

Tax Compliance in Local Government

Some common difficulties & developments

Overview

- Employee v. Independent Contractor
- Superannuation Obligations
- Fringe Benefits Tax
- Goods and Services Tax

• Employee or Independent Contractor?

- Still under the microscope....

Relevance of distinction

- Status determines rights and obligations of worker & employer
- Considered by Courts for many reasons:
 - Taxation (Federal & State)
 - Workers compensation
 - Industrial relations
 - Vicarious liability

Advantages of Contracting

- Employer
 - Savings in certain on-costs (e.g. super) and leave entitlements
 - Flexibility to engage contractor for a specific project and then cease contract
 - Fewer Industrial Relations restrictions (but note Independent Contractor Legislation)
 - Greater prospects for efficiency as contractor often paid only at completion of a job or producing a result

Advantages of Contracting

- Worker
 - Scope to obtain work from a variety of sources
 - Can establish a business and generate goodwill
 - Lifestyle considerations
 - Opportunity to increase earning capacity, as contracts regularly based on a fee rather than time

Disadvantages

- Employer
 - Less control over workers
 - Possibility workers not available when needed
- Worker
 - Loss of various entitlements
 - Lower degree of job security
 - Less protection for unfair dismissal

Characterising the Relationship

- The term "employee" is not defined for tax purposes
- Takes on its ordinary meaning
- Self-evident in most cases:
 - Employer / employee; or
 - Principal / independent contractor
- Often difficult to discern the true character of the relationship

Characterising the Relationship

- Relationship between employer & employee is a contractual one
- Starting point is to consider at common law whether:
 - Contract **of** service exists; or
 - Contract **for** services exists?
- Contract of service connotes ‘master/servant’ relationship
- Contract for services implies ‘principal/independent contractor’

Common Law

- Difficulties continue to lead to a significant amount of judicial consideration of the meaning of “employee”
- Long history of case law looking at the ‘master & servant’ concept:
 - Queensland Stations Pty Ltd v FC of T [1945]
 - Neal v Atlas Products (Vic) Pty Ltd [1955]
 - Zuijs v Wirth Bros Pty Ltd [1955]

Common Law – key indicators

- Body of case law has resulted in a series of ‘key indicators’ to allow you to ‘test’ any given contractual relationship, including:
 - The totality of the relationship
 - Formation & terms of contract
 - The ability to ‘control’
 - The power to delegate
 - The level of risk a worker bears

Common Law – key indicators

- The provision of tools, equipment and payment of business expenses
- Whether in business on own account or working in the business of employer
- The existence of a ‘results based’ contract

No single feature is determinative of the nature of the relationship

Totality of Relationship

- Generally accepted that ‘control’ is principal test for determining the nature of a contract
- *Stevens v Brodribb Sawmilling Company Pty Ltd* (1986) is authority for the proposition that the totality of a particular relationship has to be examined
- Question of degree, for which there is no exclusive measure
- This view has been adopted with approval by later Courts

Formation & Terms of Contract

- Terms and conditions need to be considered
- Includes express or implied terms in light of circumstances surrounding the contract
- Circumstances leading to the formation of the contract can also assist to determine character of relationship
- The underlying reality of a relationship cannot be varied merely by having the contract state that the worker's status is that of a contractor – *Roy Morgan Research Centre Pty Ltd [RMRC] v. Commissioner for State Taxation [2003]*

Formation & Terms of Contract

Substance over Form prevails

The written contract does not generally override the practical workings of a relationship

Control Test

- ‘Control’ widely considered the ‘classic’ test for determining the nature of a working relationship
- Question of *degree* and *extent* of control exercised over the worker
- General rule of thumb is that common law employees are told what to do, how to do it and when to do it
- Hollis v Vabu Pty Ltd (2001)

Control Test

- Hollis v Vabu [2001] HCA 44
 - Vicarious liability case
 - Hollis injured by a bicycle courier identifiable only by jacket worn
 - Hollis sued Vabu on basis it was liable for actions of the courier
 - Hollis contended liability arose by virtue of an employment relationship between Vabu and the courier

Control Test

High Court held courier was employee

- Significant control exercised
- Courier not running own enterprise
- Uniform required and dress standards set
- Finances superintended by Vabu (paid by delivery)
- Not providing skilled labour or specialist qualifications
- Confirmed the totality of relationship approach

