BUSINESS NSW

13 February 2025

Portfolio Committee No. 1 - Premier and Finance
6 Macquarie Street,
SYDNEY NSW 2000

Dear Mr Buckingham and Committee

RE: Application of the contractor and employment agent provisions in the *Payroll Tax Act 2007*

Business NSW welcomes the opportunity to provide a submission to Portfolio Committee 1 – Premier and Finance regarding the contractor and employment agent provisions in the Payroll Tax Act 2007 (NSW).

Business NSW represents almost 50,000 businesses across New South Wales, advocating for policies that foster economic growth, business sustainability, and a competitive environment. Payroll tax has long been a matter of concern for businesses of all sizes, particularly small and medium-sized enterprises (SMEs), due to its impact on employment, business viability, and investment.

This submission outlines the key issues associated with payroll tax, the historical context of its introduction, and the need for reform to align tax policy with the evolving nature of work.

Key recommendation

- That a comprehensive review of payroll tax as part of a broader Federal-State financial reform agenda be undertaken. This should include consideration of alternative revenue sources that better reflect the current modern economy and do not impose a disproportionate burden on businesses that create jobs and hamper business' ability to become more productive by restricting investment in modernisation.

Ancillary recommendation

- That, given our key recommendation would take time to adopt and implement, the NSW Government take incremental and immediate steps to minimise the harmful impact that payroll tax has on the viability of NSW businesses by adopting the following recommendations that Business NSW has long been advocating for, which includes:
    - Reducing the payroll tax rate.
    - Increasing the payroll tax threshold.
    - Indexing the payroll tax threshold annually, based on the Wage Price Index.
    - Institute a regional payroll tax in line with Victoria (1.21%) to ensure regional businesses stay competitive.

Main submissions

Business NSW's submission is based on the following propositions:

1. Being a tax on labour, pay-roll tax is both a regressive, unfair and inequitable tax as well as being particularly harmful to particular industry sectors and to the economy as a whole.
2. At the time it was introduced, these features were recognised but, given its purpose was to fund a child endowment system, the means were regarded as justifying the end result. This was especially the case when it was first proposed in New South Wales, given that the retail industry was describing the future economic outlook as being 'bright'.
3. The employment agency and relevant contract provisions (now contained in Divisions 7 and 8 of Part 3 of the *Payroll Tax Act 2007*) were initially introduced in 1985 as anti-avoidance measures. Since then, the legislation has been amended on multiple occasions. Being an anti-avoidance mechanism is no longer relevant. What is relevant is whether certain arrangements fall within the descriptions provided for in the legislation. It is also relevant that this legislation forms part of a harmonised regulatory regime, with the legal principles of the other jurisdictions also being of relevance.
4. Being a tax on labour, it is possible that the advent of robotics and AI, the revenue inflow from pay-roll tax will deteriorate per capita. Given that the child endowment system being funded through the imposition of a pay-roll tax is no longer the reason why we have pay-roll tax (and hasn't been so for decades), coupled with the detrimental impact that pay-roll tax has always had on the economy, there is an urgent need for the Federal-State Financial Relations arrangements and the tax base mix to be revised and updated.

We appreciate the opportunity to contribute to this inquiry. Payroll tax remains a critical issue for businesses in NSW, and its reform is essential to fostering a competitive and sustainable economic environment. We urge the Committee consider our submission and explore policy alternatives that align with the needs of businesses and the broader economy.

We welcome further engagement on this matter and are available for discussions at your convenience. Should you require additional information, please contact Liz Greenwood, Senior Policy Manager, WHS and Regulation (elizabeth.greenwood@businessnsw.com).

Yours sincerely,

David Harding
Executive Director
Business NSW

INTRODUCTION

We note the terms of Reference are as follows:

1. That Portfolio Committee 1 - Premier and Finance inquire into and report on the application of the contractor and employment agent provisions in the Payroll Tax Act 2007, and in particular:

    (a) the provisions in Division 7 of Part 3 of the Payroll Tax Act 2007 on contractors

    (b) the provisions in Division 8 of Part 3 of the Payroll Tax Act 2007 on employment agents

    (c) revenue rulings and Commissioner's practice notes issued by Revenue NSW addressing the contractor and employment agencies provisions in the Payroll Tax Act 2007

    (d) decisions of courts in cases involving the application of the contractor and employment agencies provisions in the Payroll Tax Act 2007

    (e) the applicability of the contractor and employment agent provisions in the Payroll Tax Act 2007 on particular industries including the on-demand and gig economy, and

    (f) any other related matter.

