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Clerk of the Parliaments,
NSW Legislative Council
NSW Parliament House
6 Macquarie Street
Sydney NSW 2000

7 February 2025

Dear Legislative Council

RE: Inquiry into the application of the contractor and employment agent provisions in the Payroll Tax Act 2007

The Council of Small Business Organisations Australia (**COSBOA**) welcomes the launch of the NSW Parliamentary inquiry. COSBOA considers that there are major issues with payroll tax legislation and its enforcement, reflected in prolonged and costly litigation that has placed unnecessary strain on both small businesses and NSW taxpayers.

Background

COSBOA is focussed on promoting, supporting, and advancing the interests of privately owned businesses and family-owned enterprises in Australia. Small businesses make up 97 per cent of all Australian businesses and are the backbone of the Australian community and economic growth. An estimated 2.5 million small businesses that employ over 5 million people, and train over 40 per cent of all apprentices and trainees in Australia.

COSBOA welcomes the NSW Parliamentary Committee's Inquiry into the application of the contractor and employment agent provisions in the Payroll Tax Act 2007 (NSW) (**Act**). COSBOA represents many industries significantly impacted by the administration of payroll tax laws by Revenue NSW. The application relevant contractor provisions, in particular, are very concerning.

The growing tax burden, exacerbated by "regulatory creep," is increasingly falling on the smallest businesses in NSW, threatening their viability. This is likely to impact consumers through reduced competition and higher costs. The small business experience is that increased costs, regulatory burden and the complexity of meeting requirements takes more time than actually growing the business.

Payroll Tax Act 2007 (NSW)

Payroll tax taxes employers on payment of wages for employees or those in employee type arrangement (contractors, agents). Whilst the introduction of the GST in 2000 aimed to simplify the tax system, including to phase out state taxes like payroll tax, this transition was never fully

implemented, leaving payroll tax as a key revenue source for state governments (alongside property and stamp duties).

Although payroll tax was intended to be harmonised across Australia, inconsistencies remain. States and territories have varying tax rates, payroll thresholds, and legislative frameworks, such as differences in contractor exemptions in the ACT and Tasmania. As such, it is costly and complex for businesses with a national precedence to comply with legislation across multiple jurisdictions. It is not a productive nor efficient tax and small businesses view it as a disincentive to employing staff.

COSBOA notes that in 2022 the NSW Legislative Council's Select Committee on the Impact of Technological and other Change on the Future of Work and Workers in New South Wales, the committee's Report indicated that the Committee was very open to the suggestion that New South Wales would be better served by a different tax regime altogether to payroll tax. The Committee recommended that NSW Government undertake a study of the advantages and disadvantages of replacing payroll tax with a business cash-flow tax (Recommendation 13).

COSBOA's view is that payroll tax generally is effectively a tax that acts as a barrier to productivity by discouraging businesses, particularly small businesses, from hiring staff and expanding their operations. COSBOA has heard account of some small businesses considering off-shore hires due to the financial burden of payroll tax falling on the employer, the complexities of working it out and the admin burden in time taken disincentivises them to keep employing people directly.

Contractor Provisions of the Act

COSBOA submits that the Contractor Provisions are poorly drafted and outdated, causing significant challenges for several industries where small and micro businesses operate including the mortgage broking and direct selling industries. The lack of clarity allows for the Contractor Provisions to be interpreted, not just to capture *bona fide* contractor relationships, but in ways that do not reflect modern day business practices. The contractor provisions in many issues are not addressing any alleged issues around sham contracting and in some circumstances due to the complexity of different business models Revenue NSW is applying them to, has the effect of actually creating an unlevel playing field. The law is no longer fit for purpose for modern businesses, particularly given advancements in technology and the widespread reliance on platform providers, especially by small businesses who use platform services and technology to scale operations and connect with customers more efficiently.

The provisions regarding relevant contracts were originally introduced as anti-avoidance measures. However, Revenue NSW and other state revenue offices have shifted from the original anti-avoidance purpose of relevant contractor provisions, resulting in genuine independent contractor relationships being included. As evidenced by recent case law, tax regulators, particularly in NSW, continue to test the limits of the law, deviating from the law's original intent, requiring businesses to pursue costly litigation.

