TR 1999/13 - Income tax: tax instalment deductions

Taxation Ruling
Income tax: tax instalment deductions

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Preamble

*The number, subject heading, **Class of person/arrangement**, **Ruling and explanations** and **Date of effect** parts of this document are a 'public ruling' for the purposes of Part IVAAA of the **Taxation Administration Act 1953** and are legally binding on the Commissioner. Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a public ruling and how it is binding on the Commissioner.*

What this Ruling is about

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

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;

(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;
- a member of an Australian Parliament; or
- a member of an eligible local governing body;

(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.

3. **Excluded** from the scope of PAYE are payments of exempt income, living-away-from-home allowances (within the meaning of the *Fringe Benefits Tax Assessment Act 1986*), 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**.

4. This Ruling is concerned only with the scope of categories (1) and (2) highlighted in **bold** in paragraph 2.

5. Category (1) is the most significant category as it accounts for the bulk of PAYE collections. The determination of whether a person is an employee or an independent contractor according to the common law may be difficult and contentious in some cases. The Commissioner's views on the issue are detailed below under the heading, '**Who is an employee within the ordinary meaning of that expression?**' (paragraphs 12 to 44).

6. The Commissioner's views on Category 2 are detailed below under the heading, '**Payments made under a contract wholly or principally for labour**' (paragraphs 45 to 69).

Payments made to persons other than individuals

7. The PAYE system does not apply to payments made to partnerships, companies, or trustees - provided the arrangement is not a sham or a mere redirection of an employee's salary or wages.

8. A sham is an arrangement that creates the appearance of rights and obligations different from those actual rights and obligations that the parties intend to create.[1] The parties must have a common intention that the arrangement is a mere facade, disguise or false front for a sham arrangement to exist.[2]

9. Also, a payment to a third party is treated as a redirection of an employee's salary or wages (and hence a constructive payment of salary or wages to the employee) in circumstances where there is a subsisting employment contract that has not been terminated and the payments are attributable to services rendered by the employee. In *Southern Group Ltd v Smith*[3] the Full Court of the Western Australian Supreme Court found that the contract of employment was between the plaintiff and an individual rather than with the individual's private company.

10. Where a service company is used to provide the personal services of its principal, all the terms of the contract must be consistent with such an engagement. The contract must indicate an intention to contract with the service company rather than with the individual. In addition, any payments of salary or wages from the service company to its employees are subject to the PAYE system.

11. Alternatively, where personal services income is diverted through a company, partnership or trust to avoid the incidence of income tax, the general anti avoidance provision in Part IVA of the Act may apply. Taxation Ruling IT 2121 outlines some instances where the Commissioner may invoke Part IVA.

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[1] *Snook v. London and West Riding Investment Ltd* (1967) 2 QB 786 at 802 per Diplock J; *Sharrment Pty Ltd v. Official Trustee in Bankruptcy* (*Sharrment's* case) (1988) 82 ALR 530 at 536; (1988) 18 FCR 449 at 454 per Lockhart J.

[2] *Scott v. FC of T (No 2)* (1966) 40 ALJR 265 at 279 per Windeyer J as quoted in *Sharrment's* case at ALR 538; FCR 456 per Lockhart J.

[3] *Southern Group Ltd v. Smith* (1997) 37 ATR 107; 98 ATC 4733.

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

Background

12. 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 that, 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) while an employee works in the service of the employer, i.e., in the employer's business.

13. At law there is a clear distinction between a contract **for services** (where the contractor is self-employed and works on his or her own account) and a contract **of service** (where the contractor is employed by the payer and works on account of, or in the business of, the payer). In most cases, the character of the contract is self-evident. However, it is sometimes difficult to discern the true character of a contract from the facts of the case as the intentions of the contracting parties may be unclear or ambiguous, such as where the terms of the contract are disputed or are otherwise in apparent conflict.

14. The distinction is important as significantly different consequences arise for both the payer and payee. From the payer's perspective, the engagement of an employee as opposed to an independent contractor may trigger or add to various employer/business obligations and risks such as:

- superannuation;
- payroll tax;
- workers compensation insurance;
- public liability insurance;
- award rates and conditions;
- unfair dismissal action; and
- PAYE and FBT.

15. The engagement of an independent contractor may obviate some or all of the above obligations or risks and provide enhanced labour flexibility. However, costs and flexibility are not the only issues to be considered. There are a number of intangible benefits from engaging employees, such as work force stability and the retention of core knowledge, skills and expertise required by the

business. These factors ensure the continuing importance of employees in core roles.

