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Internal Revenue Commission - Circular

Taxation Circular TC 2013/1

Subject: Distinguishing Employee and Independent Contractors and their Tax Implications.

PURPOSE

1. This Circular sets out the key characteristics of a contract of service, which is the employer/employee relationship and distinguishes these characteristics from that of a contract for services (i.e. an independent contractor). In discussing these, the Circular considers the relevant provisions of the Income Tax Act 1959 hereafter referred to as “the Act” and the various indicia common law courts have considered in determining whether a person engaged by another entity is engaged as an employee within the common meaning of the term. It is further intended to alert employers and contractors to their various tax obligations to withhold and remit under the relevant provisions.
2. The manner in which employer/employee relationship and independent contractors are treated respectively affects their tax liability, which influences other important areas of tax. Some of the areas that are affected include salary or wages tax, foreign contractor (withholding) tax, business payment tax, superannuation and salary packaging. It also extends to non-tax commercial issues including visas, work permits, and insurance issues. The definition of an employee versus an independent contractor has always been a grey area of law and no one indicia is said to be conclusive of either an employer/employee relationship, or an independent contractor. Each case is reviewed according to its own facts to determine its status. It is rare for a contract with an individual to be anything other than as an employee subject to salary and wages tax. Indeed, our general experience of these situations in Papua New Guinea (“PNG”), where individuals are providing personal services on a routine basis over a period of time, is that in all but exceptional circumstances they would be subject to salary or wages tax.
3. The Principles discussed in this circular apply to both the formal and the informal sectors of the economy. They apply equally to government departments, the commercial sector and even non-profit and aid organisations.

Contents

PURPOSE	1
INTERPRETATION	3
What is an employment relationship?	3
Background	4
Formation of Contract.....	5
Key Indicia of Employment	6
Provision of Benefits.....	6
Control –Master/ Servant Relationship	7
Does the worker operate on their own account or in the business of the payer?	8
‘Results’ Contracts.....	9
Whether the work can be delegated or subcontracted?	10
Risk	11
Provision of tools and equipment and payment expense.....	11
Other common law indicia	12
Role of common law criteria in the Act	13
Other Indicia.....	14
Payments to other parties.....	14
TAX IMPLICATIONS FOR THOSE WHO ENGAGE EMPLOYEES AND CONTRACTORS.....	15
<i>Collection of Salary or Wages Tax</i>	15
Contract for services	16
Management Fee (Withholding) Tax	16
Foreign Contractor (Withholding) Tax	16
Business Payments Tax.....	18
Arrangements to Avoid Tax	19
EXAMPLES.....	21
1. Haus-Meri – Employer/Employee	21
2. Brick Layer (Sub-contractor).....	22
3. Management Consultant - Foreign Contractor (Withholding) Tax.....	23
4. Non Residential Fly- In Fly- Out Employees	24
5. PNG Company with Sole Employee.....	25

INTERPRETATION

What is an employment relationship?

4. Section 299D of the Act states:

For the purposes of enabling the collection of salary or wages tax from employees, where an employee receives or is entitled to receive from an employer in respect of a fortnight, or part of a fortnight, salary or wages, the employer shall make a deduction from the salary or wages at such rate as is declared by the Act.

5. In order for the provision to apply there must be an “employer” making “salary or wages” payments to an “employee”. The three essential components; employer, employee and salary and wages, are all defined terms within the Act. The term “employer” is specifically defined in section 299C to be “a person who pays or is liable to pay any salary or wages...” Section 4 of the Act defines an employee to mean:

a person who receives, or is entitled to receive, salary or wages, and includes a member of the National Parliament, a person employed in the Public Service and a person employed by an authority constituted by or under a law of PNG;

6. The most critical definition is that of “salary or wages” in section 4 which, in relation to any person, means:

- a) *salary, wages, commission, bonus, remuneration of any kind or allowances (whether paid in cash or otherwise) paid (whether at piece-work rates or otherwise) in respect of, or in relation to the employment of that person as an employee; or*
- b) *any remuneration by way of fees or otherwise for professional services, or services as an adviser, consultant or manager (whether at piece work rates or otherwise) where such remuneration is paid wholly or substantially for personal services rendered by that person in PNG,;*

and without limiting the generality of the foregoing, includes any payment made—

- c) *under a contract that is wholly or substantially for the labour of the person to whom the payments are made; or*
- d) *by a company by way of remuneration to a director of that company; or*
- e) *by way of superannuation, pension or retiring allowances; or*
- f) *by way of commission to an insurance or time-payment canvasser or collector,*

but does not include payments of exempt income.