We also note the contents of the Media Release released by the Committee chair, the Hon Jeremy Buckingham MLC, dated 16 December 2024, where he explained that:

"… This is an opportunity for a forensic look at the scope and intent of these provisions, including their interpretation and application by the Chief Commissioner of State Revenue and the courts.'

'If there is complexity or ambiguity in applying these provisions, this inquiry seeks to shed light on the reasons why. Where there are differing views between government administrators of the Act and the courts about their applicability, we have a duty to unpack why this is occurring and what remedies might be available. Whether there's something inherent in the construction of these provisions, or that widespread use of the types of contractor-style arrangements we are seeing in certain sectors of the economy were never contemplated when the provisions were written and enacted – this inquiry is about ventilating and testing the issues with the benefit of expert evidence from those closest to the legislation',

SUBMISSION

1. The obvious problems with payroll tax

The harm it causes to industry and the economy as a whole

The extent of harm which inflicted upon industry and the economy as a whole has been raised on numerous occasions.

In 1941, when the Australian government decided to introduce a national child endowment scheme, the Premier of NSW (Mr Mair) drew on the experience of New South Wales, warning the government that, if *"a national endowment plan is to be successful, it should be a national charge, and not a levy or burden on industry and employment. The State Government can speak authoritatively on family endowment, as New South Wales is the only State that has provided this magnificent social service. Originally there was a tax, payable by employers, to sustain the funds for endowment, but this taxation proved disastrous, as it discouraged employment…*

The New South Wales Government had substantial reasons for removing the burden of the family endowment tax from industry. Small employers were forced into the position of running their businesses at a loss and still being called upon to pay tax because they continued to keep their employees at work. Surely such a principle is unsound and will cause dismissals from employment at a time when it is very necessary to have full employment. One of the most important objectives that we should strive for is to prevent the cost of living from increasing. If an endowment tax is levied on industry it will certainly go into business costs and will find its way into commodity prices, increasing them."

This concern was echoed in the Chamber "*unprofitable as well as profitable industries must contribute towards the cost of this scheme. Businesses which are flourishing are able to take care of themselves; but Parliament has some responsibility towards those industries which are not yet thoroughly established, or have not passed their teething period…I am now considering whether child endowment should be financed by a pay-roll tax, or by all-round contributions to Consolidated Revenue. In the latter case, incomes of all classes would contribute towards the cost of the scheme; but businesses not yet successfully launched, or which are being run at a loss, will be obliged to pay the pay-roll tax*."

It is a regressive tax

The fact that payroll tax is a regressive tax is well-known and has been since its inception.

This feature was probably best explained during the 1971 NSW parliamentary debates.

By the Labor Party

In 1971, during debate, after having explained the Labor Party's philosophy on taxation, the Hon L.D. Serisier explained[1] that pay-roll tax did not accord with this philosophy because it was *"… taxes outlay without any attempt at personal assessment of taxation liability. It is a regressive tax. The payroll tax that we are*

[1] P1192-3

dealing with at the present time is indiscriminate in its application … the bill sets out to impose this flat rate of indiscriminate taxation on salaries that are paid to people throughout this State… Being imposed on an outlay, it becomes one of the breeder contributors towards the inflationary trend that exists in the community today…The time has well and truly come, as far as the Commonwealth tax was concerned, when this taxation provision should have been repealed and the sources of revenue for the Commonwealth-just as now for the State-should have done without it."

In addition to failing the party's two broad principles[2], he described how pay-roll tax also failed the Labor Party's three tests with regard to taxation.

Test #1: The tax is not practical

He explained how this tax failed the first test because it was "*a tax on only one aspect of outlay – payroll. Because it is a tax on payroll, it adds directly to the cost of production. In the long-term, after passing through various phases, it is a tax that increases the cost of living: it induces the inflationary trend about which everybody talks... It is an impractical tax because it is a tax on labour alone… it induces a situation that restricts employment…On those grounds alone, the House should reject the Bill*.[3]"

Test #2: The tax is not just

At page 1194, the Hon L D Serisier explained that on "*the test of justice, the payroll tax is bad, for it is not related in any way to the taxpayer's ability to pay. For this reason, it offends the principle of just taxation. It is unjust, in the first instance, at the level at which it is applied, and in the second instance, where it ends up. The tax is applied first to the employer . . . This is unjust. It imposes on him, in the first instance, a burden that is not then imposed on the rest of the community. More important, the tax is unjust because eventually it imposes a burden on the consumer. In the ultimate, the consumer pays the tax. Because consumers are individual persons, individuals on a head count or poll tax basis will pay this tax.*

It is unjust that pensioners, farmers who do not earn anything like the basic wage today, workers on a basic wage and others who earn considerably less that the average wage, should have to pay the same measure of payroll tax as people earning the greatest incomes.