16. From a payee's perspective there may be perceived advantages in being an independent contractor rather than an employee, for example:

- being your own 'boss';
- being in 'business';
- greater opportunity for substantial wealth enhancement; and
- greater income tax deductions.

17. There are, of course, a number of countervailing costs and risks associated with being an independent contractor, namely:

- personal provision for superannuation;
- the need for public liability insurance;
- the need for personal sickness and accident/income protection insurance;
- no paid leave;
- reduced work/income security; and
- greater cost pressures.

Other types of contract

18. The arrangement between the parties may be structured in a way that does not give rise to a payment for services rendered but rather a payment for something entirely different, such as a lease or a bailment. In these circumstances, a person enters into a lease or bailment for the use of property owned by another person, and payments are made from the lessee or bailee to the lessor or bailor. Consequently, the lessee or bailee, rather than being a provider of services to the owner of the asset, acquires a right to exploit that asset for his or her own benefit in return for a 'rental' payment to the owner. In *FCT v. De Luxe Red and Yellow Cabs Co-op (Trading) Society Ltd and Others*,[4] the Full Federal Court found that a bailment contract existed between the taxi licence owner and the taxi driver, which effectively precluded the existence of an employer/employee relationship.

[4] 98 ATC 4468; (1998) 38 ATR 609 - an application for special leave to appeal to the High Court was refused.

Common law

19. The common law meaning of the term 'employee' was stated by the High Court in *Stevens v. Brodribb Sawmilling Company Pty Ltd*.[5] 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 ...';[6] and
>
> '... the question is one of degree for which there is no exclusive measure ...'.[7]

20. 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 working in the service of another (i.e., as an employee) or is working on his or her own behalf (i.e., as an independent contractor).

Terms and the circumstances of the formation of the contract

21. Where there is a written contract, the express and implied terms of the contract provide evidence of the intention of the parties at the 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.[8]

22. 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*:[9]

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[5] (1986) 160 CLR 16; (1986) 63 ALR 513; (1986) 60 ALJR 194 (*Stevens*' case).

[6] *Stevens*' case per Mason J at CLR 29; ALR 521; ALJR 198.

[7] *Stevens*' case per Wilson and Dawson JJ at CLR 36; ALR 526; ALJR 201.

[8] 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.

[9] (1989) 34 IR 179 at 184.

> '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.[10]

23. 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.

24. The circumstances surrounding the formation of the contract may assist in determining the true character of the contract.[11] Thus, if a 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.[12]

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

25. 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**.

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[10] *AMP* case at ALR 389-390.

[11] 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.

[12] *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; this decision was affirmed by the Court of Appeal (97 ATC 5070; (1997) 37 ATR 528) and an application for special leave to the High Court was refused.

Control

26. 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.[13]

27. The mere fact that a contract may specify in detail how the contracted services are to be performed, does not necessarily imply an employment relationship. In fact, a high degree of direction and control is not uncommon in contracts for services. The payer has a right to specify how the contracted services are to be performed, but such control must be expressed in the terms of the contract otherwise the contractor is free to exercise his or her discretion (subject to any terms implied by law). This is because the contractor is working for himself or herself.

28. Under a contract of service, on the other hand, the employer has an implied right within the limits imposed by industrial relations laws, to direct and control the work of an employee. This is because the employee is working in the employer's business and the owner of a business has the right (within the confines of applicable law) to manage that business as the owner sees fit.

29. In *Zuijs v. Wirth Brothers Pty Ltd*[14] the High Court articulated the significance of control in an employment relationship in the following way:[15]

> '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.'

'Results' contracts

30. Where the substance of a contract is to achieve a specified result, there is a strong (but not conclusive) indication that the contract

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[13] *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.

[14] (1955) 93 CLR 561; (1955) 29 ALJ 698 (*Zuijs*' case).

[15] *Zuijs*' case at CLR 571; ALJ 700.

is one for services. In *World Book (Australia) Pty Ltd v. FC of T*[16] 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.'[17]

31. In a contract for services, the contract specifies the services to be performed in return for an agreed payment. Satisfactory completion of the specified services is the 'result' for which the parties have bargained. Conversely, under a contract of service, payment is not necessarily (but may be) dependent on, and referable to, the completion of specified services.