7. It is the terms:

- “in relation to the employment of that person as an employee”,
- “wholly or substantially for personal services,” and
- “a contract wholly or substantially for labour”

within the definition of “salary or wages” that leads us to consider the common law interpretation of the employment relationship.

8. Whether one person is an employee of another is a question of fact to be determined by examining the terms and circumstances of the contract between them, having regard to the key indicia expressed in the relevant case law. Defining the contractual relationship is a process of examining a number of factors and evaluating those factors within the context of the relationship between the parties. No one indicia of itself is determinative of that relationship. The totality of the relationship between the parties must be considered.

Background

9. The relationship between an employer and an employee is a contractual one. It is often referred to as a contract of service. Such a relationship is contrasted with the principal/independent contractor relationship, which is referred to as contract for services. An independent contractor typically contracts to achieve a result, whereas an employee contracts to provide their labour (to enable the employer to achieve a result.)

10. Common law cases have considered the contractual relationship between parties in a variety of legislative contexts, including income tax, industrial relations, payroll tax, vicarious liability, workers compensation and superannuation guarantee. As a result, a substantial and well-established body of case law has developed various indicia to assist in determining the character of a contracting partner. Currently, there is no case law on point in PNG that discusses such contractual relationship with the various indicia. The PNG courts have stated in *Internal Revenue Commission v Hamidian Rad*¹ by J Amet

A quick comparative look at other jurisdictions’ tax legislation such as that of our closest neighbour, Australia, reveals that this provision is not unique to PNG. Instead it is a common provision. Such provisions have been judicially considered in their own settings. They offer assistance in the absence of anything to the contrary to understand the meaning and or the application of the provision in our setting subject to meeting the constitutional requirements as to the reception or the use of foreign judgements, which are met in this case.”

11. In light of what the PNG courts have said, it is the Commissioner General’s view that the principles discussed were effectively adopted into PNG law and subsequent development of these principles would be highly persuasive.

¹ *Internal Revenue Commission v Hamidian Radd* [2002] SC 692.

12. There are often many relevant facts and circumstances, some pointing to a contract of service, others pointing to a contract for services.² Whatever the facts of each particular case may be, there is no single feature which is determinative of the contractual relationship. The totality of the relationship between the parties must be considered to determine whether, on balance, the worker is an employee or an independent contractor.³ Consideration should be given to various indicia identified in judicial decisions which have considered the employee/independent contractor distinction, bearing in mind that no list of factors is to be regarded as exhaustive and the weight to be given to particular facts will vary according to the circumstances.⁴ Where a consideration of the indicia point one way, so as to yield a clear result, the determination should be in accordance with that result.⁵

Formation of Contract

13. In determining the nature of the contractual relationship, it is important to consider all the terms and conditions of the contract between the parties, whether express or implied, in light of the circumstances surrounding the making of the Contract.⁶
14. Contractual arrangements often contain a clause that purports to characterise the relationship between the parties as that of principal and independent contractor and not that of employer and employee. Such a clause cannot receive effect according to its terms if it contradicts the effect of the agreement as a whole⁷ that is, the parties cannot deem the relationship between themselves to be something it is not.⁸ The parties to an agreement cannot alter the true substance of the relationship by simply giving it a different label.⁹ If the underlying reality of the relationship is one of employment, the parties cannot alter that fact by merely having the contract state (or have the worker acknowledge) that the worker's status is that of an independent contractor.¹⁰
15. As Gray J in *Re Porter: re Transport Workers Union of Australia*¹¹ said:

²*Commissioner of Payroll Tax (Vic) v. Mary Kay Cosmetics Pty Ltd* 82 ATC 4444. As per Gray J.

