

GMS Flash Alert

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Australia – ATO Issues Guidance on ‘Employee’ Versus ‘Independent Contractor’

On 15 December 2022, the Australian Taxation Office (ATO) released the draft [TR 2022/D3](#) and draft [PCG 2022/D5](#) in respect of the assessment of workers as either employees or contractors. The guidance updates the Commissioner’s view to take account of two recent High Court decisions, and to provide practical guidance on when the ATO will apply compliance resources to review contractor arrangements.

WHY THIS MATTERS

The characterisation of workers as either employees or contractors is complex.

In PCG 2022/D5, the ATO provides a practical administration approach to assist taxpayers in complying with relevant tax laws considering recent High Court decisions and draft TR 2022/D3.

TR 2022/D3 considers who is an employee to determine whether an entity has a PAYG withholding obligation. However, the draft ruling has a wider application as the classification of a worker as a common-law employee will give rise to the full range of employer tax and superannuation obligations.

While the draft PCG is a welcome development, it remains to be seen whether it will materially alleviate the burden of contractor management processes. Most notably, to classify a contractor as ‘very low’, ‘low,’ or ‘medium’ risk, advice must be obtained from internal legal counsel or a suitably qualified external adviser (among other requirements). This would appear to set a very high bar.

TR 2022/D3 Income Tax: ‘Pay As You Go’ Withholding – Who Is An Employee?

Draft TR 2022/D3 replaces Taxation Ruling TR 2005/16.

Draft TR 2022/D3 explains when an individual is an employee of an entity for the purposes of section 12-35 of Schedule 1 to the *Taxation Administration Act 1953* ('TAA') which 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).

TR 2022/D3 explains the Commissioner's approach in applying the recent High Court decisions of *Personnel Contracting* and *ZG Operations* to the question of whether the worker is an 'employee' for the purposes of section 12-35 of Schedule 1 to the TAA (of [Personnel Contracting](#) and [ZG Operations](#)).

Is the 'Multi-Factor Test' Still Relevant?

Yes. According to the ATO, the central question is whether the worker is working in the business of the engaging entity, based on the construction of the terms of the contract, having regard to the indicia of employment identified in case law.

PCG 2022/D5 – Classifying Workers As Employees or Independent Contractors – ATO Compliance Approach

PCG 2022/D5 provides a practical administration approach to assist taxpayers in complying with relevant tax laws considering recent High Court decisions and draft TR 2022/D3.

The ATO's allocation of compliance resources depends on which of the four risk zones the arrangement falls into: very low, low, medium, or high risk.

Parties can self-assess against this risk framework to understand the likelihood of the ATO applying compliance resources to review their arrangements. The PCG should be read in conjunction with draft TR 2022/D3.

Other Points

- For now, SGR 2005/1 continues to apply in respect of superannuation, however this ruling is also subject to review.
- Draft PCG 2022/D5 sets out the circumstances in which the ATO will or will not direct compliance resources to consider the tax and superannuation implications of contractor arrangements. 'Green zone' contractors with 'very low' risk should not be subject to ATO scrutiny.

KPMG INSIGHTS

The characterisation of workers as either employees or contractors is complex and has been subject to recent focus following several precedential court decisions.

In particular, in February 2022, two High Court decisions overturned many years of accepted practice by emphasising the importance of the terms of the written contract when determining whether the workers are independent contractors or employees.

A key element of the High Court's reasoning in both judgments was that where the rights and duties of the parties are

KPMG INSIGHTS continued:

comprehensively set out in a written contract, and the contract is not a sham and has not otherwise been varied, the legal rights and obligations existing under the contract are decisive in determining the worker's status.

RELATED RESOURCE:

For the full report, see "Fresh Guidance from the ATO Regarding Contractors," published in *KPMG Tax Now* (see: <https://contentplus.kpmg.com.au/taxnow/>), a publication of the KPMG International member firm in Australia.

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