


# ***TR 97/D9 - Income tax: tax instalment deductions***

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This document has been finalised by TR 1999/13.



## Draft Taxation Ruling

### Income tax: tax instalment deductions

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#### other Rulings on this topic

IT 2077; IT 2626; TR 95/6;  
TR 95/15; TR 97/8

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*Draft Taxation Rulings (DTRs) represent the preliminary, though considered, views of the Australian Taxation Office.*

*DTRs may not be relied on by taxation officers, taxpayers and practitioners. It is only final Taxation Rulings which represent authoritative statements by the Australian Taxation Office of its stance on the particular matters covered in the Ruling.*

## What this Ruling is about

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### Class of person/arrangement

1. This Ruling discusses certain aspects of the meaning of the term 'employee' as it is used in Division 2 of Part VI of the *Income Tax Assessment Act 1936* (the Act). That Division, headed 'Collection by Instalments of Tax on Persons other than Companies', provides the legislative framework for what is commonly referred to as the Pay As You Earn (PAYE) system. Subsection 221C(1A) of the Act requires **employers** to deduct instalments of tax from payments of **salary or wages to employees**. The definitions in subsection 221A(1), of the terms in **bold**, extend the scope of the PAYE system to cover certain payments to persons other than employees within the ordinary meaning of that expression.

## Ruling and explanations

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### From which payments should tax instalments be deducted?

2. Subsection 221C(1A) of the Act requires employers to make tax instalment deductions from the salary or wages paid to their employees. Section 221A provides definitions which, in effect, identify the categories of payments that are subject to these deductions. In summary, those categories are:

- (1) **salary, wages, commission, bonuses or allowances paid to a person as an 'employee' within the ordinary meaning of that expression;**
- (2) **payments made under certain contracts that are wholly or principally for the labour of the person paid;**

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- (3) salary, wages, commission, bonuses or allowances paid to:
  - a person who holds or performs the duties of an appointment, office or position under the Constitution or under a law of the Commonwealth, a State or a Territory;
  - a person who is otherwise in the service of the Commonwealth, a State or a Territory; or
  - a member of an Australian Parliament;
- (4) directors' fees;
- (5) payments of superannuation, pension, retiring allowance or annuities or supplements to a pension or annuity;
- (6) commission to insurance or time-payment canvassers or collectors;
- (7) regular payments by way of compensation or for sickness or accident pay in respect of incapacity for work; and
- (8) payments under a range of specified Government schemes, programs, pensions or benefits.

**Excluded** from the scope of PAYE are payments of exempt income, living-away-from-home allowances, payments to members of certain local governing bodies and prescribed payments under the Prescribed Payments System (PPS) in Division 3A of Part VI of the Act. A flow chart to assist in determining whether PAYE applies is at Attachment A.

3. Categories (1) and (2), highlighted in **bold** in paragraph 2, are the most general and the most contentious. The Commissioner's views in respect of each are detailed below under the headings, '**Who is an employee within the ordinary meaning of that expression?**' (paragraphs 4 to 28) and '**Payments made under a contract wholly or principally for labour**' (paragraphs 29 to 45).

## **Who is an 'employee' within the ordinary meaning of that expression?**

### ***Context***

4. The relationship between an employer and an employee is a contractual one. It is often referred to as a contract **of service** (or, in the past, as a master/servant relationship). Such a relationship is typically contrasted with the independent contractor/principal relationship which, at law, is referred to as a contract **for services**. An independent contractor typically contracts to achieve a result whereas an employee contracts to provide his or her labour (typically to enable

the **employer** to achieve a result). An independent contractor works in his or her own business (or on his or her own account); an employee works in the service of the employer, i.e., in the employer's business.

5. While at either end of the **of service/for services** spectrum it may be easy to discern a classic employee and a classic independent contractor, at the centre there is no sharp division between the two relationships. The emergence of performance-based contracts, flexible working hours and work from home typify a trend which is blurring the traditional distinctions between employee and independent contractor.

6. The issue is contentious because of the different consequences attaching to each relationship, particularly from the payer's perspective. The obligation to make PAYE deductions is one consequence of having an employee. Other consequences may include vicarious liability, workers compensation, industrial award rates and conditions, superannuation and payroll tax.