³*Stevens v Brodribb Sawmilling Company Pty Ltd* (1986) 63 ALR 513 (*Stevens v. Brodribb*) at CLR 29; ALR 521, per Mason J. The Principle that the 'totality of the relationship between the parties' be considered to determine the nature of the contractual relationship at common law was adopted with approval by the majority of the Australian High Court in *Hollis v. Vabu* (2001) 207 CLR 21 (*Hollis v. Vabu*).

⁴*Abdalla v. Viewdaze Pty Ltd as Malta Travel* (2003) 53 ATR 30. The Full Bench of the Australian Industrial Relations Commission provided a summary of the state of the law governing the determination of whether an individual is an employee or independent contractor following *Hollis v. Vabu*.

⁵*Ibid*

⁶See *Steven v. Brodribb* (1986) 160 CLR 16 at 37, as per Wilson and Dawson JJ

⁷*Australia Mutual Provident Society v. Chaplin and Anor* (1978) 18 ALR 385 at 389.

⁸*Hollis v. Vabu* (2001) 207 CLR 21 at 45.

⁹*Massey v. Crown Life Insurance Co* [1978] 2 All ER 576.

¹⁰ In *Commissioner of State Taxation v. The Roy Morgan Research Centre Pty Ltd* [2004] SASC 288; 2004 ATC 4933; (2004) 57 ATR 147 (*Roy Morgan*) the Full Court of the Supreme Court of South Australia considered whether interviewers engaged by Roy Morgan were employees or independent contractors in the context of payroll tax. In arriving at the decision that the interviewers were employees, the Court held that such a clause should not be regarded as confirmation of the status of the interviewers as independent contractors.

¹¹ (1989) 34 IR 197.

Although the parties are free, as a matter of law, to choose the nature of the contract which they will make between themselves, their own characterisation of the contract will not be conclusive. A court will always look at all the terms of the contract, to determine its true essence, and it will not be bound by the express choice of the parties as to the label to be attached to it. As Mr Black put it in the present case, the parties cannot create something which has every feature of a rooster, but call it a duck and insist that everybody else recognise it as a duck.

However, such a clause may be used to overcome any ambiguity as to the true nature of the relationship.¹²

16. For example, an employer may seek to change the status of an employee to that of an independent contractor by both parties signing a contract of engagement that includes a clause to the effect that the worker is an independent contractor rather than an employee. That clause is ineffective if it is inconsistent with the true nature of the relationship inferred from the contract as a whole. If the terms of the subsisting relationship are not changed, it is likely that the worker's status would remain that of an employee.
17. The circumstances surrounding the formation of the contract may assist in determining the true character of the contract.¹³ Thus, if the contract comes into existence because the contractor advertises their services to the public in the ordinary course of carrying on a business, or as a result of a successful tender application, the existence of a principal/independent contractor relationship is more likely. Conversely, if the contract is formed in response to a job vacancy advertisement, or through the services of a placement agency, the existence of an employer/employee relationship is more likely.¹⁴

Key Indicia of Employment

18. The features discussed below have been regarded by the courts as key indicia of whether an individual is an employee or independent contractor at common law.
19. There are several indicia that have been generally accepted as determinative of an employer/employee relationship. Some are so critical that they are basically conclusive as to the nature of the relationship. There are other indicia which cannot be seen as conclusively determining the employer/employee relationship and these will need to be considered as part of the broader analysis of the facts of the specific case.

Provision of Benefits

20. One of the key indicia of an employer/employee relationship is the provision of benefits. The provision of certain benefits is accepted in most cases as a conclusive indicator of such

¹²*Australian Mutual Provident Society v. Chaplin and Anor* (1978) 18 ALR 385 at 389-390.

