TR 2005/D3 - Income tax: Pay As You Go - withholding from payments to employees

This document has been finalised by TR 2005/16.

Draft Taxation Ruling

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

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Preamble

This document is a draft for industry and professional comment. As such, it represents the preliminary, though considered views of the Australian Taxation Office. This draft may not be relied on by taxpayers and practitioners as it is not a ruling for the purposes of Part IVAAA of the Taxation Administration Act 1953. It is only final Taxation Rulings that represent authoritative statements by the Australian Taxation Office.

What this Ruling is about

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 in Schedule 1 to the *Taxation Administration Act 1953* (TAA). That section imposes an obligation on the paying entity to withhold an amount from the relevant payment.

2. This Ruling considers the various indicators the courts have considered in establishing whether a person engaged by another individual or entity is an employee within the common law meaning of the term.

Date of effect

3. It is proposed that when the final Ruling is issued, it will apply both before and after its date of issue. However, the Ruling will 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

4. Taxation Ruling TR 2000/14 is withdrawn on and from the issue date of this draft Ruling. To the extent that our views in that Ruling still apply, they have been incorporated in this Ruling. The views expressed in that previous Ruling are mostly unchanged. However this draft Ruling reflects recent case law developments and is consistent with Superannuation Guarantee Ruling SGR 2005/1 to the extent they cover the same matters.

Ruling

5. The term 'employee' is not defined in the TAA. For the purposes of withholding under section 12-35 the word 'employee' has its ordinary meaning.

6. Whether a person is an employee of another is a question of fact to be determined by examining the terms and circumstances of the contract between them having regard to the key indicators expressed in the relevant case law. Defining the contractual relationship is often a process of examining a number of factors and evaluating those factors within the context of the relationship between the parties. No one indicator of itself is determinative of that relationship. The totality of the relationship between the parties must be considered.

7. An arrangement between parties that is 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, does not give rise to an employer/employee relationship for the purposes of the TAA.

8. A person who holds an Australian business number (ABN) may still be an employee for the purposes of section 12-35 in Schedule 1 to the TAA.

9. Section 12-35 in Schedule 1 to 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.

10. The operation of the personal services income measures in Part 2-42 of the *Income Tax Assessment Act 1997* (ITAA 1997) is not determinative of whether an individual is an employee for the purposes of section 12-35.

11. Payment does not necessarily have to be between employer and employee for the payment to be covered by section 12-35 in Schedule 1 to the TAA. However, the payment made to the individual must be in their capacity as an employee, either of the payer or another entity.

Explanation

12. Section 12-35 in Schedule 1 to 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).

13. For the provision to apply, there must be an employee, a payment of salary, wages etc to an employee as a consequence of his/her employment and finally, the payment must be made by an 'entity'.

14. Section 12-35 is subject to three general exceptions listed in section 12-1 in Schedule 1 to the TAA:

- an entity need not withhold an amount under section 12-35 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 *Fringe Benefits Tax Assessment Act 1986* (FBTAA); and
- 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 FBTAA 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.

15. The term 'employee' is not defined in the TAA, therefore it has its ordinary meaning. In most cases, it will be self-evident whether an employer/employee or principal/independent contractor relationship exists. However, it is sometimes difficult to discern the true character of the relationship from the facts of the case as the intentions of the parties may be unclear or ambiguous, such as where the terms of the contract are disputed by the parties or are otherwise in apparent conflict. Because of these difficulties, the ordinary meaning of employee has been the subject of a significant amount of judicial consideration. These cases have discussed a number of factors that may be applied in determining whether an individual is a common law employee.

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

Background

16. The relationship between an employer and employee is a contractual one. It is often referred to as a *contract of service*. Such a relationship is typically contrasted with the principal/independent contractor relationship that is referred to as a *contract for services.* An independent contractor typically contracts to achieve a result whereas an employee contracts to provide their labour (typically to enable the employer to achieve a result).