### ***Common law***

7. The common law meaning of the term 'employee' was most recently stated by the High Court in *Stevens v. Brodribb Sawmilling Company Pty Ltd*.<sup>1</sup> It is clear from that case that there is no single objective **test** which will give the answer:

'... it is the totality of the relationship between the parties which must be considered ...';<sup>2</sup>

'... the question is one of degree for which there is no exclusive measure ...'.<sup>3</sup>

8. While various features have been identified by the courts as indicators of the true nature of the relationship, those features are only ever a guide to answering that question. It is necessary in each case to examine **all** the terms of the contract and to determine whether, on balance, the person is acting as an employee of another or is acting on his or her own behalf.

### ***Terms of the contract***

9. Where there is a written contract, the express and implied terms of the contract provide evidence of the intention of the parties at the

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<sup>1</sup> (1986) 160 CLR 16; (1986) 63 ALR 513; (1986) 60 ALJR 194 (*Stevens'* case).

<sup>2</sup> *Stevens'* case per Mason J at CLR 29; ALR 521; ALJR 198.

<sup>3</sup> *Stevens'* case per Wilson and Dawson JJ at CLR 36; ALR 526; ALJR 201.

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time of its formation. Those terms are identified and construed according to the circumstances surrounding the making of the contract. Conduct after formation of the contract is only relevant where it can be shown to amount to a modification of the original contract.<sup>4</sup>

10. A clause in a contract that purports to characterise the relationship between the parties as that of principal and independent contractor and not that of employer and employee must be considered with all the other terms of the contract. Such a clause cannot receive effect according to its terms if it contradicts the effect of the agreement as a whole; the parties to an agreement cannot alter the true substance of the relationship by simply giving it a different label. As Gray J stated in *Re Porter: re Transport Workers Union of Australia*:<sup>5</sup>

'Although the parties are free, as a matter of law, to choose the nature of the contract which they will make between themselves, their own characterisation of that contract will not be conclusive. A court will always look at all of the terms of the contract, to determine its true essence, and will not be bound by the express choice of the parties as to the label to be attached to it. As Mr Black put it in the present case, the parties cannot create something which has every feature of a rooster, but call it a duck and insist that everybody else recognise it as a duck.'

However, the parties may use such a clause to overcome any ambiguity as to the true nature of the relationship.<sup>6</sup>

11. For example, an employer may seek to change the status of an employee to that of independent contractor by both parties signing a contract of engagement that includes a clause to the effect that the worker is an independent contractor rather than an employee. That clause is ineffective if it is inconsistent with the apparent true nature of the relationship inferred from the contract as a whole. If the terms of the subsisting relationship (such as leave entitlements and other employee benefits) are not changed it is likely that the worker's status would remain that of employee.

12. The circumstances surrounding the formation of the contract may assist in determining the true character of the contract.<sup>7</sup> Thus, if a

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<sup>4</sup> See *Australian Mutual Provident Society v. Chaplin and Anor* (1978) 18 ALR 385 at 392-393 (*AMP case*); *Narich Pty Ltd v. Commissioner of Pay-roll Tax (NSW)* 84 ATC 4035 at 4038-40; (1983) 15 ATR 153 at 155-158; (1983) 50 ALR 417 at 419-423; (1983) 58 ALJR 30 at 31-33.

<sup>5</sup> (1989) 34 IR 179 at 184.

<sup>6</sup> *AMP case* at ALR 389-390.

contract comes into existence because the contractor advertises his or her services to the public in the ordinary course of carrying on a business or as a result of a successful tender application, the existence of a principal/independent contractor relationship is inferred. Conversely, if the contract is formed in response to a job vacancy advertisement or through the services of a placement agency, the existence of an employer/employee relationship is inferred.<sup>8</sup>

***Key indicators of whether a contract is 'of service' or 'for services'***

13. Bearing the above in mind, the features discussed below have traditionally been regarded by the courts as key indicators of whether a contract is one of **service** or **for services**.

*Control*

14. The classic 'test' for determining whether the relationship of master and servant existed was the exercise of control over the manner in which work was performed. While this may have been appropriate in a traditional nineteenth century master/servant relationship, it is not necessarily a relevant concept in the engagement of labour in the late twentieth century. With increasing usage of skilled labour and consequential reduction in supervisory functions, the focus of the control test has changed from the actual exercise of control to the right of control. Moreover, while control is important, it is not the sole indicator of whether or not a relationship is one of employment.<sup>9</sup>

15. The shift in emphasis from **exercise** to **right** of control is generally attributed to the earlier High Court decision in *Zuijs v. Wirth Brothers Pty Ltd*<sup>10</sup> in which the High Court articulated the significance of control in an employment relationship. The Court said:<sup>11</sup>

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<sup>7</sup> For example, *Reardon Smith Line Ltd v. Yngvar Hansen-Tangen* [1976] 1 WLR 989 at 997 per Lord Wilberforce; and *Codelfa Construction Pty Ltd v. State Rail Authority of New South Wales* (1982) 149 CLR 337 at 347-352; (1982) 41 ALR 367 at 371-375; (1982) 56 ALJR 459 at 461-463 per Mason J.