Power to Delegate

- Unlimited power to delegate material parts of the contracted work to others
- Under a contract for services, emphasis is on performance of the agreed result
- Unless contract expressly requires the provider to personally perform the services, contractor free to delegate

Power to Delegate

- Where worker can delegate or sub-contract, it is that worker who has responsibility of paying for services of replacement
- Merely inserting a clause into contract in respect of delegation with no genuine intention is not sufficient
- Delegation by common law employee (e.g. performing a supervisory role) is fundamentally different to delegation exercised by contractor

- Where worker bears little or no risk arising from injury or defect they are more likely to be an employee
- Contractors bear commercial risk and responsibility for poor workmanship or injury sustained in performance of work
- Contractors will often carry their own insurance and indemnity policies (indicative not conclusive factor)

Tools and Equipment

- Provision of assets, tools and equipment whilst incurring expenses and overheads is an indicator the individual is a contractor

Integration Test

- Considers the extent to which the worker's activities form an integral part of employer's business
- Is worker truly in business on own account?
- Does worker carry business cards for employer?
- Has had 'mixed history' in the Courts

Quick Guide to Key Indicators - Control

Employee	Contractor
Employer directs and controls manner of performance – right to how it is to be done	Who has ultimate authority
Authority of command	Control in manner performing work
Working in the business of the employer	Working for own business

Quick Guide to Key Indicators - Delegation

Employee	Contractor
Employer has exclusive services of employee	Works for others (or has ability to do so)
Personal performance of services	Right to delegate
Organises/manages but not responsible for paying a replacement	Takes commercial risk

Quick Guide to Key Indicators – Risk & Results

Employee		Contractor
		Produce a given result
		Free to employ own means – other labour, plant & equipment
Hourly rate		“negotiated” contract price
Commission		Commission
Little or no risk		Bears the commercial risk, may have insurances

Quick Guide to Key Indicators – Integration

Employee	Contractor
Serves the employer's business	Conducting own business, creates goodwill Different clients, advertises
Employer has right to particular person	Independence in the conduct of their operations
Employer dictates the place and hours of work	High level of discretion and flexibility
Gets reimbursed for business expenses	Incur business expenses

Quick Guide to Key Indicators – Other Factors

Employee	Contractor
Company uniform and / or ID	
Employee entitlements	No benefits, no obligation to work
Job vacancy advertising	Contract by tender
Termination	Review written agreements? What is the intention of the parties?
ABN?	ABN?

Relevance of Distinction?

- Pay As You Go (PAYG) Withholding
- Superannuation Guarantee
- Fringe Benefits Tax
- Workers Compensation (WorkCover)
- How the individual is treated for tax purposes

PAYG Withholding

- There are over 20 types of withholding payments specified, including the payment of:
 - Salary or wages to an employee
 - Unused leave on termination or retirement
 - Social security or similar payments
 - “No-ABN” withholding

PAYG – employee

Generally a worker is an employee if they:

- Are paid for time worked
- Receive paid leave
- Are not responsible for providing materials/equipment
- Must perform the duties of their position
- Agree to provide their personal services
- Work set hours
- Are recognised as part of the payer's business
- Take no commercial risks and cannot make a profit/loss from the work performed

PAYG – Independent Contractors

If a worker is an independent contractor, a payer is required to withhold an amount from payments to them only where the contractor:

- Has entered into a voluntary agreement to have amounts withheld
 - Provides their services for a client under a labour hire arrangement; or
 - Has not quoted their ABN to the payer
- SG laws can also apply to payments for work and services by an independent contractor

Superannuation Guarantee

- Employers required to provide a prescribed minimum level of superannuation support for its 'employees'
- Superannuation Guarantee (Administration) Act 1992 provides that for SG purposes the term 'employee' has"
 - Its ordinary (common law) meaning; and
 - An extended definition

Superannuation Guarantee

- Extended definition includes:
 - Individuals that work under contracts ‘wholly or principally for labour’
 - Performing artists or sportspersons
 - Members of Federal or State Parliaments
 - Federal & State public servants