17. The Courts have considered the common law contractual relationship between parties in a variety of legislative contexts, including income tax, industrial relations, payroll tax, vicarious liability, workers compensation and superannuation guarantee. As a result, a substantial and well-established body of case law has developed on the issue. There are often many relevant facts and circumstances, some pointing to a contract of service, others pointing to a contract for services.[1] Whatever the facts of each particular case may be, there is no single feature which is determinative of the contractual relationship; the totality of the relationship between the parties must be considered to determine whether, on balance, the worker is an employee or independent contractor.[2]

18. Consideration should be given to the various indicators identified in judicial decisions which have considered the employee/independent contractor distinction bearing in mind that no list of factors is to be regarded as exhaustive and the weight to be given to particular facts will vary according to the circumstances.[3] Where a consideration of the indicia points one way so as to yield a clear result, the determination should be in accordance with that result.[4]

Terms and the circumstances of the formation of the contract

19. In determining the nature of the contractual relationship, the terms and conditions of the contract between the parties, whether express or implied, in light of the circumstances surrounding the making of the contract will give some indication of the proper characterisation of the relationship between the parties.[5]

20. Contractual arrangements often contain a clause that purports to characterise the relationship between the parties as that of principal and independent contractor and not that of employer and employee. Such a clause cannot receive effect according to its terms if it contradicts the effect of the agreement as a whole[6] - that is, the parties cannot deem the relationship between themselves to be something that is not.[7] The parties to an agreement cannot alter the true substance of the relationship by simply giving it a different label.[8]

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[1] *Commissioner of Payroll Tax (Vic) v. Mary Kay Cosmetics Pty Ltd 82* ATC 4444, per Gray J.
[2] *Stevens v. Brodribb Sawmilling Company Pty Ltd* (1986) 160 CLR 16; (1986) 63 ALR 513 (*Stevens v. Brodribb*) at CLR 29; ALR 521, per Mason J. The principle that the 'totality of the relationship between the parties' be considered to determine the nature of the contractual relationship at common law was adopted with approval by the majority of the High Court in *Hollis v. Vabu* (2001) 207 CLR 21 (*Hollis v. Vabu*).
[3] *Abdalla v. Viewdaze Pty Ltd t/as Malta Travel* (2003) 53 ATR 30 (*Abdalla v. Viewdaze*). The Full Bench of the Industrial Relations Commission provided a summary of the state of the law governing the determination of whether an individual is an employee or independent contractor following *Hollis v. Vabu*.
[4] Ibid.
[5] See *Stevens v. Brodribb* (1986) 160 CLR 16 at 37, per Wilson and Dawson JJ.
[6] *Australian Mutual Provident Society v. Chaplin and Anor* (1978) 18 ALR 385 at 389.
[7] *Hollis v. Vabu* (2001) 207 CLR 21 at 45.
[8] *Massey v. Crown Life Insurance Co* [1978] 1 WLR 676; [1978] 2 All ER 576.

If the underlying reality of the relationship is one of employment the parties cannot alter that fact by merely having the contract state (or have the worker acknowledge) that the worker's status is that of an independent contractor.[9]

21. As Gray J stated in *Re Porter: re Transport Workers Union of Australia*:[10]

> 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, such a clause may be used to overcome any ambiguity as to the true nature of the relationship.[11]

22. 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 are not changed, it is likely that the worker's status would remain that of an employee.

23. The circumstances surrounding the formation of the contract may assist in determining the true character of the contract.[12] Thus, if a contract comes into existence because the contractor advertises their 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 more likely. Conversely, if the contract is formed in response to a job vacancy advertisement or through the services of a placement

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[9] In *Comr of State Taxation v. The Roy Morgan Research Centre Pty Ltd* [2004] SASC 288 the Full Court of the Supreme Court of South Australia considered whether interviewers engaged by Roy Morgan were employees or independent contractors in the context of pay-roll tax. A clause in the contract between the parties stipulated that the interviewers were independent contractors. In arriving at the decision that the interviewers were employees, the Court held that such a clause should not be regarded as confirmation of the status of the interviewers as independent contractors.

[10] (1989) 34 IR 179 at 184.

[11] *Australian Mutual Provident Society v. Chaplin and Anor* (1978) 18 ALR 385 at 389-390.

[12] 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.

agency, the existence of an employer/employee relationship is more likely.[13]

Key indicators of whether an individual is an employee or independent contractor

24. The features discussed below have been regarded by the courts as key indicators of whether an individual is an employee or independent contractor at common law.

Control

25. The classic 'test' for determining the nature of the relationship between a person who engages another to perform work and the person so engaged is the degree of control which the former can exercise over the latter.[14] A common law employee is told not only what work is to be done, but how and where it is to be done. With the increasing usage of skilled labour and consequential reduction in supervisory functions, the importance of control lies not so much in its actual exercise, although clearly that is relevant, as in the right of the employer to exercise it.[15] As stated by Dixon J in *Humberstone v. Northern Timber Mills*:[16]

> The question is not whether in practice the work was in fact done subject to a direction and control exercised by an actual supervision or whether an actual supervision was possible but whether ultimate authority over the man in the performance of his work resided in the employer so that he was subject to the latter's orders and directions.