COSBOA notes that payroll tax requires businesses to self-assess their liability to pay. This causes several particular issues. Firstly, whether the contractor arrangements are potentially caught and secondly if they are, whether any of the highly complex exemptions in the section are applicable to the arrangements. Businesses who use contractors report the highly complicated processes they have to engage in to understand whether they even have a liability under the provisions. This usually involves hiring professionals such as accountants and lawyers to undertake an analysis and incur significant expense in doing so. Indeed, some businesses have reported spending more in professional fees to understand if they have a liability than the actual

liability itself, such is the complexity of applying the provisions themselves. The self-assessment complexity is also reflected in the number of legal cases which have been brought in front of courts to determine whether a liability exists. It is by no means a simple exercise.

Direct selling example

One small direct selling business recounted having to navigate a payroll tax audit shortly after acquiring the business after due diligence did not pick up the fact that the relevant contractor provisions would be applicable to certain commission payments, thus resulting in an unexpected post-acquisition burden in time, legal fees and payments, but also in ongoing liability costs were not factored into budget. It is a small business and it takes at least half a day to calculate its payroll tax liability per month in NSW. Following the confusing removal of an exemption to the contractor provisions 10 years ago, the burden around the contractors payroll tax involves significant internal labour cost and admin burden in determining which selling agents, as contractors, are exempt or not exempt from Payroll tax each month, depending whether they are sole operators, in a partnership etc. This involves direct selling companies requiring significant additional information from contractors regarding their internal business and tax structures and gathering and holding additional information. Relevant contractor exemptions applicable to direct selling remain in many other states, adding to the confusion. Indeed, most businesses. In the direct selling sector need to rely on the replacement method provisions in order to calculate payroll tax as commissions are made to consultants based on the amount of products sold rather any correlation to time spent selling product. The “deemed wages” therefore are calculated by reference to product sales. Companies do not control how or when contractors choose to sell products, hence why they are independent contractors and not employees in the first instance. In these circumstances, for payroll tax is essentially becomes a tax on product sales which ultimately will be passed onto consumers.

Mortgage broking example

More recently and well documented within the mortgage broking sector, the decision in the Loan Market case has fundamentally altered the application of payroll tax in a way that was neither anticipated nor intended by the industry. Nor, as noted by the judge presiding over the case, is the interpretation consistent with the objectives of the legislation. To suggest otherwise is to ignore the significant financial and operational upheaval now facing thousands of small broking businesses.

COSBOA notes that NSW Government’s policy response to the General Practitioner industry following the Thomas and Naaz decision, where the NSW government recognised the need to and did intervene to avoid unintended consequences for GP’s who effectively also run small businesses. COSBOA submits that similar exemptions should be afforded to other circumstances where small businesses and/or consumers are likely to be hit by the unintended consequences from imposing the relevant contractor provisions to genuine independent contracting arrangements.

COSBOA further submits that the ambiguity of relevant provisions requires clearer regulatory guidance to help businesses comply. Anecdotal reports indicate that businesses often do not recognise the description of their industries and how they work in practice. COSBOA understands that information on some Revenue NSW webpages outlining industry guidance was collated without reference to the relevant industry bodies and fails to capture the complexity of various business models and how the contractor provisions may apply in practice thus creating further confusion for businesses.

Proposed Solutions

COSBOA submits the following:

- that broad based tax reform to abolish payroll tax altogether is required, as was the original intent when the GST was implemented and per the recommendations of the previous NSW Inquiry recommending a review of the merits of replacing payroll tax in NSW. In the interim, a national conversation is required to consider the proper harmonisation of payroll tax.
- NSW Treasury should open a consultation to review the broader construct of the Payroll Tax Act to ensure it is fit for purpose in the modern-day economy and in the interim Revenue NSW should apply the law as intended, targeting anti-avoidance rather than genuine business arrangements.
- specific and workable exemptions should be introduced to make the contractor provisions fit for purpose so they don't capture bona fide contractor arrangements.
- it is also vital that the Commissioner's Practice Notes are developed in consultation with industry.

Conclusion

A wholesale review of the payroll tax system should be undertaken as the current laws are out of step with modern business practices and this is particularly the case in relation to the contractor provisions which create many inadvertent consequences and discourage investment and productivity through a regime which is overly cumbersome, expensive to navigate and targeting industries and contractual arrangements which were not part of the original policy intent of the tax.

We continue to advocate for small business stakeholder consultation in relation to payroll tax and we look forward to assisting the Committee in this regard wherever possible.

Kind regards,



Luke Achterstraat
Chief Executive Officer