



Australian Government

The Treasury

HOUSE OF REPRESENTATIVES

**STANDING COMMITTEE ON EMPLOYMENT, WORKPLACE RELATIONS AND
WORKFORCE PARTICIPATION**

**INQUIRY INTO INDEPENDENT CONTRACTING AND LABOUR HIRE
ARRANGEMENTS**

MAY 2005

HOUSE OF REPRESENTATIVES STANDING COMMITTEE ON EMPLOYMENT, WORKPLACE RELATIONS AND WORKFORCE PARTICIPATION

Inquiry into independent contracting and labour hire arrangements

INTRODUCTION

The House of Representatives Standing Committee on Employment, Workplace Relations and Workforce Participation (the Committee) agreed to conduct an inquiry referred by the Minister for Employment and Workplace Relations to inquire into and report on:

- the status and range of independent contracting and labour hire arrangements;
- ways independent contracting can be pursued consistently across state and federal jurisdictions;
- the role of labour hire arrangements in the modern Australian economy; and
- strategies to ensure that independent contracting arrangements are legitimate.

A number of submissions received by the Committee to date have raised issues that fall within Treasury's portfolio responsibilities. Specific issues raised include:

- Alienation of personal services income measures, including the potential application of Part IVA of the *Income Tax Assessment Act 1936* to personal services businesses;
- ATO compliance activity in relation to personal services income legislation; and
- The restrictions imposed by the *Trade Practices Act 1974* on collective bargaining, and the authorisation process.

The purpose of this Submission is to provide the Committee with additional information on the above issues to assist them in their deliberations.

ALIENATION OF PERSONAL SERVICES INCOME

Background

Prior to the introduction of the alienation of personal services income measures in 2000, there were no legislative rules to limit the avoidance of income tax that occurred through the alienation of personal service income.

- Personal services income is income that is earned by the personal exertion of an individual. This income can be 'alienated' when an entity (a company, trust or partnership) is interposed between the individual and the person paying for their services, so that the interposed entity derives the income rather than the individual.
- The income may be split with other members of the interposed entity or retained within the interposed entity, allowing less tax to be paid or the tax liability to be deferred.

Instead, the Commissioner of Taxation (the Commissioner) relied on the general anti-avoidance provisions of Part IVA of the *Income Tax Assessment Act 1936* and the common law to address the problem. However, the Commissioner could only apply Part IVA on a case

by case basis. This was both labour intensive and an inefficient use of Australian Tax Office (ATO) resources.

The personal services income measures were recommended by an independent panel, chaired by John Ralph. The Government accepted the recommendation and the legislation was passed by Parliament in June 2000, with effect from 1 July 2000.

The legislation prevents individuals who earn income as individuals from claiming to be businesses in order to avoid paying income tax at individual rates. It does not affect individuals who are genuinely in business.

- The provisions achieve consistent taxation treatment for personal services income irrespective of the structures in places to receive that income.
- The law does not impinge on any commercial or contractual obligation between parties affected by the measures and does not impact on genuine business undertakings.

Assessment of personal services income

The legislation sets out a number of tests that are designed to allow independent contractors and entities to either self assess or seek a determination from the Commissioner that they are not affected by the measures.

The measures offer flexibility to take into account the unique circumstances of particular businesses. This flexibility delivers an equitable regime through limiting the number of businesses that may need to be assessed on a case by case basis by the Commissioner. The alienation of personal services income measures result in a better allocation of ATO resources as well as reducing the risk to revenue.

The results test

In 2001, the Government modified the law to provide that all taxpayers earning personal services income will be able to self-assess whether they are independent contractors against the 'results test'. If the results test is passed, the taxpayer is not affected by the alienation measures regardless of the proportion of their income derived from a single source.

To satisfy the 'results test' the individual must:

- work to produce a result; and
- provide plant and equipment or tools of the trade (if required); and
- be liable for rectification of any defects in work performed.

The 80 per cent rule and personal services business tests

If an individual or entity does not satisfy the results test and they earn less than 80 per cent of their income from a single source during the income year they may self assess against the personal services business tests.

The personal services business tests are that the individual or entity:

- had two or more unrelated clients who were obtained as a result of making offers or invitations to the public at large or to a section of the public (unrelated clients test); or

- had separate business premises (business premises test); or
- had an employee who performed at least 20 per cent of the principal work by value of the business (employment test).
 - Principal work is the work that generates the personal services income, rather than other (ancillary) work, such as office administration and bookkeeping.

If the taxpayer earns less than 80 per cent of their income from a single income source during an income year and can satisfy one of the personal services business tests the taxpayer will not be affected by the alienation of personal services income measures.

The requirement that the 80 per cent rule be satisfied during a 12 month period allows taxpayers to self assess for a period which is consistent with the period over which the income is earned.

Personal services business determination

The majority of taxpayers, approximately 75 per cent, self assess under the results test. However, entities can apply for a Personal Services Business Determination (PSBD) to confirm whether the taxpayer is not subject to the measure, or if the taxpayer is not sure whether they are within the measure, or if the taxpayer is subject to unusual circumstances. Currently, less than 2 per cent of taxpayers in receipt of personal services income apply to the Commissioner for a PSBD.

- For example, a taxpayer can seek a determination from the Commissioner if the taxpayer is not able to satisfy the 80 per cent rule during a 12 month period as a result of unusual circumstances.