26. Likewise, the High Court in *Zuijs*[17] described the significance of control in the following way in the context of skilled employment where the nature of the work performed left little scope for detailed control:

> 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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[13] *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.

[14] *Stevens v. Brodribb* (1986) 160 CLR 16 at 24, per Mason J; and CLR 35, per Wilson and Dawson JJ.

[15] *Stevens v. Brodribb* (1986) 160 CLR 16 at 24, per Mason J; and CLR 36, per Wilson and Dawson JJ. In *Stevens v. Brodribb,* the High Court was adjusting the notion of 'control' to modern industrial conditions and, in doing so, continued the developments in *Zuijs v. Wirth Brothers Pty Ltd* (1955) 93 CLR 561 and *Humberstone v. Northern Timber Mills* (1949) 79 CLR 389. The control test as articulated in *Stevens v. Brodribb* was cited and adopted with approval by the majority of the High Court in *Hollis v. Vabu*.

[16] (1949) 79 CLR 389 at 404.

[17] (1955) 93 CLR 561 at 571.

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.[18] 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 their discretion (subject to any terms implied by law). This is because the contractor is working for themselves.

28. While control is important, it is not the sole indicator of whether or not a relationship is one of employment.[19] The approach of the Courts has been to regard it as one of a number of indicia which must be considered in determination of that question.

29. However, even though the modern approach to defining the contractual relationship is to have regard to the totality of the relationship between the parties, control is still the most important factor to be considered. This was recognised by Wilson and Dawson JJ in *Stevens v. Brodribb* ((1986) 160 CLR 16 at 36), where they state:

> In many, if not most cases, it is still appropriate to apply the control test in the first instance because it remains the surest guide to whether a person is contracting independently or serving as an employee.

30. In *Hollis v. Vabu*, the fact that the couriers engaged by Vabu had little control over the manner of performing their work (the corollary being that Vabu had considerable scope for the actual exercise of control over the performance of the courier's activities) was an important factor leading to the conclusion that the bicycle courier in question was a common law employee of Vabu. Gleeson CJ, Gaudron, Gummow, Kirby and Hayne JJ observed that:

> Vabu's whole business consisted of the delivery of documents and parcels by means of couriers. Vabu retained control of the allocation and direction of the various deliveries…Their work was allocated by Vabu's fleet controller. They were to deliver goods in the manner in which Vabu directed. In this way, Vabu's business involved the marshalling and direction of the labour of the couriers, whose efforts comprised the very essence of the public manifestation of Vabu's business.[20]

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[18] See *Queensland Stations Pty Ltd v. FC of T* (1945) 70 CLR 539; (1945) 19 ALJ 253; (1945) 8 ATD 30; [1945] ALR 273 (*Queensland Stations*).
[19] For example, *Stevens v. Brodribb* (1986) 160 CLR 16 at 24, per Mason J.
[20] *Hollis v. Vabu* (2001) 207 CLR 21 at 44-45.

Does the worker operate on their own account or in the business of the payer?

31. In *Hollis v. Vabu,* the majority of the High Court quoted the following statement made by Windeyer J in *Marshall v. Whittaker's Building Supply Co*:

> … the distinction between an employee and independent contractor is 'rooted fundamentally in the difference between a person who serves his employer in his, the employer's business, and a person who carries on a trade or business of his own.[21]

This distinction is also referred to as the integration or organisation test.[22]

32. In *Hollis v. Vabu*, the High Court considered this distinction when determining whether a bicycle courier was a common law employee of Vabu. The majority found that the bicycle courier was a common law employee of Vabu and stated:

> Viewed as a practical matter, the bicycle couriers were not running their own business or enterprise, nor did they have independence in the conduct of their operations.[23]

33. While the majority did, in reaching its decision, consider lawful authority to command (that is control) and other relevant aspects of the relationship between the parties, it at the same time was concerned with the fundamental question of whether the worker was operating their own business or was operating within Vabu's business. Therefore, whenever applying the indicators of employment listed in this ruling it is also necessary to keep in mind the distinction between a worker operating on his or her own account and a worker operating in the business of the payer.

