



# ***TR 2000/14 - Income tax: Pay As You Go - withholding from payments to employees***

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## Taxation Ruling

### Income tax: Pay As You Go - withholding from payments to employees

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#### ***Preamble***

*This document does not rule on the application of a 'tax law' (as defined) and is, therefore, not a 'public ruling' for the purposes of Part IVAAA of the **Taxation Administration Act 1953**. The document is, however, administratively binding on the Commissioner of Taxation. 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**

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1. This Ruling applies to entities that pay salary, wages, commission, bonuses or allowances to an individual as an employee (whether of the paying entity or another entity). The Ruling provides guidance as to whether an individual is paid as an employee for the purposes of section 12-35, Schedule 1, Part 2-5 Pay As You Go (PAYG) of the *Taxation Administration Act 1953* (TAA). That section imposes an obligation on the paying entity to withhold an amount from the relevant payment.

#### **Background**

2. The PAYG system, contained in Schedule 1 to the TAA, is a comprehensive new system for the collection of income tax and other liabilities. Schedule 1, Part 2-5 of the TAA, relates specifically to the PAYG withholding provisions. These provisions replace the Prescribed Payments System (PPS) and the Reportable Payments System (RPS) and incorporate the main elements of the Pay As You Earn (PAYE) system. The remaining withholding systems which cover various types of payments (e.g., dividends, interest and royalties payments to non-residents) have also been standardised and form part of the new PAYG withholding regime.

3. Before PAYG, the income tax law had 9 systems under which amounts were required to be withheld from payments and remitted to the Commissioner. These systems included: PAYE; PPS; RPS; withholding where no Tax File Number (TFN) is quoted on investments; collection of withholding tax on dividends, interest and

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royalties paid to non-residents etc. Each of these systems had its own legislative structure with its own discrete set of machinery rules (i.e., rules in relation to the reporting and remission of these amounts to the Commissioner).

4. The new withholding provisions - the PAYG withholding provisions - provide a single set of common machinery rules applicable to all withholding payments. The PAYG withholding provisions have effect in relation to payments made on or after 1 July 2000.

5. How much an entity is required to withhold is set out in Tax Tables published by the Commissioner or in the *Income Tax Regulations 1936* (section 15-10 of Schedule 1 of the TAA). In special circumstances, the Commissioner has the power to vary the amount of withholding that applies to an entity or a class of entities (section 15-15 of Schedule 1 of the TAA).

6. Division 12 of Part 2-5 of Schedule 1 of the TAA contains the PAYG withholding provisions that apply to cash payments. Division 14 of Part 2-5 of Schedule 1 of the TAA, applies to non cash benefits. A non-cash benefit includes property or services in any form except money. Under these provisions, an entity (the payer) must pay an amount to the Commissioner before providing a non-cash benefit to another entity (the recipient) if they would have been required to withhold an amount had that payment been in the form of money. However, there is no requirement to pay an amount to the Commissioner if the benefit is:

- a fringe benefit under the *Fringe Benefits Tax Assessment Act 1986* (FBTAA)
- an exempt benefit under the FBTAA or
- a benefit being the acquisition of a share or right under an employee share scheme within the meaning of Division 13A of Part III of the *Income Tax Assessment Act 1936* (ITAA 36).

The provision of non-cash benefits is outside the scope of this Ruling.

7. Section 10-5 of Schedule 1 of the TAA lists the 24 withholding payments to which PAYG obligations attach (see Attachment A). Where the PAYG provisions refer to 'employees' the reference is to employees at common law. Paragraphs 21 and 22 of this Ruling provide a summary of who is a common law employee. The relevant features are discussed in paragraphs 23 to 45 and summarised in Attachment B.

8. PAYG incorporates the main elements of the PAYE system. Payments under labour hire arrangements are now specifically

covered and there is flexibility to specify other payments for work or services. In addition there are two new withholding events:

- payments for work or services where businesses and workers voluntarily agree that withholding will occur from payments made; and
- payments made in respect of a supply where the supplier has not provided their Australian Business Number (ABN) to the payer where the supplier and the payer are each carrying on an enterprise.

These withholding events are not dealt with in this Ruling. This ruling is only concerned with payments to which section 12-35 of Schedule 1 of the TAA applies.