<sup>8</sup> *Roy Morgan Research Centre Pty Ltd v. Commissioner of State Revenue (Vic)* 96 ATC 4767 at 4772-4773; (1996) 33 ATR 361 at 366-367 per Byrne J.

<sup>9</sup> *Stevens'* case per Mason J at CLR 24; ALR 517; ALJR 196; and per Wilson and Dawson JJ at CLR 36; ALR 526; ALJR 201.

<sup>10</sup> (1955) 93 CLR 561; (1955) 29 ALJ 698 (*Zuijs'* case).

<sup>11</sup> *Zuijs'* case at CLR 571; ALJ 700.

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'What matters is lawful authority to command so far as there is scope for it. And there must always be some room for it, if only in incidental or collateral matters.'

16. This concept of a lawful authority to command vested in the payer is a necessary feature of an employment relationship. Consistent with the notion of an employee working in the employer's business, it is to be expected that the employer possesses (within applicable industrial relations law) an overriding discretionary power over its employees. Conversely, the incidence of a reserve power of control vested in the payer cannot transform what is in essence a contract **for services** into a contract **of service**.<sup>12</sup>

17. This change in emphasis is particularly important for skilled workers who may exercise significant discretion in how their tasks are performed.

## *'Results' contracts*

18. Where the substance of a contract is to achieve a specified result there is a strong indication that the contract is one for services. In *World Book (Australia) Pty Ltd v. FC of T*<sup>13</sup> Sheller JA said:

'Undertaking the production of a given result has been considered to be a mark, if not the mark, of an independent contractor.'<sup>14</sup>

## *Power to delegate*

19. An unlimited power to delegate work is an important indication that the worker is an independent contractor.<sup>15</sup> Delegation is generally implied in a contract for services where the emphasis is on result rather than person. The notion of a payer not requiring a contractor to perform personally any work under a contract is anathema to the employment concept of a person working in the service of another. However, delegation clauses are considered in the context of the

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<sup>12</sup> *Queensland Stations Proprietary Limited v. The Federal Commissioner of Taxation* (1945) 70 CLR 539 at 552; (1945) 19 ALJ 253 at 254; (1945) 8 ATD 30 at 35; [1945] ALR 273 at 277 per Dixon J (*Queensland Station* case).

<sup>13</sup> 92 ATC 4327 at 4334; (1992) 23 ATR 412 at 419-420 (*World Book* case).

<sup>14</sup> See also the *Queensland Stations* case at CLR 545; ALJ 253; ATD 31; ALR 274 per Latham CJ and at CLR 548; ALJ 254; ATD 32; ALR 275 per Rich J.

<sup>15</sup> For example, the *AMP* case at ALR 391 and *Stevens'* case at CLR 26; ALR 518; ALJR 197 per Mason J and at CLR 38; ALR 527; ALJR 202 per Wilson and Dawson JJ.

contract as a whole to determine if they are consistent with the apparent essence of the contract or if they are merely self-serving statements.

### *Risk*

20. Where the worker bears little or no risk of the costs arising out of injury or defect in carrying out his or her work, he or she is more likely to be an employee.

21. The higher the degree to which a worker is exposed to the risk of commercial loss (and the chance of commercial profit) the more he or she is likely to be seen as independent. Typically, a worker who derives piece rate payments and sustains large outgoings would be so exposed.

22. The higher the proportion of the gross income which the worker is required to expend in deriving that income, and the more substantial the assets which the worker brings to his or her tasks, the more likely it is that the contract is for services.<sup>16</sup>

### *Conditions of engagement*

23. The terms of the contract, when considered as a whole, indicate the presence or absence of the above features and therefore the true character of the contract. For example, the following circumstances point to an employment relationship:

- provision of benefits such as annual, sick, and long service leave;
- provision of other benefits prescribed under an award for employees;
- payer prescribed times and location for the performance of work;
- remuneration in the form of a salary or wage;
- worker uses assets and materials provided by the payer or is reimbursed, or paid a compensatory allowance, for expenses incurred in respect of use of own assets and materials; and

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<sup>16</sup> See, for example, *Humberstone v. Northern Timber Mills* (1949) 79 CLR 389 at 404; [1949] ALR 985 at 992; *Vabu Pty Ltd v. FC of T* 96 ATC 4898 at 4900; (1996) 33 ATR 537 at 538 per Meagher JA and ATC at 4902; ATR at 540 per Sheller JA (*Vabu* case).