32. Therefore, while the notion of 'payment for a result' is expected in a contract for services, it is not necessarily inconsistent with a contract of service, for example, in contracts for commission only sales.[18] Accordingly, the other terms of the contract must still be considered in order to determine the true character of the contract.

Power to delegate

33. An unlimited power to delegate work (with or without the approval of the service requirer) is an important indication that the service provider is an independent contractor.[19] Under a contract for services, the emphasis is on performance of the agreed services (achievement of the 'result'). Unless the contract expressly requires the service provider personally to perform the contracted services, that person may arrange for his or her employee(s) to perform all or some of the work or may subcontract all or some of the work to another service provider.

34. The notion of the payer not requiring the payee personally to perform any work at all under the contract is contrary to the employment concept of a person working in the service of another. However, delegation clauses are considered in the context of the 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.

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[16] 92 ATC 4327 at 4334; (1992) 23 ATR 412 at 419-420 (*World Book* case).

[17] 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.

[18] *Federal Commissioner of Taxation v. Barrett and Ors* 73 ATC 4147; (1973) 4 ATR 122 (*Barrett's* case).

[19] 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.

Risk

35. 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.

36. 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 regarded as being independent. Typically, a worker who derives piece rate payments and sustains large outgoings would be so exposed.

37. 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.[20]

Conditions of engagement

38. Some conditions of engagement are intimately associated with employment and may, therefore, be persuasive indicators. For example:

- provision of benefits such as annual, sick, and long service leave;
- superannuation contributions;
- provision of other benefits prescribed under an award for employees;
- where the worker uses assets and materials provided by the payer or is reimbursed, or is paid a compensatory allowance, for expenses incurred in respect of using their own assets and materials; and
- where there is a payer discretion (within the constraints of industrial relations laws) in respect of task allocation and termination of engagement.

39. However, this list is not exhaustive and it must be emphasised that there is not a standard set of conditions applicable to an employee and a different set of conditions applicable to an independent contractor. Also, most conditions of engagement, when viewed

[20] 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).

individually, are equivocal as indicators of the true character of the contract.

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

40. In *Montreal v. Montreal Locomotive Works*[21] 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*[22] Denning LJ said:

> '... 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.'

41. From these statements, the notion of an 'integration' test (or organisation test as it is sometimes called) arose. While the factor is not solely determinative, this 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)?[23]

42. 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.[24] Nevertheless, the Courts have been prepared to use the concept as an ancillary check to

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[21] [1947] 1 DLR 161 at 169.

[22] [1952] 1 TLR 101 at 111.

[23] 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).

[24] 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 *Barrett's* case at CLR 402; ATC 4150; ATR 125 per Stephen J.

reinforce conclusions based on the lawful authority to command concept.[25]

43. 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.

44. **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**.

Payments made under a contract wholly or principally for labour

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

46. 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**,[26] 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. 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 a payment of a kind declared by the Regulations to be a prescribed payment.

47. The payments that are currently prescribed are:

- certain payments within nine specified industries (see PPS Bulletins 1 to 9 for information on how PPS affects these industries); and

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[25] 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.

[26] For more information on the meaning of the term 'payment' for PPS purposes see PPS Bulletin 11.

- any other payment that the payer and payee have voluntarily agreed is a prescribed payment (see PPS Bulletin 10 - *Voluntary Agreements*).

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

48. 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*.[27] 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.

49. 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.

50. 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.

51. This interpretation of the expression was followed by the Full Court of the Supreme Court of South Australia in *Filsell v. Top Notch Fashions Pty Ltd*[28]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.

Residual scope

52. While it is clear from the Courts' decisions that the provision, on its own (i.e., excluding the operation of paragraph 221A(2)(c) - discussed below), does not generally expand the scope of the PAYE

[27] (1955) 94 CLR 419 (*Neale's* case).

[28] 94 ATC 4656; (1994) 29 ATR 224.

system beyond payments of salary or wages to common law employees, the Courts have not dismissed the provision as being redundant.

53. In *Neale's* case[29], the High Court made the following comment:

> 'It may be, however, that in cases where an independent contractor is required by the terms of his contract to perform the contractual work himself the addition to the general definition may have some application, but it is unnecessary, in the circumstances of this case, to express any concluded view concerning contracts of such a special class.'