The tax is unjust and impractical, and for those reasons it should be rejected."

Test #3: Whether there is any other source of income from which revenue can be brought to this State

At page 1195, the Hon L D Serisier suggested that a capital gains tax "*with a proper rate of exemption*" could be the solution, explaining that in "*times of galloping inflation there will need to be an annualised adjusted rate of exemption*" concluding that it "*is a practical, mathematical possibility to do this.*".

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[2] The first being that "*the purpose of taxation is to bridge the gap between sources of revenue available to the State and the cost of services*" with the second described as "*being a socialist party, the Australian Labor Party believes that the purpose of taxation is to achieve more equal distribution of wealth and income…the principle of equality of sacrifice is recognised by economists as a progressive factor in taxation measures.*": at page 1192

[3] P1194

Conclusion

"*(The Labor Party) is not concerned only with taking money from the community- it is concerned with taking money from the community in a way that will allow it still to function in an efficient manner, in a practical, progressive way, and in such a way that the imposition itself is just*.[4]"

By the then Government

The Hon J B M Fuller summarised the Government's view as "*I reiterate that the government does not like this tax. However, if someone can produce a better method of raising the revenue of this State, which is as easily implemented and will have the general accord of the other States of the Commonwealth, I should like to hear of it*."[5]

2. To fund a child endowment scheme, it was 'a means to an end'

First recognised in 1927

In 1927, when a tax on wages was first being considered in New South Wales (and subsequently introduced), its harmful effects on the economy were noted[6].

However, due to the shortcomings of the minimum wage system, the NSW Government felt that it needed to establish a Family Endowment Scheme funded through employer contributions calculated as a percentage of wages paid to their employees.

At the time, it was strongly criticised as being a financial burden unfairly borne by industry, which would result in increased production costs which would then be passed on to the general community.

The then president of the NSW Chamber of Manufactures (as Business NSW was then called) wrote "*Early in the new year we hope to have childhood endowment, a social experiment which holds out prospects of most helpful influences towards industrial peace. In years to come, when we are able to read the signs more clearly, we may yet describe this measure as the greatest single blow at Bolshevism ever struck in Australia…*"

However, this concern was dismissed, with reliance placed on a statement made by the then president of the Retailer Traders' Association who, when describing the Bill, said in effect, that despite the "*handicap . . . of the chopping and changing of taxations systems . . . the outlook is very bright . . . there is very little unemployment. Money is plentiful and the outlook is generally bright*."

During the second reading debate, when discussing the scheme it was said that that "*whatever other weaknesses it may possess, its chief aim is to establish and secure the integrity of the family as the chief institution in our national life*" where "*the business of bearing and rearing children is without doubt the most important of the nation's activities, for without it there would be no nation*"

[4] P1194

[5] P1199

[6] The *Family Endowment Bill 1927*

Raised again during World War II

During World War Two, the Commonwealth took over the State's income-taxing powers in exchange for Commonwealth grants.

In 1941, the Commonwealth decided to create a national child endowment scheme.

However, it found that, it had insufficient funds to both fund the scheme and be ready for "*the fact that was demands will become greater and greater, and considers that whatever fields of taxation remain should be reserved for legitimate war purposes.*"

Another concern related to the haste in which the legislation was introduced, with Mr Brennan (Batman) saying "*I regret that we have not had, from the Government, a more sober and considered analysis of the question as to the most equitable and just method of raising the money needed.*

… I am prepared to waive my objection in favour of my strong desire that no serious obstacle should be placed in the way of child endowment.".

However, payroll tax was described as being "*the only way to finance child endowment*", with the government ensuring that the Payroll Tax laws were passed before introducing the Child Endowment Bill.

At the time, Business NSW's position was that "*While not opposing principle of family endowment strongly object to suggested method of financing the project by taxing the employers pay roll and request you as our member to give your best support to this objection*"[7].

During debate, the justification for placing the financial burden of funding such a scheme on employers was that the family unit should be regarded as a future source of labour. Just as employers made provision for the depreciation of plant and equipment, they should do the same for the depreciation of their human capital.

