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Dear Ben,

**Draft Taxation Ruling – TR 2022/D3 Income tax: pay as you go withholding – who is an employee? and Draft Practical Compliance Guidance - PCG 2022/D5 Classifying workers as employees or independent contractors - ATO compliance approach**

CPA Australia represents the diverse interests of more than 170,000 members working in over 100 countries and regions around the world. We provide the following comments in relation to **TR 2022/D3** *Income tax: pay as you go withholding – who is an employee?* (**the draft TR**) and **PCG 2022/D5** *Classifying workers as employees or independent contractors - ATO compliance approach* (**the draft PCG**).

We appreciate the commitment by the ATO to provide updated guidance following High Court decisions relevant to the determination of a worker's classification for tax purposes.

**TR 2022/D3**

The draft TR updates the ATO view, i.e., in following the contractual emphasis espoused in the 2022 High Court decisions in ***Construction, Forestry, Maritime, Mining and Energy Union v Personnel Contracting Pty Ltd [2022] HCA 1*** (***Personnel Contracting***) and ***ZG Operations Australia Pty Ltd v Jamsek [2022] HCA 2*** (***Jamsek***). The draft TR reiterates the High Court's decision that it is necessary to determine the legal rights and obligations established by the contract, and then consider whether that arrangement is one of contracting or employment by reference to the totality of the relationship.

**PCG 2022/D5**

The draft PCG outlines the ATO's compliance framework for worker classification including the four risk zones on how it applies its compliance resources. We find the risk zones to be a useful classification for agents and their clients in ascertaining their ATO compliance risks and areas of exposure.

**Current market trends and issues**

Our members have raised concerns that, since the above High Court decisions were handed down, they are observing a high incidence of workers being classified or reclassified as independent contractors based on new or revised contractual terms. There is a concern that certain advisors may be creating contracts that classify a working relationship as independent contracting when the facts of the arrangement would indicate that they are, or remain, an employee.

As a result, tax agents are observing an increasing number of clients presenting with standardised contracts which, in the tax agent's view, do not necessarily properly reflect the performance of the arrangement. Issues identified by our members include:

- Existing clients with no change in their present working arrangements presenting with revised contracts that may appear consistent with the draft TR and re-characterise the relationship from one of employment to independent contracting
- Tax agents seeking to confirm the particulars of the performance of the arrangement against the contract terms are rebuffed by taxpayers who are confident that the contract itself and their agreement thereto is sufficient to demonstrate tax compliance

- Taxpayers who achieve lower effective tax rates through such contracts are unlikely to disclose the arrangements as a sham, creating uncertainty for tax agents as to how to take reasonable care in checking whether or not they are actually working in the business of the engaging entity
- Templated agreements with standardised terms are being utilised and, despite client attestations, agents remain concerned as to whether the individual properly and fully understands and accepts the tax and superannuation consequences
- Clients are unable or reluctant to obtain specific advice from the engaging entity confirming the classification as required for low-risk classifications under the draft PCG
- Broader concerns about the preference to shift from employment to independent contracting due to improved tax outcomes for certain groups, leading to lower tax revenues and superannuation contributions.

**Member case study**

A public practice accounting firm specialises in the health industry, including providing tax advice to pharmacists. Due to a current shortage of pharmacists, there is high demand for their services. The tax agent is finding clients are now presenting contracts that classify the working relationship as one of an independent contractor when, prior to the High Court decision, they were (or were found to be) an employee, despite the wording of the contract. As a result, these individuals are effectively earning up to 30 percent more than when they were engaged as an employee. As independent contractors, these workers are also claiming additional expenses as tax deductions which they were unable to do when previously classified as employees.

**Reinstatement of ATO Employee or contractor decision tool**

Our members have advised us that the currently-withdrawn ATO **Employee or contractor decision tool** (**decision tool**) was incredibly useful in demonstrating to clients that that their self-assessed independent contractor classification may be incorrect. They are now having difficulty in convincing their clients that there could be an alternative worker classification outcome, without having an updated decision tool to risk-assess the self-assessed worker status.

We recommend that the ATO release an updated decision tool as soon as possible to reflect the risk framework set out in the draft PCG. This will enable agents and taxpayers to more confidently self-assess where their arrangement falls within the four risk zones and facilitate agent-client discussions about working arrangements. Elements of particular focus are the need to hold advice from the engaging entity's counsel or a third party and identifying when the performance of the arrangement has deviated significantly from the contract.

Further enhancements to the decision tool could include:

- embedding the various indicia (paragraphs 35 to 69 of the draft TR) for the purpose of assessing the contractual rights and obligations of the parties
- more detailed decision tree nodes that assist in identifying situations where the performance of arrangements may have deviated significantly from the contractual rights including material changes.

**Education and awareness**

The draft TR and draft PCG are necessary to formally set out the Commissioner's view and compliance approach following the High Court decisions. For tax agents and their clients, the key shift is the application of the relevant indicia (previously considered under the multi-factorial test) to the contract itself (paragraphs 35 to 69 of the draft TR) as opposed to how the contract was actually performed (paragraph 25 of the draft TR).

Unaware of the precedents, tax agents may continue to seek to apply the now-withdrawn multi-factorial approach to new arrangements or fail to restrict the application of the indicia to the contract itself. They may instead extend it to the performance of the arrangement. Further education and guidance are recommended to ensure that tax agents are aware of the changed approach and are able to apply the law and precedents correctly.

Where the arrangement is not challenged as a sham or there is no disclosure by the taxpayer as to any variation, waiver or discharge, messaging to tax agents is required to signal that the application of the PCG methodology and resulting risk rating is sufficient assurance to the ATO for tax agents to demonstrate that they have satisfied their reasonable care requirements under the *Tax Agent Services Act 2009*.

Further to the ruling and PCG, additional information on the consequences of non-compliance and actions available to the ATO may be beneficial. In particular, we were unable to find ATO guidance on sham arrangements that provided a clear definition or that referenced Division 6 of the *Fair Work Act 2009*.

**Superannuation**

Given the High Court's remittance of *Jamsek* to the Full Federal Court to address the extended definition of 'employee' for employer superannuation purposes, our members have observed a reluctance by some employers to address the possible need to pay the superannuation guarantee charge for their independent contractors. When decided, we recommend that the ATO issues guidance on the matter as soon as possible to ensure that engaging entities fully understand their obligations.

**Interaction with the *Fair Work Act 2009***

We recognise that the ATO cannot provide guidance in relation to the administration of the *Fair Work Act 2009 (**FWA**)* and appreciate cross-agency efforts to publish contemporaneous, consistent guidance. Advisers seeking further guidance on concepts such as sham arrangements referenced in the ATO guidance will then need to refer to the Fair Work Commission (**FWC**). We note that the **FWC guidance** on Division 6 of the *FWA* displays an alert referencing the High Court decisions and that the still-public content is under review.

As expressed in earlier consultations, we encourage the ATO to work more closely with the FWC to produce contemporaneous and consistent guidance for workers/taxpayers and their advisors. Because evidence of a sham arrangement has become one of the only ways in which a contract can be questioned for tax purposes, its importance is now heightened in relation to tax and superannuation compliance. In addition, the issue of whether sections 357 to 359 of the *FWA* can be applied to challenge an arrangement that is mutually agreed to by both parties (that is, where there is no coercion on the part of the employer/engaging entity) is unclear and an express statement either way would be of assistance.

If you have any queries, please contact Elinor Kasapidis, Senior Manager Tax Policy, on 0466 675 194 or **elinor.kasapidis@cpaaustralia.com.au**.

Yours sincerely,

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Executive General Manager
Policy and Advocacy