54. In the *World Book* case, Sheller JA[30], in the NSW Court of Appeal, after noting that 'undertaking the production of a given result has been considered to be a mark, if not the mark, of an independent contractor,' concluded:

> 'It may be that there are contracts for services which are wholly or principally for the labour of a person and which are not undertaken by the contractor to produce a given result. To the rewards of such contracts the definition may apply. But a contract which is undertaken by a contractor to produce a given result is not, in my opinion, a contract wholly or principally for the labour of a person for reason that the labour is undertaken not for the principal but for the contracting party himself to produce the result he has contracted to produce.'

55. The decided cases have not indicated examples of a class of contracts for work, being neither employment contracts nor 'result' contracts, that can reasonably be construed as being wholly or principally for the labour of a person. However, certain labour hire arrangements (specifically, those that are described in paragraphs 56 to 60) whereby labour hire firms hire out contract workers to clients, are considered by the Commissioner to come within that class.

Labour hire arrangements

56. The expression 'labour hire' is a term often used in a generic sense to describe the use of any form of labour market intermediary. In this generic sense, 'labour hire' gives rise to a variety of contractual relationships. Whenever a contract is formed with an individual to perform work, it is that contract that must be characterised for PAYE purposes. The first test is always to determine if a contract of service

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[29] (1955) 94 CLR 419 at 425.

[30] 92 ATC 4327 at 4334; (1992) 23 ATR 412 at 419-420.

exists and only if the answer to that question is negative, is the 'wholly or principally for labour' issue considered.

57. A user of labour or service requirer may contract 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.

58. The question of whether such a tripartite arrangement gives rise to a common law employment relationship was considered by the Full Federal Court in *Building Workers' Industrial Union of Australia and Others v. Odco Pty Ltd*.[31] 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. 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.

59. It was decided that workers engaged under that particular type of labour hire arrangement are neither common law employees of the user nor the labour hire firm. However, a question that the Court was not required to consider 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.

60. The Commissioner considers that the contract between the labour hire firm and worker is not properly characterised as a contract for a result. In a labour hire arrangement, the contract in substance requires the worker to provide some services for the benefit of a third party. The worker does not undertake to provide a particular result; rather, the worker undertakes to perform some work for a client of the labour hire firm. Therefore, the labour hire firm is liable to make

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[31] (1991) 29 FCR 104; (1991) 99 ALR 735 (*Odco* case). The Supreme Court of Victoria followed and applied *Odco* in *Drake Personnel Limited & Others v. Commissioner of State Revenue (Victoria)* 98 ATC 4915; (1998) 40 ATR 304. However, at the time of finalising this Ruling, that decision was on appeal to the Full Court.

PAYE tax instalment deductions from payments to contracted workers, unless the payment is a prescribed payment within the meaning of PPS.

Significant alternative views

61. It has been argued that, in substance, the contract between the labour hire firm and the worker must be characterised as being for a result and, therefore, is not wholly or principally for labour. That is, if the worker is determined to be working for himself or herself and not in the service of the payer, any labour performed by the worker is for the benefit of the worker to enable the worker to perform his or her contractual obligation to the labour hire firm.

62. The Commissioner considers that such a view ignores the substance of the arrangement, as stated in paragraph 60, and defeats the purpose of the legislative provision by rendering it redundant. In the absence of any clear judicial statement to the effect that a contract wholly or principally for the labour of the person paid is always a contract of service, the Commissioner will seek to give the provision practical application.

63. Accordingly, where a labour hire arrangement is in substance a device to 'employ' labour without creating employment contracts, the Commissioner may construe the contract between the labour hire firm and the worker as being wholly or principally for labour and, therefore, subject to PAYE. Of course, in all cases where a common law employment relationship is not created and the payment is not otherwise prescribed (for PPS purposes), it is open for the parties to agree that the payment be prescribed and, therefore, subject to PPS rather than PAYE (see PPS Bulletin 10 for more information).

64. A further alternative view was that the relationship between the labour hire firm and worker is *sui generis* (of its own kind). The relationship is not **for services** or **of service** but rather of a third kind. In *Construction Industry Training Board v. Labour Force Ltd*, Cooke J[32] in *obita* alluded to the possible existence of a third type of contract in the context of labour type arrangements. However, this approach has not received subsequent support in Australia. Woodward J[33] in the *Odco* case at first instance, did refer to the decision of Cooke J but this approach was not adopted by the Full Federal Court on appeal. Since the Courts have shown no inclination to develop this line of argument, the Commissioner maintains that the

[32] *Construction Training Board v. Labour Force Ltd* [1970] 3 ALL ER 220 at 225.

[33] *Odco Pty Ltd v. Building Workers Industrial Union (Australia) and Others* (Federal Court, Woodward J, 24 August 1989).

only distinction is between a contract of service and a contract for services.