¹³ For example, *Reardon Smith Line Ltd v. Yngvar Hansen-Tangen* [1976] 1 WLR 989 at 997 per Lord Wilberforce; and *Codelfa Construction Pty Ltd v. State Rail Authority of New South Wales* (1982) 149 CLR 337 at 347-352; (1982) 41 ALR 367 at 371-375; (1982) 56 ALJR 459 at 461-463 per Mason J.

¹⁴*Roy Morgan Research Centre Pty Ltd v. Commissioner of State Revenue* (Vic) 96 ATC 4767 at 4772-4773 1996 33 ATR 361 at 367 per Byrne J. This decision was affirmed by the Court of Appeal (97 ATC 5070; (1997) 37 ATR 528) and an application for special leave to the Australian High Court was refused.

a relationship. In a typical employer/employee relationship, the employer provides a range of benefits which may include, but are not limited to, sick leave, annual leave, superannuation leave fares, salary packaging, accommodation, and the provision of motor vehicles.

21. An employer does not necessarily provide all of these benefits. For example, provision of accommodation and motor vehicles may be sufficient to indicate an employment relationship. An employee is not generally responsible for a motor vehicle or accommodation provided for his use. The employer may also have the right to withdraw the provision of the motor vehicle in the event of any misuse by the employee and the employee may be regulated in the manner of the usage of a motor vehicle. There is a high probability that sick leave, annual leave and leave fares would also indicate the employer/employee relationship.

Control –Master/ Servant Relationship

22. The classic “test” for determining the nature of the relationship between a person who engages another to perform work and the person so engaged is the degree of control which the former can exercise over the latter.¹⁵ A common law employee is told not only what work is to be done, but how and where it is to be done. With the increasing use of skilled labour and the consequential reduction in supervisory functions, the importance of control lies not so much in its actual exercise, although clearly that is relevant, as is the right of the employer to exercise it.¹⁶ As Dixon J stated in the Australian High Court case, *Humberstone v Northern Timber Mills*:¹⁷

The question is not whether in practise the work was in fact done subject to a direction and control exercised by actual supervision or whether an actual supervision was possible, but whether ultimate authority over the man in the performance of his work resided in the employer so that he was subject to the latters’ orders and directions.

23. Likewise, the Australian High Court in *Zuijjs*¹⁸ described the significance of control in the following way in the context of skilled employment, where the nature of the work performed left little scope for detailed control:

What matters is lawful authority to command so far as there is scope for it. And there must always be some room for it, if only in incidental or collateral matters.

24. The mere fact that a contract may specify in detail how the contracted services are to be performed does not necessarily imply an employment relationship. In fact, a high degree of

¹⁵*Stevens v. Brodribb* (1986) 160 CLR 16 at 24, per Mason J; and CLR 35, per Wilson and Dawson JJ

¹⁶*Stevens v. Brodribb* (1986) 160 CLR 16 at 24, per Mason J; and CLR 35, per Wilson and Dawson JJ. In *Stevens v. Brodribb*, the High Court was adjusting the notion of ‘control’ to modern industrial conditions and in doing so, continued the developments in *Zuijjs v. Wirth Brothers Pty Ltd* (Zuijjs) (1955) 93 CLR 561 and *Humberstone v. Northern Timber Mills* (1949) 79 CLR 389. The control test as articulated in *Stevens v. Brodribb* was cited and adopted with the approval by the majority of the High Court in *Hollis v. Vabu*.

¹⁷(1949) 79 CLR 389 1949 ALR 985.

¹⁸(1955) 93 CLR 561, (1956) ALR 123.

direction and control is not uncommon in contracts for services.¹⁹ The payer has a right to specify how the contracted services are to be performed, but such control must be expressed in the terms of the contract; otherwise the contractor is free to exercise their discretion (subject to any terms implied by law). This is because the contractor is working for themselves.