'Results' contracts

34. 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*[24] 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'.[25]

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[21] *Hollis v. Vabu* (2001) 207 CLR 21 at 39, per Gleeson CJ, Gaudron, Gummow, Kirby and Hayne JJ.

[22] The notion of an 'integration' test arose in *Montreal v. Montreal Locomotive Works* 20 (1947) 1 DLR 161 at 169 and was affirmed by Lord Denning in *Stevenson Jordan and Harrison Ltd v. MacDonald and Evans* [1952] 1 TLR 101 at 111 and reaffirmed in *Bank Voor Handel En Scheepvaart NV v. Slatford* [1953] 1 QB 248 at 295.

[23] *Hollis v. Vabu* (2001) 207 CLR 21 at 41.

[24] 92 ATC 4327.

[25] *World Book (Australia) Pty Ltd v. FC of T* 92 ATC 4327 at 4334. Sheller JA referred to the High Court decision in *Queensland Stations Pty Ltd v. FC of T* (1945) 70 CLR 539; (1945) 19 ALJ 253; (1945) 8 ATD 30; (1945) ALR 273 (1945) (*Queensland Stations*) as authority for that proposition. He also used the facts of that case as an example of a contract to produce a result. Note that, given the emphasis that the courts have placed on the control test (discussed above), the

35. The phrase 'the production of a given result' means the performance of a service by one party for another where the first-mentioned party is free to employ their own means (such as third party labour, plant and equipment) to achieve the contractually specified outcome. Satisfactory completion of the specified services is the 'result' for which the parties have bargained. The consideration is often a fixed sum on completion of the particular job as opposed to an amount paid by reference to hours worked. If remuneration is payable when, and only when, the contractual conditions have been fulfilled, the remuneration is usually made for producing a given result.[26]

36. In contracts to produce a result, payment is often made for a negotiated contract price, as opposed to an hourly rate. For example, in *Stevens v. Brodribb*, payment was determined by reference to the volume of timber delivered, and in *Queensland Stations* where it was a fixed sum per head of cattle delivered.

37. Having regard to the true essence of the contract, the manner in which the payment is structured will not of itself exclude genuine result based contracts. For example, there are results based contracts where the contract price is based on an estimate of the time and labour cost that is necessary to complete the task, or may even be calculated on that basis, subject to reasonable completion times.

38. 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. The High Court in *FC of T v. Barrett & Ors*[27] found that land salesmen who were engaged by a firm of land agents to find purchasers for land entrusted to the firm for sale and who were remunerated by commission only were employees and not independent contractors. Likewise, the High Court in *Hollis v. Vabu*[28] considered that payment to the bicycle couriers per delivery, rather than per time period engaged, was a natural means to remunerate employees whose sole purpose is to perform deliveries. Further, the Full Court of the Supreme Court of South Australia in *Roy Morgan*[29] found that interviewers who were only paid on the completion of each assignment, not on an hourly basis, were employees and not independent contractors.

39. Accordingly, the contractual relationship as a whole must still be considered in order to determine the true character of the relationship between the parties.

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production of a given result is probably not *the* mark of an independent contractor but merely *a* mark

[26] *Neale v. Atlas Products (Vic) Proprietary Limited* (1955) 94 CLR 419 at 424-425.
[27] 73 ATC 4147 at 4153
[28] (2001) 207 CLR 21 at 44
[29] [2004] SASC 288

Whether the work can be delegated or subcontracted

40. The power to delegate or subcontract (in the sense of the capacity to engage others to do the work) is a significant factor in deciding whether a worker is an employee or independent contractor.[30] If a person is contractually required to personally perform the work, this is an indication that the person is an employee.

41. If an individual has unlimited power to delegate the work to others (with or without the approval or consent of the principal), this is a strong indication that the person is engaged as an independent contractor.[31] Under a contract for services, the emphasis is on the performance of the agreed services (achievement of the 'result'). Unless the contract expressly requires the service provider personally to perform the contracted services, the contractor is free to arrange for their employees to perform all or some of the work or may subcontract all or some of the work to another service provider. In these circumstances, the contractor is the party responsible for remunerating the replacement worker.[32]

42. A common law employee may frequently 'delegate' tasks to other employees, particularly where the employee is performing a supervisory or managerial role. However, this 'delegation' exercised by an employee is fundamentally different to the delegation exercised by a contractor outlined above. When an employee asks a colleague to take an additional shift or responsibility, the employee is not responsible for paying that replacement worker, rather the workers have merely organised a substitution or shared the work load. This is not delegation consistent with that exercised by a contractor.