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- payer discretion (within the constraints of industrial relations laws) in respect of task allocation and termination of engagement.

24. However, the list is not exhaustive and it must be emphasised that there is not a standard set of conditions applicable to an employee and another (different) set applicable to an independent contractor. Most conditions, when viewed individually, will be equivocal as indicators of the true character of the contract. For example:

- worker discretion in matters such as time and place of work may be consistent with a modern employment relationship;
- payer prescription as to time and place of work may be consistent with an independent contractor relationship;
- a performance based mode of payment may be consistent with an employment relationship; and
- a time based mode of payment may be consistent with an independent contractor relationship (but this may be construed as a contract **wholly or principally for labour** - see paragraphs 29 to 45 below).

25. Therefore, the significance, if any, of these matters depends on the facts of each case. What matters is how the conditions combine to colour the character of the contract. Attachment B sets out a summary of the key indicators and illustrates the different application of these indicators to a contract **of service** and a contract **for services**.

### ***Working on one's own account or in the business of the payer? - the so called 'integration' test***

26. In *Montreal v. Montreal Locomotive Works*<sup>17</sup> Lord Wright said:  
'it is in some cases possible to decide the issue by raising as the crucial question whose business is it, or in other words by asking whether the party is carrying on the business, in the sense of carrying it on for himself or on his own behalf and not merely for a superior.'

Similarly, in *Stevenson, Jordan and Harrison Ltd v. MacDonald and Evans*<sup>18</sup> Denning LJ said:

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<sup>17</sup> [1947] 1 DLR 161 at 169.

<sup>18</sup> [1952] 1 TLR 101 at 111.

'... under a contract of service, a man is employed as part of the business, and his work is done as an integral part of the business; whereas, under a contract for services, his work, although done for the business, is not integrated into it but is only accessory to it.'

From this, the notion of an 'integration' test (or organisation test as it is sometimes called) arose. While the label is not particularly illuminating, the underlying distinction drawn between an employee and an independent contractor may be a useful aid or reference point in determining the status of a worker, i.e., is the worker working on his or her own account (independent contractor) or in the service of the payer (employee)?<sup>19</sup>

27. However, the notion of integration has been treated by Australian courts with some suspicion and certainly as subsidiary to the notion of lawful authority to command.<sup>20</sup> Nevertheless, the courts have been prepared to use the concept as an ancillary check to reinforce conclusions based on the lawful authority to command concept.<sup>21</sup>

28. Therefore, integration should not to be viewed as an alternative test but rather, as another relevant consideration to be taken into account in conjunction with lawful authority to command and other relevant factors.

### **Payments made under a contract wholly or principally for labour**

29. The PAYE system includes payments made under a contract **wholly or principally for the labour** of the person to whom the payments are made, but excludes payments that are wholly or principally of a private or domestic nature (paragraph (a) of the definition of **salary or wages** in subsection 221A(1) of the Act).

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<sup>19</sup> See also *Bank Voor Handel en Scheepvaart NV v. Slatford and Anor* [1953] 1 QB 248 at 295 per Denning LJ; *Market Investigations Ltd v. Minister of Social Security* [1969] 2 WLR 1 at 9 per Cooke J; and *Marshall v. Whittaker's Building Supply Company* (1963) 109 CLR 210 at 217; [1963] ALR 859 at 863; (1963) 37 ALJR 92 at 95 per Windeyer J (*Marshall's case*).

<sup>20</sup> See *Marshall's case* at CLR 218; ALR 864; ALJR 95 per Windeyer J; *Stevens' case* at CLR 27-28; ALR 519-520; ALJR 197-198 per Mason J and at CLR 35-36; ALR 525-526; ALJR 201-202 per Wilson and Dawson JJ; and *Federal Commissioner of Taxation v. Barrett & Ors* (1973) 129 CLR 395 at 402; 73 ATC 4147 at 4150; (1973) 4 ATR 122 at 125 per Stephen J (*Barrett's case*).