25. While control is important, it is not the sole indicator of whether or not a relationship is one of employment.²⁰ The approach of the common law courts has been to regard it as one of a number of indicia which must be considered in determination of that question.
26. However, even though the modern approach to defining the contractual relationship is to have regard to the totality of the relationship between the parties, control is still the most important factor to be considered. This was recognised in the Australian High Court by Wilson and Dawson JJ in *Stevens v Brodribb*²¹ where they stated:

In many, if not most cases, it is still appropriate to apply the control test in the first instance because it remains the surest guide to whether a person is contracting independently or serving as an employee.

27. In *Hollis v Vabu*,²² another Australian High Court case, the fact that the couriers engaged by Vabu had little control over the manner of performing their work (the corollary being that Vabu had considerable scope for the actual exercise of control over the performance of courier's activities) was an important factor leading to the conclusion that the bicycle courier in question was a common employee of Vabu. Gleeson CJ, Gaudron, Gummow Kirby and Hayne JJ observed that;

*Vabu's whole business consisted of the delivery of documents and parcels by means of couriers. Vabu retained control of the allocation and direction of the various deliveries. Their work was allocated by Vabu's fleet controller. They were to deliver goods in the manner in which Vabu directed. In this way, Vabu's business involved the marshalling and direction of the labour of the couriers, whose efforts comprised the very essence of the public manifestation of Vabu's business.*²³

Does the worker operate on their own account or in the business of the payer?

28. In *Hollis v Vabu*, the majority of the High Court quoted the following statement made by Windeyer J in *Marshall v Whittaker's Building Supply Co* (1963) 109 CLR 210:

¹⁹See *Queensland Stations Pty Ltd v. FC* (1945) 70 CLR 539; (1945) 19 ALJ 253;(1945) 8 ATD 30; [1945] ALR 273 (Queensland Stations).

²⁰For example, *Stevens v. Brodribb* (1986) 160 CLR 16 at 24, per Mason J.

²¹(1986) 160 CLR 16 at 36.

²²(2001) 207 CLR 21.

²³ *Ibid*

*The distinction between an employee and independent contractor is 'rooted fundamentally in the difference between a person who serves his employer in his, the employer's business, and a person who carries on a trade or business of his own'*²⁴.

This distinction is also referred to as the integration or organisation test.²⁵

29. In *Hollis v Vabu*, the High Court considered this distinction when determining whether a bicycle courier was a common law employee of Vabu. The majority found that the bicycle courier was a common law employee of Vabu and stated:

*Viewed as a practical matter, the bicycle couriers were not running their own business or enterprise, nor did they have independence in the conduct of their operations.*²⁶

30. While the majority did, in reaching its decision, consider lawful authority to command (that is control) and other relevant aspects of the relationship between the parties, at the same time was concerned with the fundamental question of whether the worker was operating their own business, or was operating within Vabu's business. Therefore, when applying the indicia of employment listed in this Taxation Circular, it is also necessary to keep in mind the distinction between a worker operating on his or her own account and a worker operating in the business of the payer.

'Results' Contracts

31. Where the substance of a contract is to achieve a specified result, there is a strong (but not conclusive) indication that the contract is one for services. In *World Book (Australia) Pty Ltd v FC of T*²⁷ Sheller JA said:

*Undertaking the production of a given result has been considered to be a mark, if not the mark, of an independent contractor.*²⁸

32. The phrase 'the production of a given result' means the performance of a service by one party for another where the first-mentioned party is free to employ their own means (such as third party labour, plant and equipment) to achieve the contractually specified outcome. Satisfactory completion of the specified services is the 'result' for which the parties have bargained. The consideration is often a mixed sum on completion of a particular job as opposed to an amount paid by reference to hours worked. If remuneration is payable when,

²⁴ *Hollis v. Vabu* (2001) 207 CLR 21 at 41.

²⁵ The notion of an 'integration' test arose in *Montreal v. Montreal Locomotive Works* (1947) 1 DLR 161 at 169 and was affirmed by Lord Denning in *Stevenson Jordan and Harrison Ltd v. MacDonald and Evans* [1952] 1 TLR 101 at 111 and reaffirmed in *Bank Voor Handel En Scheepvaart NV v. Slatford* [1953] 1 QB 248 at 295.

²⁶ *Hollis v. Vabu* (2001) 207 CLR 21 at 41.