Risk

43. Where the worker bears little or no risk of the costs arising out of injury or defect in carrying out their work, he or she is more likely to be an employee.[33] On the other hand, an independent contractor bears the commercial risk and responsibility for any poor workmanship or injury sustained in the performance of work. An independent contractor often carries their own insurance and indemnity policies.

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[30] *Stevens v. Brodribb* (1986) 160 CLR 16 at 26, per Mason J.

[31] *Australian Mutual Provident Society v. Chaplin and Anor* (1978) 18 ALR 385 at 391 In such cases as *Ready Mixed Concrete (South East) Ltd v. Minister of Pensions and National Insurance* [1968] 1 All ER 433, *Bowerman v. Sinclair Halvorsen Pty Ltd* [1999] NSWIRComm 21 and *Express & Echo Publications Ltd v. Tanton* [1999] ICR 693, it was held that a power of delegation is inconsistent with a contract of service even if the principal has the right to approve or qualify any replacement worker.

[32] In *McFarlane v. Glasgow City Council* [2001] IRLR 7, it was held that gymnastic instructors engaged by the council were employees of the council, notwithstanding the fact that the instructors were obliged to find replacements when they were unable to take a class. One of the factors leading to this conclusion was that the replacements were paid directly by the council rather than by the instructors.

[33] In *Hollis v. Vabu*, Vabu undertook the provision of insurance for the couriers and deducted the amounts from their payments to the couriers.

Provision of tools and equipment and payment of business expenses

44. It had been held that the provision of assets, equipment and tools by an individual and the incurring of expenses and other overheads is an indicator that the individual is an independent contractor.[34]

45. In *Stevens v. Brodribb*, the High Court observed that working on one's own account (as an independent contractor) often involves:

> the provision by him of his own place of work or of his equipment, the creation by him of goodwill or saleable assets in the course of his work, the payment by him from his remuneration of business expenses of any significant proportion…[35]

46. Similarly, in *Queensland Stations* the droving contractor was required to find and pay for all the men, plant, horses and rations necessary and sufficient for the task. Their own means were employed to accomplish a result.[36]

47. However, the provision of necessary tools and equipment is not necessarily inconsistent with an employment relationship. As highlighted in *Hollis v. Vabu*, the provision and maintenance of tools and equipment and payment of business expenses should be significant for the individual to be considered an independent contractor. The majority of the High Court stated that:

> In classifying the bicycle contractors as independent contractors, the Court of Appeal fell into error in making too much of the circumstances that the bicycle couriers owned their own bicycles, bore the expenses of running them and supplied many of their own accessories…A different conclusion might, for example, be appropriate where the investment in capital was more significant, and greater skill and training were required to operate it.[37]

48. There are situations where, having regard to the custom and practice of the work, or the practical circumstances and nature of the work, very little or no tools of trade or plant and equipment are necessary to perform the work. This fact by itself will not lead to the conclusion that the individual engaged is as an employee. The weight or emphasis given to this indicator (as with all the other indicators) depends on the particular circumstances and the context and nature of the contractual work. All the other facts must be considered to determine the nature of the contractual relationship.

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[34] See, for example, *Stevens v. Brodribb* and *Vabu Pty Ltd* v. *FC of T* 96 ATC 4898; (1996) 33 ATR 537 (*Vabu v. FC of T*).
[35] (1986) 160 CLR 16 at 36-37, per Wilson and Dawson JJ.
[36] Per Rich J at CLR 548.
[37] (2001) 207 CLR 21 at 47. The High Court was referring to the NSW Court of Appeal taxation decision in *Vabu v. FC of T* where it was held that the couriers engaged by Vabu (including those who provided motor vehicles and motor cycles) were independent contractors. The majority decision in *Hollis v. Vabu* overturned that decision insofar as bicycle couriers were concerned.

49. Further, an employee, unlike an independent contractor, is often reimbursed (or receives an allowance) for expenses incurred in the course of employment, including for the use of their own assets such as a car.