In making the determination, the Commissioner may consider any unusual circumstances that exist in the income year in question.

- The Commissioner has provided a public ruling on what constitutes unusual circumstances.

The Commissioner will grant a PSBD if, but for unusual circumstances, the entity could reasonably be expected to:

- have been able to satisfy at least one of the above mentioned tests; or
- have two or more unrelated clients in the income year.

In determining if there are unusual circumstances, the Commissioner will consider if there are any exceptional circumstances that are temporary and if it is likely that the usual circumstances will resume in the short term.

- Unusual circumstances that exist (or are likely to exist) for less than 12 months would not be regarded as having become usual circumstances, except where that time period is significant having regard to the nature of the activity.

The Commissioner may also make a determination in situations where he is satisfied that had the unusual circumstances not occurred, the entity would have met or could reasonably have been expected to meet at least one of the three personal services business tests.

- Given that the legislation specifies the income year as the relevant period for the 80 per cent rule, unusual circumstances extending over a time span of five years (as suggested in some submissions to the Inquiry) would seem to go far beyond the boundaries envisaged by the legislators.

Potential application of Part IVA

The personal services income legislation makes specific reference to the fact that the general anti avoidance provisions in Part IVA may still apply to personal services businesses. That is, even though a taxpayer is able to satisfy one of the personal services business tests contained in the legislation (or has a personal services business determination from the Commissioner), Part IVA may operate in some circumstances.

- For instance, Part IVA may apply to prevent the taxpayer from splitting the personal services income with family members or retaining the income within an interposed company and paying tax at the corporate rate.

The ATO has become aware, through its field work and its liaison with tax practitioners and industry groups, that the potential application of Part IVA was the source of some uncertainty. In response to the concerns raised the ATO has:

- consulted with tax practitioner representatives to clarify the issue and potential solutions;
- issued a Fact Sheet (in March 2003) which was developed in consultation with tax practitioners through the Alienation working group of the ATO Tax Practitioner Forum (ATPF);
- worked through industry groups such as the Independent Contractors Association to clarify the position; and
- announced its intention to undertake a test case litigation program to seek further guidance from the courts on the potential application of Part IVA to PSB's.
 - This announcement was made by the Commissioner in March 2003.
 - The test case program has been developed in consultation with tax and legal practitioners through the ATPF working group.

At the current time the ATO is in the final stages of determining the cases to proceed as part of the test case program. Agreement has been reached that the ATO will meet the legal and accounting costs of the taxpayers participating. Pending the outcome of the test case program, the ATO will not undertake specific activities in this area as part of its audit program.

Determination of Compliance Activity

Under the self assessment system the Government accepts the need for taxpayers to fully understand their tax obligations to maximise the rate of voluntary compliance. For this reason, the ATO undertook an extensive education program to assist taxpayers to understand their obligations under the personal services income legislation, before gradually moving to a more compliance based approach. In line with the ATO's general approach, levels of compliance with the personal services income legislation have been monitored, the risks assessed and rated against other compliance priorities. This process comes together in the ATO's Compliance Program.

As part of its Compliance Program for 2004-05 the ATO undertook to review around 400 arrangements that may involve alienation of personal services income (refer to page 15 of the ATO's 2004-05 Compliance Program). This commitment was made in the context of the risk involved and an assessment of the priorities of other compliance risks which the ATO needed to address.

- The commitment to review 400 cases has already been met with a total of 553 cases completed by 30 April 2005.

SMALL BUSINESS COLLECTIVE BARGAINING PROPOSALS

Under current arrangements, the Australian Competition and Consumer Commission (ACCC) can authorise collective bargaining arrangements that would otherwise risk breaching the *Trade Practices Act 1974* in situations where the ACCC is satisfied that the public benefit of such an arrangement will outweigh the detriment caused by the substantial lessening of competition.

A list of authorisation determinations for the last ten years is attached. Those matters involving collective bargaining, and further involving unions, are separately identified.

Consistent with the recommendations of the Dawson Review¹, the Government has proposed amendments, included within the *Trade Practices Legislation Amendment Bill (No. 1) 2005*, which are intended to reduce the regulatory burden on small business by implementing a notification process for collective bargaining by small business dealing with large business. The notification process will provide a streamlined and less costly alternative to the authorisation process.

The collective bargaining notification scheme will be available for any small business, including an independent contractor, which meets the necessary requirements. However, in line with the clear demarcation between the regulation of business relationships and employment relationships, which was acknowledged and supported by the Dawson Review, it is not envisaged that the collective bargaining provisions would be used to pursue matters affecting employment relationships.

In considering whether a collective bargaining proposal should be rejected, the ACCC will consider the harm that might result from efforts to reduce the competitiveness of an industry

¹ *Review of the Competition Provisions of the Trade Practices Act*, <http://tpareview.treasury.gov.au>

by coordinating arrangements that apply to employees and those that apply to small business corporations or independent contractors who might also provide services in that industry.

The Dawson Review envisaged that industry associations – who represent businesses in a particular industry whose interaction is regulated through trade practices legislation – would notify on behalf of small businesses as allowed for in the Bill.

The Bill was amended in early 2005 to include new subsection 93AB(9) which provides that a purported collective bargaining notice is not a valid notice if it is given, on behalf of the corporation, by a trade union, an officer of a trade union, or a person acting on the direction of a trade union.