Entertainers and sportspersons

65. 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*[34] (see the explanatory memorandum relating to the Income Tax Assessment Amendment Bill 1983). In the *Bolwell* case, Lush J,[35] 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.

66. 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:
>
> (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'.

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

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[34] (1967) 1 ATR 862 (*Bolwell* case).

[35] ATR at 873.

Significant alternative view

68. It has been argued that paragraph 221A(2)(c) was designed to overcome the narrow interpretation of 'labour' apparent from the *Bolwell* case and it was not intended to obviate the need to characterise the contract as wholly or principally for 'labour'. Consequently, if a contract for a performance, etc., could be construed as a contract for a result, then PAYE would not apply.

69. The Commissioner does not consider this to be a correct interpretation of the legislation. It neither gives effect to the clear words of the provision nor does it confer any practical application to the provision as contracts for a performance, etc., may be readily characterised as being for a result. Accordingly, the Commissioner has adopted a view that both gives effect to the provision as drafted and gives it potential practical application.

Private 'rulings' and enforcement procedures

70. 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.

71. 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 penalty and general interest charge in whole or in part.

Date of effect

72. 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 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

73. Taxation Rulings IT 2009, IT 2077, 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 are now withdrawn. To the extent that our views in those Rulings still apply, they have been incorporated in this Ruling.

Detailed contents list

74. Below is a detailed contents list for this Ruling:

Commissioner of Taxation
8 September 1999

Previous draft:
Previously released as TR 97/D9

Related Rulings/Determinations:
IT 2121; IT 2500

Subject references:
- employer v independent contractor
- extended definition of salary or wages
- independent contractor issues
- master/servant relationship issues
- PAYE
- PAYE employer obligations
- PAYE instalment deduction issues

Legislative references:
- ITAA36 Pt VI Div 2
- ITAA36 221A
- ITAA36 221A(1)
- ITAA36 221A(2)(b)
- ITAA36 221A(2)(c)
- ITAA36 221C(1A)
- ITAA36 221YHA(1)
- ITAA36 Pt IV Div 3A
- ITAA36 Pt IVA
- SGAA 12(3)
- TAA Pt IVAA
- TAA Pt IVC

Case references:
- 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
- Australian Timber Workers Union v. Monaro Sawmills Pty Ltd (1980) 42 FLR 369; (1980) 29 ALR 322
- Bank Voor Handel en Scheepvaart NV v. Slatford and Anor 1953] 1 QB 248
- Building Workers' Industrial Union of Australia and Others v. Odco Pty Ltd (1991) 29 FCR 104; (1991) 99 ALR 735
- Codelfa Construction Pty Ltd v. State Rail Authority of New South Wales (1982) 149 CLR 337; (1982) 41 ALR 367; (1982) 56 ALJR 459
- Construction Training Board v. Labour Force Ltd [1970] 3 All ER 220
- Deputy Commissioner of Taxation v. Bolwell (1967) 1 ATR 862
- Drake Personnel Limited and Others v. Commissioner of State Revenue (Victoria) (1998) 40 ATR 304; 98 ATC 4915
- FCT v. De Luxe Red and Yellow Cabs Co-op (Trading) Society Ltd and Others 98 ATC 4468; (1998) 38 ATR 609

- Federal Commissioner of Taxation v. Barrett and Ors (1973) 129 CLR 395; 73 ATC 4147; (1973) 4 ATR 122
- Filsell v. Top Notch Fashions Pty Ltd 94 ATC 4656; (1994) 29 ATR 224
- Humberstone v. Northern Timber Mills (1949) 79 CLR 389; [1949] ALR 985
- Market Investigations Ltd v. Minister of Social Security [1969] 2 WLR 1
- Marshall v. Whittaker's Building Supply Company (1963) 109 CLR 210; [1963] ALR 859; (1963) 37 ALJR 92
- Montreal v. Montreal Locomotive Works [1947] 1 DLR 161
- 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
- Neale v. Atlas Products (Vic) Proprietary Limited (1985) 94 CLR 419
- Queensland Stations Proprietary Limited v. FC of T (1945) 70 CLR 539; (1945) 19 ALJ 253; (1945) 8 ATD 30; [1945] ALR 273
- 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
- Scott v. FC of T (No 2) (1966) 40 ALJR
- Sharrment Pty Ltd v. Official Trustee in Bankruptcy (1988) 82 ALR 530; (1988) 18 FCR 449
- Snook v. London and West Riding Investment Ltd (1967) 2 QB 786
- Southern Group Ltd v. Smith (1997) 37 ATR 107; 98 ATC 4733
- 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