Other indicators

50. In addition to the above, other indicators of the nature of the contractual relationship have been variously stated and have been added to from time to time.[38] Those suggesting an employer-employee relationship include the right to suspend or dismiss the person engaged,[39] the right to the exclusive services of the person engaged,[40] provision of benefits such as annual, sick and long service leave and the provision of other benefits prescribed under an award for employees. However, the fact that a contract does not contain provisions for annual and sick leave will not, in itself, be an indicator of a principal/independent contractor relationship.[41]

51. The requirement that a worker wear a company uniform is an indicator of an employment relationship existing between the contracting parties. In *Hollis v. Vabu*, the fact that the couriers were presented to the public and to those using the courier service as emanations of Vabu (the couriers were wearing uniforms bearing Vabu's logo) was an important factor supporting the majority's decision that the bicycle couriers were employees.[42]

Neither employee nor independent contractor – lease or bailment

52. There are circumstances in which the relationship between a person who engages another to perform work and the person engaged does not give rise to a payment for services rendered or provision of labour but rather a payment for something entirely different, such as a lease or 'bailment'. In these circumstances, a person enters into a lease or bailment for the use of property owned by another person, and the 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 their own benefit in return for a 'rental' payment to the owner.

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[38] *Stevens v. Brodribb* (1986) 160 CLR 16 at 36, per Wilson and Dawson JJ.
[39] Ibid.
[40] Ibid.
[41] *Stevens v. Brodribb* (1986) 160 CLR 16 at 24, per Mason J. This is because in contracts that are structured to suggest a contract for services, leave entitlements are not provided. In *Roy Morgan*, the interviewers did not receive any paid sick leave or annual leave, or amounts in lieu of those entitlements because it was expressly agreed in writing between Roy Morgan and the interviewers that they were, in relation to the company, independent contractors.
[42] *Hollis v. Vabu* (2001) 207 CLR 21 at 42, per Gleeson CJ, Gaudron, Gummow, Kirby and Hayne JJ.

53. A common form of bailment relationship is that of owner and taxi driver. In the taxi industry, some taxi drivers who operate under a bailment arrangement make a payment to the owner allowing them to use the taxi to drive. These payments may take the form of lease payments or a percentage of shift takings. In *FC of T v. De Luxe Red and Yellow Cabs Co-operative (Trading) Society Ltd & Ors*,[43] the Full Federal Court held that a taxi licence owner and taxi drivers were not in a relationship of employer and employee. The relationship was rather one of 'bailment', even though the licence owner had a degree of control over the drivers' work.

The interaction of ABN with the TAA

54. Section 8 of the *Australian Business Number Act 1999* (ABNA) provides in part that an entity is entitled to an ABN if they carry on an enterprise in Australia. Section 38 of the ABNA provides in part that an enterprise includes activities done in the form of a business but generally does not include activities done by a person as an employee.[44]

55. The fact that an individual has an ABN does not prevent that individual from also being engaged as an employee in another role or position. Someone who carries on a business or trade in their own right other than as an employee might also at certain times perform work for another as an employee.[45] For example, Jeffery has an ABN because the activities he undertakes as an IT consultant in sole practice amount to an enterprise. Jeffery is also an employee because he is employed on weekends by the local hotel as a barman. Ultimately, in the common law context, each contract entered into by an individual must be examined in order to determine whether, on balance, the individual is engaged as an employee or independent contractor.

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[43] 98 ATC 4466; (1998) 82 FCR 507.

[44] This is subject to certain exceptions stated in paragraph 38(2)(a) of the ABNA.

[45] As noted by the Industrial Relations Commission in *Application for Registration by an Association of Employees, ACT Visiting Medical Officers Association* D2001/9 7 May 2004:

> A party to an employment relationship may well, contemporaneously, carry on a trade or business in her or his own right for purposes other than in respect of the employment relationship…A tradesperson such as a carpenter or cabinetmaker may be carrying on a business as such in her or his own right and in her or his own name. As an independent contractor, such a person may provide her or his services to a variety of others as and when required. The same person, in the pursuit of her or his trade, might also for varying periods of time perform work for another as an employee. The fact that such a person carries on some work as an independent contractor does not alter the character of the work that the same person carries on as an employee.

Payments made to persons other than individuals

56. Section 12-35 in Schedule 1 to 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.

57. 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.[46] The parties must have a common intention that the arrangement is a mere facade, disguise or false front for a sham arrangement to exist.[47]

58. 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 or wages to an employee. For example, where the payer pays an employee's salary into a bank account at the direction of the employee.

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

60. In *Southern Group Ltd v. Smith*[48] the Full Court of the Western Australian Supreme Court considered an arrangement whereby an individual's remuneration as managing director of a public company was paid to the individual's private company. Making payments to the individual's private company was a continuation of the practice required under an earlier short term consultancy contract between the two companies. The Full Court found that the individual's appointment as managing director was as an employee, and the payments to the individual's private company were made under an administrative practice. In circumstances such as this, there would be a constructive payment of salary or wages to the employee.