The Leader of the Opposition stated that "*Whatever views the Opposition may hold of the general principles of taxation, we believe that as the Government has said that this is the only way in which child allowances can be paid to mothers in Australia at the present time, we should not oppose it."*

In recognition that the tax was only payable by 30,000 of the total 230,000 businesses throughout Australia and given the inequitable nature of payroll tax, the Commonwealth also made the payment of payroll tax tax-deductible.

As observed by Mr Spooner "*I feel sure that were honorable members asked to vote on this measure quite detached from any scheme of child endowment, it would be given an entirely different reception*".

Why it was introduced as a State tax in 1971

On a number of occasions, following World War II, attempts to agree on a mechanism to hand back the taxing powers to the States failed.

[7] A. J. Hendy, Acting President, Chamber of Manufacturers of New South Wales.

The Premiers' conferences in February and June 1970 led to a "*marked improvement in tax grant arrangements"* but it was feared that *"the new arrangement did not go far enough to place the States on a sound financial basis. That fear has been borne out by the extraordinary series of wage increases in 1970-71…for school teachers, nurses, police and other government employees.*"

The Commonwealth and the States reached an agreement whereby the Commonwealth would take from the States' "*tax reimbursement grants the value of the pay-roll tax at 2½ per cent. That meant that if the States did not increase pay-roll tax they would have been no better off…All State Premiers agreed to increase the rate of tax to 3½ per cent*"

It was also explained that "*. . .the States agreed that this offer from the Commonwealth was a weak, inefficient, undesirable type of tax, but the Commonwealth was unwilling to give the States access to income tax . . . In effect, all States accepted the offer of pay-roll tax: they had to do so. They agreed that it was an unsatisfactory form of tax, and they wanted a better share of income tax*.

At this point in time, the revenue being raised through a State payroll tax had no connection to any child endowment scheme.

3. The employment agency and relevant contract provisions

In 1971, the States retained payroll tax as being a tax on amounts paid by employers to employees.

Why they were introduced in 1985

The measures adopted

In 1985, the amending Act included reforms designed to tackle the "*deliberate choice … to sever the employer-employee relationship*" and purported to do so in three ways.

Method #1: Employment agents

The first way was to amend the existing definitions of 'employer' and 'wages' to include employment agents.

This change was brought about following advice from the accountancy profession that the "*practice is widespread as a means of tax avoidance*."

Method #2: Relevant contracts

The second mechanism was to introduce the concept of a 'relevant contract' which was designed to capture several means of discussing the employer-employee relationship through various types of contractual relationships while also attempting to exclude genuine service contracts through a series of exemptions.

One example of a 'typical tax avoidance measure' was given in the second reading speech which explained the arrangement as one where "*the employer by arrangement with his employees enters into a contract for service with the employee's family. The employee then performs the services for an employer but his salary is paid to the trust, partnership or company, resulting in the avoidance of payroll tax*."

Method #3: The Chief Commissioner's powers

The third mechanism was to enable the Chief Commissioner to disregard contractual arrangements designed to avoid pay-roll tax.

Objections to those measures

A number of criticisms were raised in relation to the design of these reforms.

Criticism #1: There were other ways to tackle avoidance

On the advice of the accountants, these reforms were not necessary as the avoidance activity could have been addressed through the definition of wages coupled with the introduction of targeted regulation.

Criticism #2: The exclusions did not successfully protect genuine service contracts

Not only were the figures of 90 and 180 days chosen arbitrarily, but they were described as ignoring commercial reality in certain industries where independent contractors typically enter into arrangements for one or two years with one individual company. Examples given included the computer industry, used car companies, management accountants and cleaning contractors.

This situation had not been accommodated for in the exemptions.

Criticism #3: Start-up businesses are unfairly penalised

Another criticism was that, in the early stages of setting up a business, the business owner often requires the engagement of contractors on a part-time basis in order to get their business going. Then, when the business is operating efficiently, full-time employees can then be appointed.

This situation had not been accommodated for in the exemptions.

Criticism #4: Anti-avoidance practices are already caught by federal legislation

A further criticism was that the Commissioner of Taxation had already effectively stamped out these types of arrangements because they were already set up to avoid income tax[8].

The 1986 and 1987 amendments were also criticised

The employment agency provisions

The 1985 provisions were amended in 1986, to ensure that it was the employment agent who would be treated as being the employer.

In 1987, the 'employment agency' definition provisions were moved into the 'relevant contract' provisions in recognition that the vast majority of employment agency arrangements (for example the supply of home nursing services, computer services, and services that supply secretaries, book-keepers, telephonists and clerks) "*provide a genuine service*" and are therefore legitimate.

