purpose of the provisions is to prevent avoidance of payroll tax by subdividing businesses. It is therefore relevant to consider to what extent the provisions serve that purpose.

10.2 In this respect, the provisions, as presently drafted, perform two functions:

(a) They deny access to multiple tax free thresholds to employers who carry on related businesses

(b) They impose joint and several liability upon all members of the group (subject to the comments above in relation to the restraints upon section 51A(2)). In doing this, they define a 'group' which includes those employers, together with numerous other persons and entities, including those which do not carry on a business, and which have never had employees.

10.3 It may be suggested that only the first function serves the purpose of the provisions. To be generous to the drafters, it may also be suggested that the deeming provisions which expand the group to include non-employers, and persons who do not carry on businesses, serve the purpose of allowing those persons to be used as 'links' in a chain which allows other businesses to be added to the group. Breaking those links can be addressed not only by reform, but also by the manner in which the provisions are administered.

10.4 Even accepting that it is appropriate to use 'links in a chain', the provisions go far beyond what might be considered reasonable. In particular, the suggestion that all beneficiaries of a discretionary trust control that trust flies in the face of common sense and practice, particularly in cases where the beneficiary has never had a distribution made to it, and is not even aware of the existence or terms of the trust.

10.5 The second function of the provisions, however, does not serve the purpose of the provisions at all. The purpose of the provisions is sufficiently served by denying each business a separate entitlement to the benefit of the payroll tax threshold. Once that purpose has been served, it is appropriate to consider whether the same set of provisions should be applied in determining who should be liable to pay the resulting tax. This is particularly relevant if it is accepted that non-employers and persons who do not conduct businesses are legitimately included in the group only as links in a chain – the justification for them being additionally subject to personal liability is quite different, and not in any way related to the purpose of the provisions.

10.6 The situation may be contrasted with the income tax consolidation provisions, which also impose joint and several liability in many circumstances. In the case of the consolidations provisions:

(a) The head company elects into those provisions – in the absence of an election, the provisions do not apply.

(b) The provisions are limited to genuine company groups and do not extend to unrelated third parties.

(c) The companies within the group benefit from the provisions, as they simplify the tax treatment of company groups, and allow intra-group transactions to be ignored.

(d) When the provisions apply, it becomes difficult to separate out the liabilities of each entity.

10.7 None of those considerations is relevant to payroll tax.

(a) Payroll tax grouping is not voluntary

(b) The provisions extend well beyond genuine company groups, including to non-employers (subject to the remarks above) and persons who do not carry on businesses at all

(c) No company benefits from payroll tax grouping.

(d) it is very straightforward to work out the liability which each employer would otherwise have incurred had the threshold been unavailable.

Options for reform

10.8 We have broken the options into two groups – those that relate to the breadth of the grouping provisions, and those that relate to the 'dual use' of the grouping provisions.

10.9 Options which may be considered in relation to the breadth of the provisions include:

(a) Limiting the 'control' provisions relating to beneficiaries of discretionary trusts to default beneficiaries of those trusts, and perhaps to beneficiaries to whom a distribution has actually been made. This would eliminate 'accidental' groups which result simply from a wide beneficiary definition commonly used in family discretionary trusts.

(b) Removing the provision by which unrelated groups are joined together by the simple presence of a common member.

(c) Expanding the use of the de-grouping provisions, so that they focus on ensuring that the only businesses which are grouped are those which are obviously related, and could (and should) have been conducted more practically under a single umbrella. A 'similar business test' may be a good starting point here. If the businesses being conducted are not similar in nature, there is no reason to think that they have been separated simply to avoid payroll tax. Under this approach, florists would be immediately de-grouped from hotels. This option may be given effect statutorily, or by changes in administrative practice.

10.10 Options which relate to the 'dual use' of the grouping provisions include:

(a) Providing that the liability of each member of the group is no greater than their individual liability would have been had the threshold not been available at all. This strikes a balance

between ensuring that parties are not incentivised to avoid payroll tax, and ensuring that 'innocent' parties are not subject to payroll tax obligations over which they have no control.

(b) Restricting the operation of the joint and several liability provisions to actual employers who conduct businesses, and excluding non-employers and those who do not conduct businesses. If the State still considers it appropriate to pierce the corporate veil in relation to directors of companies which fail to comply with their payroll tax obligations, that could be done in a clear and specific manner, such that those directors are liable only for the obligations of companies which they direct. At present, 'back door' liability is imposed on directors, not only in relation to companies which they control, but also in relation to entirely unrelated companies over which they have no control.

(c) Removing the joint and several liability provisions altogether.