<sup>21</sup> See *Australian Timber Workers Union v. Monaro Sawmills Pty Ltd* (1980) 42 FLR 369 at 378; (1980) 29 ALR 322 at 329 per Sweeney and Evatt JJ; and *Barrett's case* at CLR 407; ATC 4153; ATR 128 per Stephen J.

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However, if the payment is a prescribed payment for the purposes of PPS, that system applies to the exclusion of the PAYE system.

30. The term **prescribed payment** is defined in subsection 221YHA(1) of the Act as a payment declared by the Income Tax Regulations to be a prescribed payment for the purposes of PPS. The term **payment**, also defined in subsection 221YHA(1), specifically excludes payments of **salary or wages** within the meaning of section 221A other than salary or wages to which paragraph (a) of the definition of **salary or wages** in subsection 221A(1) applies, i.e., payments wholly or principally for labour. For the purposes of this Ruling, a payment of salary or wages to a common law employee is always subject to the PAYE system but a payment to an independent contractor under a contract wholly or principally for labour is only subject to the PAYE system if it is not declared by the Regulations to be a prescribed payment.

31. For a payment to be a prescribed payment for PPS purposes, there are, in essence, four requirements to be met:

- there must be a payment within the meaning of Division 3A of Part VI of the Act;
- that payment must be made, or liable to be made, under a contract;
- the contract must be for the performance of work that consists of carrying out certain prescribed activities; and
- the work must be carried out for a prescribed person.

Currently there are nine prescribed activities:

- building and construction;
- transportation by road of goods or materials;
- architectural services;
- surveying services;
- engineering services;
- professional building and construction services;
- construction of items of joinery that are to become fixtures in any structure;
- reconditioning, servicing, repair or maintenance of motor vehicles; and
- cleaning of:
  - office, business, residential institutional or any other premises; and

- roadways, thoroughfares, venues and other places.

For more information about any one of these prescribed activities, as well as the other requirements of PPS, see the relevant PPS Bulletin (Nos 1-9).

***Meaning of the expression 'a contract that is wholly or principally for ... labour'***

32. An equivalent expression, **a contract which is wholly or substantially for ... labour** (as it appeared in paragraph (a) of the definition of **salary or wages** in subsection 221A(1) of the Act prior to amendment in 1983) was considered by the High Court in *Neale v. Atlas Products (Vic) Proprietary Limited*.<sup>22</sup> The Court concluded that a contract under which the contractor is free to employ others to carry out the work is not a contract wholly or at all for the labour of the contractor. Rather, it is a contract to produce a given result.

33. The current terminology of the expression was inserted in 1983, along with an explanatory provision, paragraph 221A(2)(b), following the decision of the High Court in *Neale's* case. Paragraph 221A(2)(b) was intended to apply the expression where the person who was paid actually performed, or could reasonably be expected to perform, the whole or principal part of the labour under the contract. That is, a right of delegation that was not, or was not reasonably expected to be, acted upon other than in minor respects would be insufficient to take the contract outside the scope of the expression.

34. This amendment (along with the underlying expression) was considered by the NSW Court of Appeal in the *World Book* case. It found that paragraph 221A(2)(b) did not alter the High Court's interpretation of the expression. In effect, it is necessary for the contract to be characterised as a **contract that is wholly or principally for ... labour** before the paragraph can come into operation.

35. This interpretation of the expression was followed by the Full Court of the Supreme Court of South Australia in the later case of *Filsell v. Top Notch Fashions Pty Ltd*<sup>23</sup> and again by the NSW Court of Appeal when it looked at similar words in subsection 12(3) of the *Superannuation Guarantee (Administration) Act 1992* in the *Vabu* case.

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<sup>22</sup> (1955) 94 CLR 419 (*Neale's* case).

<sup>23</sup> 94 ATC 4656; (1994) 29 ATR 224.

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## *Residual scope*

36. While it is clear from the courts' decisions that the provision does not generally expand the scope of the PAYE system beyond common law employees, there are two significant residual areas of application:

- payments under contracts for the performance of work by persons engaged by a labour hire firm; and
- payments under contracts for performances by entertainers, sportspersons and the like.

## *Labour hire firms*

37. Labour hire arrangements commonly involve at least two contracts. A user of labour (or service recipient) typically contracts with a labour hire firm for the provision of labour of a specified kind. The labour hire firm does not contract to perform the work; it merely contracts to provide labour to work under the direction of the user. The labour hire firm then ascertains the availability of suitable workers on its books. Contacted workers may accept or reject the work offer. On acceptance, a contract is formed between the labour hire firm and each worker.