²⁷ 92 ATC 4327

²⁸ *World Book (Australia) Pty Ltd v FC of T* 92 ATC 4327, Sheller JA referred to the High Court decision in *Queensland Stations Pty Ltd v. FC of T* (1945) 70 CLR 539;(1945) 19 ALJ 253;(1945) 8 ATD 30;[1945] ALR 273 (Queensland Stations) as authority for that proposition. He also used facts of that case as an example of a contract to produce a result. Note that, given the emphasis that the contract have placed on the control test (discussed above), the production of a given result is probably not the mark of an independent contractor but merely a mark.

and only when, the contractual conditions have been fulfilled, the remuneration is usually made for producing a given result.²⁹

33. In contracts to produce a result, payment is often for a negotiated contract price, as opposed to the hourly rate. For example, in *Stevens v Brodribb*,³⁰ payment was determined with reference to the volume of timber delivered, and in *Queensland Stations*³¹ where it was a fixed sum per head of cattle delivered.
34. Having regard to the true essence of the contract, the manner in which the payment is structured will not of itself exclude genuine result based contracts. For example, there are results based contracts where the contract price is based on an estimate of the time and the labour cost that is necessary to complete the task, or may even be calculated on that basis, subject to reasonable completion times.
35. While the notion of ‘payment for result’ is expected in a contract for services, it is not necessarily inconsistent with a contract of service. The High Court of Australia in *FC of T v Barrett & Ors*³² found that land salesmen who were engaged by a firm of land agents to find purchasers for land entrusted to the firm for sale and who were remunerated by commission only, were employees and not independent contractors. Likewise, the High Court in *Hollis v Vabu*³³ considered that payment to the bicycle couriers per delivery, rather than per period engaged, was a natural means to remunerate employees whose sole purpose is to perform deliveries. Further, the Full Court of the Supreme Court of South Australia in *Roy Morgan*³⁴ found that interviewers who were only paid on the completion of each assignment, not an hourly basis, were employees and not independent contractors. Accordingly, the contractual relationship as a whole must still be considered in order to determine the true character of the relationship between the parties.

Whether the work can be delegated or subcontracted?

36. The power to delegate or subcontract (in the sense of the capacity to engage others to do the work) is a significant factor in deciding whether a worker is an employee or independent contractor.³⁵ If a person is contractually required to personally perform the work, that is an indication that the person is an employee.
37. If an individual has unlimited power to delegate the work to others (with or without the approval or consent of the principal), this is a strong indication that the person is engaged as an independent contractor.³⁶ Under a contract for services, the emphasis is on the

²⁹*Neale (Deputy Commissioner of Taxation) v. Atlas Products (Vic) Proprietary Limited* (1955) 94 CLR 419 at 424-425.

³⁰(1986) 160 CLR 16.

³¹(1945) 70 CLR 539.

³²73 ATC 4147; (1973) 4 ATR 122.

³³*ibid*

³⁴97 ATC 4767, (1996) 33 ATR 528.

³⁵*Stevens v. Brodribb* (1986) 160 CLR 16 at 24, per Mason J

³⁶*Australian Mutual Provident Society v. Chaplin and Anor* (1978) 18 ALR 387 at 391. In such cases as *Ready Mix Concrete (South East) Ltd v. Minister of Pensions and National Insurance* [1968] 1 All ER 433, *Bowerman v.*

performance of the agreed services (achievement of result). Unless the contract expressly requires the service provider personally to perform the contracted services, the contractor is free to arrange for their employees to perform some or all of the work, or may subcontract some or all of the work to another service provider. In these circumstances, the contractor is partly responsible for remunerating the replacement worker.³⁷

38. A common law employee may frequently ‘delegate’ tasks to other employees, particularly where the employee is performing a supervisory or managerial role. However, this ‘delegation’ exercised by an employee is fundamentally different to the delegation exercised by a contractor outlined above. When an employee asks a colleague to take an additional shift or responsibility, the employee is not responsible for paying that replacement worker, rather the worker has merely organised a substitution or shared the work load. This is not delegation consistent with that exercised by a contractor.

