Payroll tax – Contractors – 2023 year in review

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2023 has been a busy year advising on the payroll tax treatment of payments to contractors. Audit activity has increased and the case law is evolving.

This is the first of two articles which highlight the key developments from the past 12 months regarding the three "hurdles" that clients need to consider in determining whether payments to contractors are subject to payroll tax (where the applicable tax-free threshold has been exceeded).

The second article (to be published in 2024) will examine the NSW Court of Appeal decision issued on 13 December 2023 regarding the employment agent provisions (the third hurdle explained below*): Chief Commissioner of State Revenue v Integrated Trolley Management Pty Ltd* [2023] NSWCA 302.

This article reviews the other developments from this year in relation to each of the three hurdles.

The first hurdle: common law employee classification

First, if a contractor is a sole trader, clients should assess whether the contractor might be classified as a common law employee. If classified as a common law employee, payments to the contractor would be subject to payroll tax.

In May 2023, the Full Federal Court handed down the decision in *JMC Pty Ltd v FCT* (2023) 114 ATR 795 about this common law employee classification (and regarding the extended meaning of employee for superannuation guarantee purposes).

The Court (Bromwich, Thawley and Hespe JJ) overturned the first instance decision, finding that a lecturer was not a common law employee of a higher education program provider (nor was the lecturer an employee under the extended meaning for superannuation guarantee purposes).

The main takeaways from *JMC* in a payroll tax context are:

- a contractual right to subcontract is a strong indicator of an independent contractor relationship (even where subject to consent); and
- a contractual right of control must be considered in the context of the contracted work. While control is an established indicator of an employment relationship, there are different kinds of control and not all kinds will always be significant.

The second hurdle: contractor provisions

The second hurdle to consider is the contractor provisions. Where these provisions apply in respect of a contractor (and none of the exemptions apply), payments to the contractor are subject to payroll tax (subject to concessions

regarding non-labour components).

The scope of these provisions appears to have been widened by the *Thomas and Naaz* litigation, which concluded in March with the NSW Court of Appeal decision, *Thomas and Naaz Pty Ltd v Chief Commissioner of State Revenue* [2023] NSWCA 40.

When applying the contractor provisions in practice, the focus is usually on the various exemptions to the definition of "relevant contract" in each Payroll Tax Act (except WA). *Thomas and Naaz*, however, centred on elements of the positive limbs of the definition (s 32(1) of the *Payroll Tax Act 2007* (NSW) ("NSW Act")) and on elements of the operative deeming provision (s 35 of the NSW Act). In finding that payments from an operator of medical centres to general practitioners ("GPs") fell within the contractor provisions, the following key conclusions were made:

- the GPs supplied services to the medical centre entity (in addition to the patients) for the purposes of the definition of "relevant contract" (s 32(1) of the NSW Act); and
- payments from the medical centre entity to the GPs were "for or in relation to the performance of work" for the purposes of the operative deeming provision (s 35 of the NSW Act).

It is critical to recognise that while the *Thomas and Naaz* litigation finished in the NSW Court of Appeal, the primary payroll tax issues were resolved in the NSW Civil Administrative Tribunal ("NCAT") at first instance by Senior Member Goodman SC. The later appeals failed due to lack of jurisdiction (although there were some *obiter* comments made regarding the primary payroll tax issues).

The precedential value of *Thomas and Naaz* may therefore be questioned. This is particularly so where there is a conflicting decision by another Senior Member of NCAT: *Homefront Nursing Pty Ltd v Chief Commissioner of State Revenue* [2019] NSWCATAD 145.

Nonetheless, the reaction to Thomas and Naaz has been extraordinary.

State and Territory revenue offices and Treasuries have responded with differing rulings, amnesties and legislative amendments, which payroll tax practitioners need to keep abreast of when advising across jurisdictions.

The third hurdle: employment agent provisions

The third hurdle to establish that payments to a contractor are not subject to payroll tax is to ensure that the employment agent provisions do not apply to deem the payments to be wages. The employment agent provisions take precedent over the contractor provisions and therefore, any exemptions or concessions that would otherwise be available under the contractor provisions do not apply if the employment agent provisions are engaged.

The key developments in this area in 2023 were the NSW Supreme Court decision, *Integrated Trolley Management Pty Ltd* v Chief Commissioner of State Revenue [2023] NSWSC 557, and the appeal

decision handed down on 13 December 2023, *Chief Commissioner of State Revenue v Integrated Trolley Management Pty Ltd* [2023] NSWCA 302.

Before turning to *Integrated Trolley Management*, it is useful to consider the employment agent provisions generally, including other recent decisions.