38. The question of whether such a tripartite arrangement gives rise to an employment relationship was considered by the Full Federal Court in *Building Workers' Industrial Union of Australia and Others v. Odco Pty Ltd.*<sup>24</sup> The Court found that an employment relationship did not exist between the worker and the user because a contractual relationship did not exist between these two parties; the user did not have an obligation to pay the worker. Similarly, the Court found that there was no employment relationship between the worker and the labour hire firm, although there existed a contractual relationship between these two parties, it was not in the nature of a contract of service. The workers were:

- free to accept or reject offers of work;
- not paid a weekly wage;
- not subject to leave entitlements; and
- not subject to control by the labour hire firm.

39. It is clear from the *Odco* case, that workers engaged under that particular type of labour hire arrangement are neither common law employees of the user nor the labour hire firm.

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<sup>24</sup> (1991) 29 FCR 104; (1991) 99 ALR 735 (*Odco* case).

40. A question which the Federal Court was not required to consider (being an industrial case), was whether the contract between the labour hire firm and the worker may properly be characterised as one wholly or principally for labour and therefore within the scope of the PAYE system.

41. Such a contract is not properly characterised as a contract for a result. The contract is, in substance, a contract wholly or principally for labour, although to a third party, but nonetheless also for the benefit of the labour hire firm (enabling it to fulfil its contractual obligation to the third party).<sup>25</sup> Therefore, the labour hire firm is liable to make PAYE tax instalment deductions from payments to contracted workers unless the payment is a prescribed payment within the meaning of PPS.

### ***Entertainers and sportspersons***

42. Paragraph 221A(2)(c) of the Act was introduced in 1983 (at the same time as paragraph 221A(2)(b)) as a response to the decision of the Supreme Court of Victoria in *Deputy Commissioner of Taxation v. Bolwell*<sup>26</sup> (see the explanatory memorandum relating to the Income Tax Assessment Amendment Bill 1983). In the *Bolwell* case, Lush J,<sup>27</sup> after considering the ordinary meaning of the term 'labour', found that the expression 'contract for the labour of a person':

'... does not appear ... to cover the case of the artiste or for that matter the professional man whose efforts result in something of his own creation, defined and limited according to his talents ...'

The provision is intended to ensure that the expression ('a contract that is wholly or principally for labour') encompasses performance payments and the like.

43. We believe this provision achieves its purpose as the opening words are drafted in an inclusive style. It is not necessary first to characterise the contract as being wholly or principally for labour. Rather, the provision says:

'a reference [i.e., in the definition of **salary or wages** in paragraph 221A(1)] to a contract that is wholly or principally for the labour of a person shall be read as including a reference to a contract that is wholly or principally:

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<sup>25</sup> See *Accident Compensation Commission v. Odco Pty Ltd* (1990) 95 ALR 641 at 652; (1990) 64 ALJR 606 at 612.

<sup>26</sup> (1967) 1 ATR 862 (*Bolwell* case).

<sup>27</sup> ATR at 873.

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- (i) for the performance or presentation by a person of, or the participation by a person in, any music, play, dance, entertainment, address, sport, display, promotional activity, exhibition, or any similar activity ... or for the performance of any services in connection with any such activity; or
- (ii) for the performance of services by a person in, or in connection with, the making of any film, tape or disc or of a television or radio broadcast'.

44. It is, of course, still necessary to establish that the contract is wholly or principally for the performance or presentation by a person, etc.

## **Payments made to persons other than individuals**

45. The PAYE system applies to any relevant payment to individuals. It does not apply to payments to partnerships, companies or trustees for the personal services of a third party - provided the arrangement is not a sham. Of course, any payments of salary or wages from the interposed entity to its employees would be subject to the PAYE system. Taxation Ruling IT 2121 refers to arrangements involving interposed entities for both income tax liability generally and the liability of employers to make tax instalment deductions under the PAYE system. If personal services income is diverted through a company, partnership or trust in an artificial, blatant and contrived manner to avoid the incidence of income tax, the general anti-avoidance provisions contained in Part IVA of the Act may apply.

## **Private 'rulings' and enforcement procedures**

46. The Commissioner cannot give a Private Binding Ruling on the issue of whether tax instalments are required to be deducted in the sense provided for by Part IVAA of the *Taxation Administration Act 1953* (TAA) because those provisions do not apply to tax collection matters. While the Commissioner, in accordance with Taxation Ruling IT 2500, treats as administratively binding his opinions on such matters as the application of the PAYE provisions, such opinions do not give rise to objection, review and appeal rights provided in respect of Part IVAA rulings.