Personal services income measures

61. The personal services income measures in Part 2-42 of the ITAA 1997 will not apply where the entity meets the tests in Division 87 of Part 2-42 for determining if income is from the conduct of a personal services business. It is recognised that there is some overlap between the tests used to determine whether a personal services business exists, particularly between the 'results test'[49] and the common law tests used to distinguish independent contractors and employees. However, section 84-10 of the ITAA 1997 ensures that the application of the alienation measures to an individual does

[46] *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.
[47] *Scott v. FC of T* (1966) 40 ALJR 265 at 279; 117 CLR 514 per Windeyer J quoted with approval in *Sharrment's* case at ALR 538; FCR 456 per Lockhart J.
[48] *Southern Group Ltd v. Smith* (1997) 37 ATR 107; 98 ATC 4733.
[49] This is set out in section 87-18 of the ITAA 1997.

not make the individual an employee for the purposes of section 12-35 in Schedule 1 to the TAA.[50]

62. Whether or not an individual is subject to the personal services income measures is distinct from and separate to the determination of whether that individual is an employee for the purposes of section 12-35 in Schedule 1 to the TAA. When working out whether a payment to an individual is subject to withholding under section 12-35 a payer does not need to have regard to the personal services business tests set out in Part 2-42 of the ITAA 1997. Consideration of the application of those tests is only relevant for the recipient of the payment if they are not an employee[51] and receive personal services income.

63. Section 12-35 in 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 in Schedule 1 to the TAA. Subsection 12-7(1) in Schedule 1 to the TAA excludes alienated personal service payments from the operation of Division 12 in Schedule 1 to the TAA. This reflects the fact that these payments are dealt with under Division 13 in Schedule 1 to the TAA 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?

64. The employment relationship does not necessarily have to be between the entity making the payment and the individual. Section 12-35 in Schedule 1 to 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.

[50] Section 84-10 of the ITAA 1997 states that the application of Part 2-42 to an individual does not imply, for the purposes of any Australian law or any instrument made under an Australian law, that the individual is an employee.
[51] Section 85-35 of the ITAA 1997.

65. 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*[52] discusses whether a payment is in respect of a person's employment. In that case, Dixon CJ and Williams J stated:

> Indeed, it is clear that if payments are really incidental to an employment, it is unimportant whether they come from the employer or from somebody else and are obtained as of right or merely as a recognized incident of the employment or work.[53]

66. 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, wages, commission, bonus or allowance then the entity that made the payment will be required to withhold under section 12-35 in Schedule 1 to the TAA.

67. 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.[54] The entity making the payment, the parent company, would be required to withhold from the payment under section 12-35 in Schedule 1 to the TAA.

68. Taxation Ruling TR 2003/15 Income tax: Pay As You Go (PAYG) Withholding – Payments made by trustees under the *Bankruptcy Act 1966* to former employees provides guidance on the obligation of an entity, other than an employer, to withhold from payments under section 12-35 in Schedule 1 to the TAA.

Your comments

69. We invite you to comment on this draft Taxation Ruling. Please forward your comments to the contact officer by the due date.

Due date: **8 April 2005**
Contact officer: **Stuart Dunlop**
E-mail address: **Stuart.Dunlop@ato.gov.au**
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[52] (1952) 86 CLR 540; 26 ALJ 505; 10 ATD 82.
[53] (1952) 86 CLR 540 at 556.
[54] *Dean & Anor v. Federal Commissioner of Taxation* 97 ATC 4762.

Detailed contents list

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

Commissioner of Taxation
23 February 2005

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 92/20; TR 2003/15;
SGR 2005/1

Previous Rulings/Determinations:

TR 2000/14

Subject references:

- employee v. independent contractor
- PAYG
- PAYG withholding

Legislative references:

- ABNA 1999 8
- ABNA 1999 38
- FBTAA 1986 22
- FBTAA 1986 136
- ITAA 1997 Pt 2-42
- ITAA 1997 84-10
- ITAA 1997 85-35
- ITAA 1997 Div 87
- ITAA 1997 87-18
- TAA 1953 Pt IVAAA
- TAA 1953 Sch 1 Pt 2-5
- TAA 1953 Sch 1 Div 12
- TAA 1953 Sch 1 12-1
- TAA 1953 Sch 1 12-7
- TAA 1953 Sch 1 12-7(1)
- TAA 1953 Sch 1 12-35
- TAA 1953 Sch 1 Div 13
- TAA 1953 Sch 1 13-10