[8] We are assuming they are referring to the ATO's treatment of Personal Services Income.

The relevant contract provisions

Similarly to the employment agency provisions, the relevant contract provisions were also amended.

Additional exemptions were introduced in relation to the carriage of goods, insurance brokers and door-to-door selling.

However, it was noted that these reforms were inadequate as they did not include the genuine service contracts within the housing and computing industries, instead focussing on work practices (such as door-to-door sales) that were fast becoming a thing of the past.

The amendments generally

In addition, the 1986 amendments (explained more fully below) were criticised on the basis that, given the economy was 'moving backwards', instead of adopting reforms that became a 'service type of tax' incentives were needed instead.

The government's response was simply that "*no piece of tax legislation is able to cover all circumstances with precision*."

Now in 2025, the original reason for these provisions is no longer relevant

Given the plethora of payroll tax amendments that have taken place since the late 1980's, the original reasons for having these provisions in the first place (namely, being anti-avoidance measures) are no longer relevant.

Instead, it is the text of the legislation that determines the outcome, not the contents of the second reading speeches.

For example, in *Bonner v Chief Commissioner of State Revenue* [2022] NSWSC 441, Basten J held that

"*The definitional provisions in Div 8 contain no requirement of a tax avoidance intention or effect. Nor have the glosses on the statutory language expressly adopted such a criterion. Indeed, it is not possible to define an implied limitation by reference to such an indefinite criterion…It is true that the Minister asserted that amendments would not affect "genuine independent contractors". But again, it is difficult to be sure to what he was referring.*[9]"

Nor are the cases based on earlier iterations relevant

In *Bonner v Chief Commissioner of State Revenue* [2022] NSWSC 441, Basten J also commented that "*It is not an acceptable construction of the statute to adopt language which has been used in the past but removed and replaced. The existing case law warrants appellate review.*[10]"

[9] [110] – [112]

[10] [116]

What is relevant

Whether the legislation applies to the facts of the case

It must be remembered that the employer agency and relevant contract provisions were (and continue to be) drafted in hindsight. What were originally anti-avoidance measures have evolved into an exercise of improving poor legislative drafting and overcoming the inconvenience of an adverse statutory interpretation decision.

Doubtless the recent decision of *Uber Australia Pty Ltd v Chief Commissioner of State Revenue* [2024] NSWSC 1124, where it was held that the Act doesn't apply because it is the rider who pays the driver, not the contractor company, will be a case in point.

What is relevant is how the legislation is drafted and whether the particular arrangement being considered is captured by the provisions or not.

The most striking example of this is to be found in the judgment of *Chief Commissioner Of State Revenue v E Group Security Pty Ltd* [2022] NSWCA 115 where it was explained that, the amendments made in 2017 concerning employment agents were 'significant' in that "*whereas formerly it was to the inevitable fiscal disadvantage of a person to fall within the definition of an employment agent, there is now an incentive for some persons to fall within that definition, insofar as they have clients which are exempt (such as some religious institutions and schools and hospitals). In short, following the 2017 amendments, the Act used the definition of employment agency contract both to treat some payments which were not wages as deemed wages, and also to treat some payments which were in fact wages as exempt wages*.[11]"

Whether a party can appeal – the need for an error of law

In the case of *Thomas and Naaz Pty Ltd v Chief Commissioner of State Revenue* [2023] NSWCA 40, the case involving the arrangement between medical centres and medical practitioners, where the decision being appealed from was one that held that the medical centre was the employer of the medical practitioners. The Court of Appeal held that, as there was no error of law contained in the earlier decision, there were no grounds for an appeal and the earlier decision (despite the economic disruption it caused) had to remain.

Therefore, the mechanisms for protecting commercial arrangements that arguably shouldn't be captured in the first place are inadequate.

4. The future of work

As stated before, payroll tax is a tax on labour.

Being a significant component of NSW's total revenue, it is clearly an important one.

However, in light of the changing nature of industry, especially in relation to robotics and artificial intelligence, it is possible that the nature of the workforce in currently 'labour-intensive' industries will shift.

[11] @ [37]

Key recommendation

- That a comprehensive review of payroll tax as part of a broader Federal-State financial reform agenda be undertaken. This should include consideration of alternative revenue sources that better reflect the current modern economy and do not impose a disproportionate burden on businesses that create jobs and hamper business' ability to become more productive by restricting investment in modernisation.

Ancillary recommendation

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