SG for Contractors - SGR 2005/1

- SGR 2005/1 sets out the ATO's view on the meaning of the term 'contract wholly or principally for labour'
- Where the terms of the contract and subsequent actions of the parties indicates that the worker:
 - Is remunerated (either wholly or principally) for personal labour and skills
 - Must perform the contract personally with no delegation; and
 - Is not paid to achieve a result

SG for Contractors

- Under SG rules, an employer can include a person engaged under a contract that is mainly or entirely for labour
- A contractor can therefore be considered an employee for SG purposes
- If considered 'employees' for SG purposes, the employer must provide a minimum level of superannuation support
- SG contributions need only be calculated on the labour component

SG Charge

- The SG charge applies when you do not pay enough superannuation for your employees or you are late
- SG charge made up of 3 components:
 - SG shortfall amounts
 - Interest on that amount; and
 - An administration fee.
- In addition there are several other penalties and charges which can apply

SG Charge - penalties

- GIC calculated on a daily compounding basis, applied to SG charge unpaid by due date
- Administrative penalties apply if amount of SG charge you pay is less than it should have been (the shortfall amount)
- False and misleading statements result in the base penalty amount being 75% of the shortfall, in addition to the shortfall itself

SG Charge - penalties

- If you fail to keep records adequately, maximum penalty of \$3,300
- Not providing a SG charge statement (quarterly when required) can trigger a penalty of up to 200% of the amount of charge payable
- Avoidance arrangements can result in a penalty of 50% of the avoided amount

Employees salary sacrificing super

- Can only make an “effective salary sacrifice” of amounts not yet earned
- Treated as employer contributions
- The reduction of Concessional Contribution Caps has significantly impacted employees’ salary sacrificing ability
- Reportable superannuation
 - New requirements from 1 July 2009
 - Employers must report to ATO where:
 - employee influenced the amount or rate of super their employer contributes
 - all salary sacrifice contributions
 - amounts above the compulsory contributions your employer makes under an individual employment contract
 - Reportable super (as with reportable fringe benefits) can affect an employee’s income tests for tax offsets etc

Fringe Benefits Tax

- For a fringe benefit to arise under the legislation, the benefit must be provided to the employee or an associate of the employee
- The concept of employee for FBT purposes is aligned to the PAYG withholding rules
- ‘current employee’ defined to be a person entitled to receive salary or wages

Fringe Benefits Tax

- ‘salary or wages’ is further defined as a payment to:
 - An employee
 - A company director
 - A Commonwealth education or training payment
 - Compensation, sickness or accident payment
- Employee definition also expanded to include future & former employees
- FBT not imposed on benefits to contractors, whether engaged as individuals or via interposed entities (PAYG on non-cash benefits may apply)

Fringe Benefits

- Common fringe benefits include:
 - cars
 - property (including goods, real property such as land and buildings, and shares or bonds)
 - expense payments (such as the payment of loan repayments, school fees, child care costs and home phone costs).

Exempt benefits

- A number of benefits are exempt from FBT. The following work-related items commonly provided in salary sacrifice arrangements are exempt benefits:
 - a portable electronic device (e.g. ipad)
 - an item of computer software
 - an item of protective clothing
 - a briefcase
 - a tool of trade
- Should be primarily for work-related use and employee should sign declaration as such

Common errors

- Not obtaining relevant employee declarations
- Claiming GST input-tax credits for entertainment expenses which are exempt benefits
- Not using the 'otherwise deductible rule' to reduce FBT
- Reporting exempt benefits on employee's payment summary
- Not 'grossing-up' the FBT value
- Lack of understanding / offering of benefits such as Living Away From Home Allowance

GST – taxable supplies

- Not limited to a sale
- What are taxable supplies?
 - There must be a supply
 - For consideration
 - Made in connection with an enterprise
 - Connected with Australia
 - Supplier must be registered or required to be registered
 - The supply must not be GST free or input taxed

Supply

- A supply is normally something that passes from one entity to another
- It does not matter whether the supply is legal or illegal
- Examples
 - Supplying goods
 - Services
 - Providing advice or information
 - Granting assigning or surrendering real property
 - Creating, transferring or surrendering a right etc

Consideration

- Does not have to be money
 - Could be that one entity refrains from doing something
 - Barter transaction
- Consideration could be provided to a third party

Input Tax Credits

- The credit for GST paid on acquisitions is the input tax credit
- Designed to bring enterprises to a tax neutral position and tax the end user
- You are entitled to an input tax credit equal to the GST component of your creditable acquisitions