47. The only avenue of judicial review prior to the commencement of enforcement action is the declaratory writ process instituted in a court of appropriate jurisdiction. Otherwise, a person dissatisfied with the opinion of the Commissioner must wait until enforcement action is instituted - either prosecution or imposition of 'failure to deduct'

penalties. In the case of 'failure to deduct penalties', the Commissioner has a general discretion to remit the culpability component of the penalty in whole or in part (see Taxation Ruling TR 97/8). A person dissatisfied with a remission decision of the Commissioner may object in the manner set out in Part IVC of the TAA.

## Date of effect

48. This Ruling applies to years commencing both before and after its date of issue. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

## Previous Rulings

49. Taxation Rulings IT 2009, IT 2108, IT 2129, IT 2137, IT 2396, IT 2511, IT 2541, IT 2576, IT 2677, and Taxation Determinations TD 92/191 and TD 93/228 will be withdrawn when this draft Ruling is finalised. To the extent that our views in those Rulings still apply, they have been incorporated in this Ruling.

## Detailed contents list

50. Below is a detailed contents list for this draft Ruling:

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## Your comments

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51. If you wish to comment on this draft Ruling, please send your comments by: 12 September 1997

to:

Contact Officer: Mr Stuart Dunlop  
Telephone: (07) 3213 8578  
Facsimile: (07) 3213 8490  
Address: Mr Stuart Dunlop  
Australian Taxation Office  
P O Box 9990  
CHERMSIDE QLD 4032.

**Commissioner of Taxation**

30 July 1997

|  |             |   |
|--|-------------|---|
| ISSN   | 1039 - 0731 | - Australian Timber Workers Union v. Monaro Sawmills Pty Ltd (1980) 42 FLR 369; (1980) 29 ALR 322   |
| ATO references   |             | - Bank Voor Handel en Scheepvaart NV v. Slatford and Anor [1953] 1 QB 248   |
| NO   | 97/6507-7   | - Building Workers' Industrial Union of Australia and Others v. Odco Pty Ltd (1991) 29 FCR 104; (1991) 99 ALR 735                                       |
| BO   |             | - Codelfa Construction Pty Ltd v. State Rail Authority of New South Wales (1982) 149 CLR 337; (1982) 41 ALR 367; (1982) 56 ALJR 459                     |
| Not previously released to the public in draft form                                      |             | - Deputy Commissioner of Taxation v. Bolwell (1967) 1 ATR 862   |
| Price  | \$2.20      | - Federal Commissioner of Taxation v. Barrett and Ors (1973) 129 CLR 395; 73 ATC 4147; (1973) 4 ATR 122   |
| FOI index detail   |             | - Filsell v. Top Notch Fashions Pty Ltd 94 ATC 4656; (1994) 29 ATR 224  |
| <i>reference number</i>  |             | - Humberstone v. Northern Timber Mills (1949) 79 CLR 389; [1949] ALR 985  |
| <i>subject references</i>  |             | - Market Investigations Ltd v. Minister of Social Security [1969] 2 WLR 1   |
| - employer v independent contractor  |             | - Marshall v. Whittaker's Building Supply Company (1963) 109 CLR 210; [1963] ALR 859; (1963) 37 ALJR 92   |
| - extended definition of salary or wages   |             | - Montreal v. Montreal Locomotive Works [1947] 1 DLR 161  |
| - independent contractor issues  |             | - Narich Pty Ltd v. Commissioner of Pay-roll Tax (NSW) 84 ATC 4035; (1983) 15 ATR 153; (1983) 50 ALR 417; (1983) 58 ALJR 30                             |
| - master/servant relationship issues   |             | - Neale v. Atlas Products (Vic) Proprietary Limited (1985) 94 CLR 419   |
| - PAYE   |             | - Queensland Stations Proprietary Limited v. The Federal Commissioner of Taxation (1945) 70 CLR 539; (1945) 19 ALJ 253; (1945) 8 ATD 30; [1945] ALR 273 |
| - PAYE employer obligations  |             |   |
| - PAYE instalment deduction issues   |             |   |
| <i>legislative references</i>  |             |   |
| - ITAA36 221A  |             |   |
| - ITAA36 221A(1)   |             |   |
| - ITAA36 221A(2)(b)  |             |   |
| - ITAA36 221A(2)(c)  |             |   |
| - ITAA36 Pt VI Div 2   |             |   |
| - ITAA36 221C(1A)  |             |   |
| - ITAA36 221YHA(1)   |             |   |
| - SGAA 12(3)   |             |   |
| - TAA Pt IVAA  |             |   |
| - TAA Pt IVC   |             |   |
| <i>case references</i>   |             |   |
| - Accident Compensation Commission v. Odco Pty Ltd (1990) 95 ALR 641; (1990) 64 ALJR 606 |             |   |
| - Australian Mutual Provident Society v. Chaplin and Anor (1978) 18 ALR 385              |             |   |