## **Ruling and explanations**

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### **Payments to employees - section 12-35**

9. Section 12-35 of Schedule 1 of the TAA provides that
- ‘An entity must withhold an amount from salary, wages, commission, bonuses or allowances it pays to an individual as an employee (whether of that or another entity)’.
10. For the provision to apply, there must be an employee, a payment of salary, wages etc paid to an employee as a consequence of his/her employment and finally, the payment must be made by an ‘entity’.
11. Paragraphs 14 to 46 discuss the meaning of ‘employee’. Paragraphs 47 to 52 briefly consider whether the payment is made to an individual. Paragraphs 53 to 55 discuss whether the payment is in respect of the employment of the individual.
12. For the purposes of the PAYG provisions, the definition of entity, takes its meaning from section 995-1 of the *Income Tax Assessment Act 1997* (ITAA 97).<sup>1</sup> Under that provision, an entity is defined by section 960-100 of the ITAA 97 to mean an individual, body corporate, body politic, partnership, any other unincorporated association or body of persons, a trust, and a superannuation fund. Also the trustee of a trust or superannuation fund is taken to be an entity.

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<sup>1</sup> Section 3AA(2) of the *Taxation Administration Act 1953* provides that an expression has the same meaning in Schedule 1 as in the *Income Tax Assessment Act 1997*.

13. It should also be noted that section 12-35 of Schedule 1 of the TAA is subject to three general exceptions listed in section 12-1 of Schedule 1 of the TAA:

- an entity need not withhold an amount from a payment made under section 12-35 of Schedule 1 of the TAA where the whole of the payment is exempt income of the entity receiving the payment;
- in working out how much to withhold, the payer may disregard so much of the payment as is a living away from home allowance benefit as defined by section 136 of the FBTA;
- in working out how much to withhold, the payer may disregard so much of the payment as is an expense payment benefit as defined by section 136 of the FBTA and is not an exempt benefit by virtue of the operation of section 22 of that Act which relates to cents per kilometre payments for motor vehicles.

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

#### ***Background***

14. Where section 12-35 of Schedule 1 of the TAA refers to an employee, the reference is to an employee at common law. 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.

15. 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.

16. Section 8 of the *Australian Business Number Act 1999* (ABNA) provides in part that an entity is entitled to an Australian Business Number (ABN) if they carry on an enterprise in Australia. Section 38 of the ABNA provides in part that an enterprise includes activities or a series of activities done in the form of a business etc but does not include activities done by a person as an employee.

17. The mere fact that an individual has an ABN does not mean that they can never be an employee. Each individual contract must be examined in order to determine whether the person is engaged as an employee or as an independent contractor.

18. Where an individual is engaged as an employee, section 12-35 of Schedule 1 of the TAA applies in relation to payments of salary, wages, commissions etc paid to them. If the individual is an independent contractor, then the payer needs to consider the potential application of section 12-190 of Schedule 1 of the TAA if the contractor does not quote their ABN to the payer before payment is made. The application of section 12-190 is outside the scope of this Ruling.

### ***Other types of contract***

19. 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*,<sup>2</sup> 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.

20. Labour hire arrangements have also become an increasingly common way for businesses to engage labour. A labour hire arrangement<sup>3</sup> is one where an end user of labour (a service requirer) contracts with an intermediary (a labour hire firm), acting as principal, to provide an individual or individuals to perform work or services for

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<sup>2</sup> 98 ATC 4468; (1998) 38 ATR 609 - an application for special leave to appeal to the High Court was refused.

<sup>3</sup> To be distinguished from employment agency arrangements where the agency acts as agent of the service provider and/or the service requirer and a contract (of service or for services) forms between the two principals.

the service requirer. The labour hire firm may fulfil its obligation to the service requirer by providing persons who are either employees of the labour hire firm or independent contractors. Payments made by a labour hire firm to workers who are its employees are subject to PAYG withholding under section 12-35 of Schedule 1 of the TAA. Payments made by a labour hire firm to workers who are independent contractors are subject to PAYG withholding under section 12-60 of Schedule 1 of the TAA.