Background

In all States and Territories (except WA), the employment agent provisions only apply where

there is an "employment agency contract".

This is defined in each Payroll Tax Act (except in WA) as "a contract...under which a person (an employment agent) procures the services of another person (a service provider) ***for a client*** of the employment agent" (note though that there are minor differences in the wording in some jurisdictions, which are presently immaterial).

The critical words are those emphasised above – "for a client". Read literally, those words cause the definition to encompass an absurdly broad range of contracts. For example, a solicitor could be regarded as an employment agent where they contract with a barrister for the provision of services for the solicitor's client. It would follow that payments from the solicitor to the barrister would be subject to payroll tax.

Confronted with this issue in 2016 in *UNSW Global Pty Ltd v Chief Commissioner of State Revenue* (2016) 104 ATR 577, White J concluded that the words "for a client" should be read as "in and for the conduct of the business of the client" (at [62]). This formulation has become known as the "in and for" test.

Following pointed criticism of the test by Basten J in *Bonner v Chief Commissioner of State Revenue* [2022] NSWSC 441, last year the NSW Court of Appeal confirmed that White J's construction was not to be disturbed (*Chief Commissioner of State Revenue v E Group Security Pty Ltd* (2022) 109 NSWLR 123).

The challenge for practitioners (and for Courts and Tribunals) is how to apply the *UNSW Global* "in and for" test. Many Tribunal and first instance NSW Supreme Court decisions since *UNSW Global* have adopted a fact-sensitive analysis focused on the manner in which services are provided for the client. Various indicia have been used in this analysis such as the extent of supervision by the client's staff and whether the contractor wears client-branded uniforms.

However, until this week, there had not been a Court of Appeal decision which applied the "in and for" test in any detail. The first is the *Integrated Trolley Management* appeal decision.

Integrated Trolley Management

The NSW Court of Appeal (Ward P, Payne JA and Basten AJA) has allowed an appeal by the Chief Commissioner of State Revenue from the first instance decision of Parker J, finding that payments from Integrated Trolley Management Pty Ltd to contractors to perform trolley collection and cleaning services under contracts it has with Woolworths, ALDI and IGA are captured by the employment agent provisions.

The first instance judgment of Parker J in *Integrated Trolley Management* is distinctive in a number of ways.

First, in determining whether there is an employment agency contract, his Honour considered that the relevant contract to test is the contract between the putative employment agent and the service provider (at [140]-[145]). Under this approach, the query is whether the putative employment agent procures the services of the service provider for a client under that contract as opposed to the contract between the putative employment agent and the client.

Second, Parker J appears to have departed from the fact-sensitive approach adopted in other decisions. His Honour focused on the terms of the written agreements and said that evidence about the way in which the contracts operated in practice may not be relevant (see [146]-[147]) (it was however noted that additional terms can be found outside the written contract, although none were contended in the case).

This approach is welcomed. It simplifies the

evidentiary burden and it is consistent with the approach to the common law employee classification decided by the landmark High Court decisions in *CFMMEU v Personnel Contracting Pty Ltd* [2022] HCA 1 and *ZG Operations Australia Pty Ltd v Jamsek* [2022] HCA 2.

Third, Parker J's analysis of the contracts centred on a dichotomy his Honour said exists between a service provider working in and for the business of the client, on the one hand, and conducting one's own business as an independent contractor, on the other (see [149]-[152]). His Honour pointed to various matters which indicated that the trolley collectors in question were independent contractors conducting their own business in concluding that the "in and for" test was not satisfied (eg see [159]).

Concluding remarks

In the context of the employment agent provisions in Queensland, the Queensland Supreme Court of Appeal has commented that the payroll tax provisions are to be read as a whole and in the sequence in which they are drafted: *Compass Group Education Hospitality Services Pty Ltd v Commissioner of State Revenue* (2021) 8 QR 1 at [216(f)] (Williams J).

It is unclear how the dichotomy identified by Parker J, with one side being the service provider conducting their own business as an independent contractor, fits within the broader structure of the payroll tax legislation when read as a whole. The employment agent provisions are only relevant where it has first been concluded that the service provider is not a common law employee, which necessarily involves a finding that the service provider is conducting their own business as an independent contractor (under the first hurdle set out above) (see *Compass Group Education Hospitality Services* at [215]-[218]).

The second part to this article (to be published next year) will examine the appeal decision in *Integrated Trolley Management* handed down on 13 December 2023. The decision again provides an adjusted approach to the "in and for" test, signalling that 2024 may be another busy year advising on the payroll tax treatment of payments to contractors.