ATO references:
NO 97/6507-7
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FOI Index detail: I 1020585
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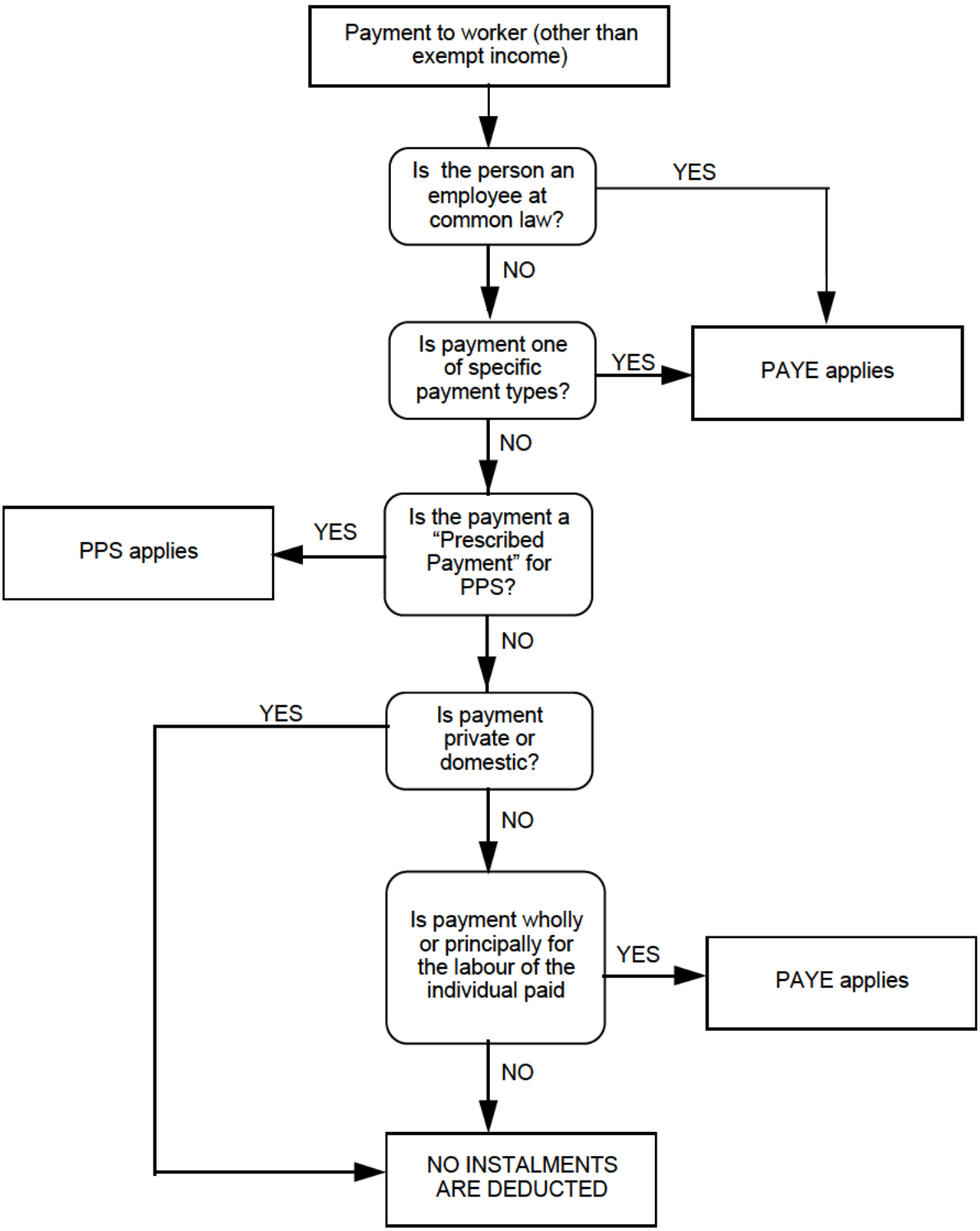
PAYE FLOWCHART

Attachment A



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

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.
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, generally provides 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 generally provides for annual leave, long service leave, sick leave and other benefits or allowances.	Generally, an independent contract does 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.	Generally, 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.
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 usually contains 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.