### ***Common law***

21. The common law meaning of the term 'employee' was stated by the High Court in *Stevens v. Brodribb Sawmilling Company Pty Ltd*.<sup>4</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>5</sup> and

'... the question is one of degree for which there is no exclusive measure ...'.<sup>6</sup>

22. 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***

23. 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.<sup>7</sup>

24. A clause in a contract that purports to characterise the relationship between the parties as that of principal and independent

<sup>4</sup> (1986) 160 CLR 16; (1986) 63 ALR 513; (1986) 60 ALJR 194 (*Stevens*' case).

<sup>5</sup> *Stevens*' case per Mason J at CLR 29; ALR 521; ALJR 198.

<sup>6</sup> *Stevens*' case per Wilson and Dawson JJ at CLR 36; ALR 526; ALJR 201.

<sup>7</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.

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>8</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>9</sup>

25. 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.

26. The circumstances surrounding the formation of the contract may assist in determining the true character of the contract.<sup>10</sup> 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.<sup>11</sup>

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<sup>8</sup> (1989) 34 IR 179 at 184.

<sup>9</sup> *AMP* case at ALR 389-390.

<sup>10</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>11</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; this

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

27. 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***

28. 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. 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>12</sup>

29. 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.

30. 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.

31. In *Zuijs v. Wirth Brothers Pty Ltd*<sup>13</sup> the High Court articulated the significance of control in an employment relationship in the following way:<sup>14</sup>

‘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.’

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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.

<sup>12</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>13</sup> (1955) 93 CLR 561; (1955) 29 ALJ 698 (*Zuijs*’ case).

<sup>14</sup> *Zuijs*’ case at CLR 571; ALJ 700.

*'Results' contracts*

32. Where the substance of a contract is to achieve a specified result, there is a strong (but not conclusive) indication that the contract is one for services. In *World Book (Australia) Pty Ltd v. FC of T*<sup>15</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>16</sup>

33. 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.

34. 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.<sup>17</sup> Accordingly, the other terms of the contract must still be considered in order to determine the true character of the contract.

*Power to delegate*

35. 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.<sup>18</sup> 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.

36. 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

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<sup>15</sup> 92 ATC 4327 at 4334; (1992) 23 ATR 412 at 419-420 (*World Book* case).

<sup>16</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>17</sup> *Federal Commissioner of Taxation v. Barrett and Ors* 73 ATC 4147; (1973) 4 ATR 122 (*Barrett's* case).

<sup>18</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*

37. 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.

38. 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.

39. 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>19</sup>

### *Conditions of engagement*

40. 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.

41. However, this list is not exhaustive and it must be emphasised that there is not a standard set of conditions applicable to an employee

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<sup>19</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).

and a different set of conditions applicable to an independent contractor. Also, most conditions of engagement, when viewed 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*

42. In *Montreal v. Montreal Locomotive Works*<sup>20</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>21</sup> 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’.

43. From these statements, the notion of an ‘integration’ test (or organisation test as it is sometimes called) arose. While the factor is not 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)?<sup>22</sup>

44. However, the notion of integration has not been endorsed by Australian Courts.<sup>23</sup> Nevertheless, the Courts have been prepared to

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<sup>20</sup> (1947) 1 DLR 161 at 169.

<sup>21</sup> (1952) 1 TLR 101 at 111.

<sup>22</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>23</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 *Barrett's case* at CLR 402; ATC 4150; ATR 125 per Stephen J.

use the concept as an ancillary check to reinforce conclusions based on the lawful authority to command concept.<sup>24</sup>

45. 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.

46. **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 to persons other than individuals**

47. Section 12-35 of Schedule 1 of the TAA applies to payments made to individuals in their capacity as employees. It does not apply to payments made to other entities - provided the arrangement is not a sham or a mere redirection of an employee's salary or wages.

48. 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.<sup>25</sup> The parties must have a common intention that the arrangement is a mere facade, disguise or false front for a sham arrangement to exist.<sup>26</sup>

49. A redirection occurs where for example a payment is made to a third party in discharge of the obligation to pay an amount of salary, wages etc to an employee. For example, where the payer pays an employee's salary into a bank account at the direction of the employee.

50. 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 payment to the third party is attributable to salary, wages etc for services rendered by the employee in the course of that employment.