Case references:

- Abdalla v. Viewdaze Pty Ltd t/as Malta Travel (2003) 53 ATR 30
- Australian Mutual Provident Society v. Chaplin and Anor (1978) 18 ALR 385
- Bank Voor Handel En Scheepvaart NV v. Slatford [1953] 1 QB 248
- Bowerman v. Sinclair Halvorsen Pty Ltd [1999] NSW IRComm 21
- Codelfa Construction Pty Ltd v. State Rail Authority of New South Wales (1982) 149 CLR 337; (1982) 41 ALR 367; (1982) 56 ALJR 459
- Commissioner of Payroll Tax (Vic.) v. Mary Kay Cosmetics Pty Ltd 82 ATC 4444; (1982) 13 ATR 360
- Commissioner of Taxation v. Dixon (1952) 86 CLR 540; 26 ALJ 505; 10 ATD 82
- Comr of State Taxation v. The Roy Morgan Research Centre Pty Ltd [2004] SASC 288
- Dean & Anor v. Federal Commissioner of Taxation 97 ATC 4762
- Express & Echo Publications Ltd v. Tanton [1999] ICR 693
- Federal Commissioner of Taxation v. Barrett and Ors 73 ATC 4147; (1973) 4 ATR 122
- Federal Commissioner of Taxation v. De Luxe Red and Yellow Cabs Co-operative (Trading) Society Ltd & Ors 98 ATC 4466; (1998) 82 FCR 507; (1998) 38 ATR 609
- Hollis v. Vabu (2001) 207 CLR 21; 2000 ATC 4508; (2001) ATR 559
- Humberstone v. Northern Timber Mills (1949) 79 CLR 389; [1949] ALR 985
- Marshall v. Whittaker's Building Supply Co (1963) 109 CLR 210
- Massey v. Crown Life Insurance Co [1978] 1 WLR 676; [1978] 2 All ER 576
- McFarlane v. Glasgow City Council [2001] IRLR 7
- Montreal v. Montreal Locomotive Works 20 [1947] 1 DLR 161
- Neale (Deputy Commissioner of Taxation) v. Atlas Products (Vic) Proprietary Limited (1955) 94 CLR 419; (1955) 10 ATD 460

- Queensland Stations Proprietary Limited v. FC of T (1945) 70 CLR 539; (1945) 19 ALJ 253; (1945) 8 ATD 30; [1945] ALR 273
- Re: Porter: re Transport Workers Union of Australia (1989) 34 IR 179
- Ready Mixed Concrete (South East) Ltd v. Minister of Pensions and National Insurance [1968] 1 All ER 433
- Reardon Smith Line Ltd v. Yngvar Hansen-Tangen [1976] 1 WLR 989; [1976] 3 All ER 570
- Roy Morgan Research Centre Pty Ltd v. Commissioner of State Revenue (Vic) 96 ATC 4767; (1996) 33 ATR 361
- Roy Morgan Research Centre Pty Ltd v. Commissioner of State Revenue (Vic) 97 ATC 5070; (1997) 37 ATR 528
- Roy Morgan Research Centre Pty Ltd v. Commr of State Taxation (SA) 2003 ATC 4919; [2003] SASC 342
- Scott v. FC of T (1966) 40 ALJR 265; 117 CLR 514
- Sharrment Pty Ltd v. Official Trustee in Bankruptcy (1988) 82 ALR 530; (1988) 18 FCR 449
- Southern Group Ltd v. Smith (1997) 37 ATR 107; 98 ATC 4733
- Snook v. London and West Riding Investments Ltd [1967] 2 QB 786
- Stevens v. Brodribb Sawmilling Company Pty Ltd (1986) 160 CLR 16; (1986) 63 ALR 513
- Stevenson Jordan and Harrison Ltd v. MacDonald and Evans [1952] 1 TLR 101
- Vabu Pty Ltd v. FCT 96 ATC 4898, (1996) 33 ATR 537
- World Book (Australia) Pty Ltd v. Federal Commissioner of Taxation 92 ATC 4327
- Zuijs v. Wirth Brothers Pty Ltd (1955) 93 CLR 561; [1956] ALR 123

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- Application for Registration by an Association of Employees, ACT Visiting Medical Officers Association D2001/9 7 May 2004

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