Creditable acquisition

- Creditable acquisitions
 - You must acquire something
 - For a creditable purpose
 - The supply to you must be a taxable supply
 - You must provide consideration
 - You must be registered or required to be registered

Acquisition

- Similar to supplies
- Examples
 - Acquiring goods
 - Services
 - Receiving advice or information
 - Accepting the grant assigning or surrendering real property
 - Accepting the grant, transferring or surrendering a right etc

Creditable purpose

- You have acquired it in carrying on your enterprise
- The acquisition is not of a private or domestic nature
- The acquisition does not relate to making supplies that would be input taxed
- Apportionment may be required if the acquisition is only partly for a creditable purpose

GST-free supplies

- No GST is charged on GST-free supplies however input tax credits can be claimed
- Examples
 - Health
 - Going Concern
 - Some Food
 - Education

Input Taxed Supplies

- No GST is charged on supplies and generally input tax credits cannot be claimed
- Examples
 - Residential premises
 - With the exception of new residential premises (sales and rents) which will be taxable supplies
 - Financial Supplies
 - In some instances input tax credits can be claimed either in full or in part

Financial Supplies

Supplies listed in the regulations

1. Accounts
2. Debit, credit arrangement or right to credit
3. Charge or mortgage over real property
4. Regulated superannuation fund
5. Annuity or allocated pension
6. Life insurance
7. Guarantees and indemnities
8. Credit under a hire purchase agreement
9. Currency
10. Securities
11. Debentures

New Rulings System

- From 1 July 2010, new GST rulings system has been introduced which replaces old regime
- Taxpayer needs to be in a position to **prove** they were **relying** on old ruling prior to 30 June 2010 to continue to rely. This may not be easy in practice – review procedures
- May impact on shortfall interest and penalties

1 July 2010 Legislative Changes

- Tax invoice easing - The requirement of tax invoices has been relaxed, however it would be prudent to continue to issue tax invoices as before.
- Four year rule for GST adjustments;
- Domestic agency arrangements;
- GST grouping changes.

Proposed Legislative Changes

- Proposed 1 July 2011 changes include:
 - Changes to transfer of going concern rules to impose a reverse charge;
- Proposed 1 July 2012 legislative changes include:
 - Margin Scheme – AGAIN!
 - Financial Supplies
 - Financial Acquisition Threshold (FAT);
 - Cross-border transactions and non-resident changes.

Margin Scheme

- If selling real estate and you are eligible to use the margin scheme, you can calculate GST on your 'margin' for the property sale, rather than GST of $1/11^{\text{th}}$ of the sale price.
- If you sell property and are not eligible, or do not want to use the margin scheme, calculate GST as $1/11^{\text{th}}$ of the sale price.
- Margin scheme may apply where both parties are registered or required to be registered and both agree to using it.
- **BEWARE!** there have been numerous changes since introduction and probably more to come!

Completing your BAS – Margin Scheme

- Sales
 - G1 only report the amount of the 'margin'. Do not report the full amount of payment you receive.
 - If the margin is nil (or a negative amount), do not report any amount at G1 (total sales).
- Purchases
 - Do not report the amount of your payment for the purchase at G10 or G11 as no GST credit is available on the purchase.
 - Do not report any GST credit for the purchase at 1B (GST on purchases).
- Tax invoices
 - If you use the margin scheme to work out the GST on your sale, you do not have to issue a tax invoice to the purchaser. This is because the purchaser cannot claim GST credits on a sale made using the margin scheme.

Common errors

- Allocating all supplies that don't attract GST to the GST-free supplies section of the BAS. This can attract ATO scrutiny unnecessarily
- Claiming input tax credits on financial supplies
- Claiming input tax credits when not holding a valid tax invoice
- Incorrectly applying the margin scheme
- Misunderstanding of what supplies are not taxable

ATO Scrutiny

- Less than 5% of GST reviews go straight to full audit
- If you receive a GST audit with no prior warning please treat this cautiously and seek advice immediately
- We are seeing increasing numbers of reviews, particularly around real property
- 'Google Earth' now being used by the ATO
- Specific property project team now set up

Political Views and Consultation

Impact of:

- Henry Review
- Tax Summit

Questions?



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