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- Reardon Smith Line Ltd v. Yngvar Hansen-Tangen [1976] 1 WLR 989
- Re Porter: re Transport Workers Union of Australia (1989) 34 IR 179
- Roy Morgan Research Centre Pty Ltd v. Commissioner of State Revenue (Vic) 96 ATC 4767; (1996) 33 ATR 361
- Stevens v. Brodribb Sawmilling Company (1986) 160 CLR 16; (1986) 63 ALR 513; (1986) 60 ALJR 194
- Stevenson, Jordan and Harrison Ltd v. MacDonald and Evans [1952] 1 TLR 101
- Vabu Pty Ltd v. FC of T 96 ATC 4898; (1996) 33 ATR 537
- World Book (Australia) Pty Ltd v. FC of T 92 ATC 4327; (1992) 23 ATR 412
- Zuijs v. Wirth Brothers Proprietary Limited (1955) 93 CLR 561; (1955) 29 ALJ 698

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ATTACHMENT A

## PAYE FLOWCHART



NOTE: If payment is not within PAYE system, reporting of payment may be necessary for RPS if in clothing, fishing, fruit and vegetable or smash repair industry

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## ATTACHMENT B

### Features of Relationship

#### Employee - Contract of service

#### Independent Contractor-Contract for Services

1. Lawful authority to command

Under a contract of service, the payer usually has the right to direct the manner of performance. Of course, where the nature of the work involves the professional skill or judgment of the worker, the degree of control over the manner of performance is diminished. What is important is the lawful authority to command that rests with the payer.

The hallmark of a contract for services is said to be that the contract is one for a given result. The contractor works to achieve the result in terms of the contract. The contractor works on his/her own account.

2. How is the work performed?

Tasks are performed at the request of the employer. The worker is said to be working in the business of the payer.

An independent contractor enters into a contract for a specific task or series of tasks. The contractor maintains a high level of discretion and flexibility as to how the work is to be performed. However, the contract may contain precise terms as to materials used and methods of performance and still be one for services.

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|                         |  |  |
|-------------------------|--|--|
| 3. Risk                 | An employee bears little or no risk. An employee is not exposed to any commercial risk. This is borne by the employer. Further, the employer is generally responsible for any loss occasioned by poor workmanship or negligence of the employee. | An independent contractor stands to make a profit or loss on the task. They bear the commercial risk. The contractor bears the responsibility and liability for any poor workmanship or injury sustained in performance of the task. Generally a contractor would be expected to carry their own insurance policy. |
| 4. Place of performance | A worker under a contract of service will generally perform the tasks on the payer's premises using the payer's assets and equipment.  | A contractor on the other hand will generally provide all their own assets and equipment.  |
| 5. Hours of work        | An employee generally works standard or set hours.   | An independent contractor generally sets their own hours of work.  |
| 6. Leave Entitlements   | The contract will generally provide for annual leave, long service leave, sick leave and other benefits or allowances.   | Generally an independent contract would not contain leave provisions.  |
| 7. Payment              | An employee is generally paid an hourly rate, piece rates or award rates.  | Payment to an independent contractor is based upon performance of the contract.  |
| 8. Expenses             | An employee is generally reimbursed for expenses incurred in the course of employment.   | An independent contractor incurs their own expenses.   |
| 9. Appointment          | An employee is generally recruited through an advertisement by the employer.   | An independent contractor is likely to advertise their services to the public at large.  |

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10. Termination

An employer reserves the right to dismiss an employee at any time (subject to State or Federal legislation).

An independent contractor is contracted to complete a set task. The payer may only terminate the contract without penalty where the worker has not fulfilled the conditions of the contract. The contract will usually contain terms dealing with defaults made by either party.

11. Delegation

An employee has no inherent right to delegate tasks to another. However, there may be a power to delegate some duties to other employees.

An independent contractor may delegate all or some of the tasks to another person, and may employ other persons.