51. In *Southern Group Ltd v. Smith*<sup>27</sup> the Full Court of the Western Australian Supreme Court found that the contract of employment was between the payer and an individual rather than with the individual's private company which received the payment.

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<sup>24</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.

<sup>25</sup> *Snook v. London and West Riding Investments 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.

<sup>26</sup> *Scott v. FC of T* (1966) 40 ALJR 265 at 279 117 CLR 514 per Windeyer J as quoted in *Sharrment's case* at ALR 538; FCR 456 per Lockhart J.

<sup>27</sup> *Southern Group Ltd v. Smith* (1997) 37 ATR 107; 98 ATC 4733.

52. Section 12-35 of schedule 1 to the TAA applies to payments made to individuals in their capacity as employees. It does not apply to an alienated personal services payment within the meaning of section 13-10 of the Schedule. An alienated personal services payment is a payment of personal services income that is received by a personal services entity and assessed to an individual under the rules in Division 86 of the ITAA 1997. Section 12-7 of Schedule 1 to the TAA excludes alienated personal service payments from the operation of Division 12 of the Schedule. This reflects the fact that these payments are to be dealt with under Division 13 and are not subject to withholding under the rules in Division 12. This Ruling does not deal with payments to which Division 13 applies.

**Has a payment of salary, wages, commission, bonuses or allowances been made to an individual as an employee, of that or another entity?**

53. The employment relationship does not necessarily have to be between the entity making the payment and the individual. Section 12-35 of Schedule 1 of the TAA provides that a withholding must be made from a payment of salary, wages, commission, bonuses or allowances paid to an individual as an employee of the payer or some other entity. The essential element is the nature of any connection between the payment and the individual's employment with the payer or any other entity.

54. If the payment is in respect of the employment of the individual it is not relevant who actually made the payment. *Federal Commissioner of Taxation v. Dixon*<sup>28</sup> discusses whether a payment is in respect of a person's employment. Where the payment is a reward for services provided by the employee to the employer in the capacity of employee, the payment would be incidental to the employment regardless of whether the payment is made by the employer or another entity. If the payment is a payment of salary etc then the entity that made the payment will be required to withhold under section 12-35 of Schedule 1 of the TAA.

55. For example, where a parent company decides to sell a subsidiary company it may decide to pay key personnel of the subsidiary company a retention payment to ensure that those personnel remain employees of the subsidiary for a certain period of time. This payment would be a payment of salary or wages or a bonus to the individual in connection with their employment with the subsidiary company.<sup>29</sup> The entity making the payment, the parent

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<sup>28</sup> (1952) 86 CLR 540; 26 ALJ 505; 10 ATD 82

<sup>29</sup> *Dean & Anor v. Federal Commissioner of Taxation* 97 ATC 4762

company, would be required to withhold from the payment under section 12-35 of Schedule 1 TAA.

### **Private ‘rulings’ and enforcement procedures**

56. The Commissioner cannot give a private binding ruling on the issue of whether a withholding is required to be made in the sense provided for by Part IVAA of the TAA because those provisions do not apply to tax collection matters. While the Commissioner, in accordance with Taxation Ruling IT 2500, will treat as administratively binding his opinions on such matters as the application of the PAYG provisions, such opinions do not give rise to objection, review and appeal rights provided in respect of Part IVAA rulings.<sup>30</sup>

57. 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 withhold’ penalties. In the case of ‘failure to withhold penalties’, the Commissioner has a general discretion to remit the penalty and general interest charge in whole or in part.

## **Date of effect**

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58. This Ruling applies to relevant payments made after 30 June 2000. 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).

## **Detailed contents list**

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

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<sup>30</sup> There is a recommendation to extend the circumstances in which private binding rulings may be obtained to include tax collection matters: *A Tax System Redesigned* - Report of the Review of Business Taxation (the Ralph Report).

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**Commissioner of Taxation**

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*Related Rulings/Determinations:*

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*Subject references:*

- employer v independent contractor
- independent contractor issues
- master/servant relationship issues
- PAYG

*Legislative references:*

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**Attachment A**  
**Section 10-5 Summary of withholding payments**

<b>Summary of withholding payments</b>		
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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.

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.