Risk

39. Where the worker bears little or no risk of the cost arising out of the injury or defect in carrying out their work, he or she is more likely to be an employee.³⁸ On the other hand, an independent contractor bears the commercial risk and responsibility for any poor workmanship or injury sustained in the performance of the work. An independent contractor often carries their own insurance and indemnity policies.

Provision of tools and equipment and payment expense

40. It has been held that the provision of assets, equipment and tools by an individual and the incurring of expense and other overheads is an indicator that the individual is an independent contractor.³⁹
41. In *Stevens v Brodribb*,⁴⁰ the Australian High Court observed that working on one’s own account (an independent contractor) often involves:

*The provision by him of his own place of work or of his equipment, the creation by him of the goodwill or saleable assets in the course of his work, the payment by him his remuneration of business expense of any significant proportion...*⁴¹

Sinclair Halvorsen Pty Ltd [1999] NSW IR Comm 21 and *Express & Echo Publications Ltd v. Tanton* [1999] ICR 693, it was held that a power of delegation is inconsistent with a contract of service even if the principal has the right to approve or qualify any replacement worker.

³⁷In *McFarlane v. Glasgow City Council* [2001] IRLR 7, it was held that the gymnastic instructors engaged by the council were employees of the council, notwithstanding the fact that the instructors were obliged to find replacements when they were unable to take a class. One of the factors leading to this conclusion was that the replacement was paid directly by the council rather than by the instructors.

³⁸In *Hollis v. Vabu*, Vabu undertook the provision of insurance for the couriers and deducted the amounts from their payments to the couriers.

³⁹See, for example, *Stevens v. Brodribb and Vabu Pty Ltd v FC of T* 96 ATC 4898; (1996) 33 ATR 537 (*Vabu v. FC of T*).

⁴⁰(1986) 160 CLR 16.

⁴¹(1986) 160 CLR 16 at 36-37, per Wilson and Dawson JJ.

42. Similarly, in *Queensland Stations*⁴² the droving contractor was required to find and pay for all the men, plan and provide horses and rations necessary and sufficient for the task. Their own means were employed to accomplish a result.⁴³

43. However, the provision of necessary tools and equipment is not necessarily inconsistent with an employment relationship. As highlighted in *Hollis v Vabu*,⁴⁴ the provision and maintenance of tools and equipment and payment of business expense should be significant for the individual to be considered an independent contractor. The majority of High Court stated that:

*In classifying the bicycle contractors as independent contractors, the Court of Appeal fell into error in making too much of the circumstance that the bicycle couriers owned their own bicycles, bore the expense of running the bicycle and supplied many of their own accessories... A different conclusion might, for example, be appropriate where the investment in capital was more significant, and greater skill and training required to operate it.*⁴⁵

44. There are situations where, having regard to the custom and practice of the work, or the practical circumstances and nature of the work, very little or no tools of trade or plant and equipment are necessary to perform the work. This fact by itself will not lead to the conclusion that the individual engaged is as an employee. The weight or emphasis given to this indicator (as with all other indicia) depends on the particular circumstances, the context and the nature of the contractual work. All the other facts must be considered to determine the nature of the contractual relationship.

45. Further, an employee, unlike an independent contractor, is often reimbursed (or receives an allowance) for expenses incurred in the course of employment, including for the use of their own assets such as a car.

Other common law indicia

46. In addition to the above, other indicia of the nature of the contractual relationship have been variously stated and have been added to from time to time.⁴⁶ Those suggesting an employer-employee relationship include the right to suspend or dismiss the person engaged,⁴⁷ the right to the exclusive services of the person engaged,⁴⁸ provision of benefits such as sick and long service leave and the provision of other benefits prescribed under an award of employees. However, the fact that a contract does not contain provisions for

⁴²(1945) 70 CLR 539

⁴³Per Rich J at CLR 548

⁴⁴(2001) 207 CLR 21

⁴⁵(2001) 207 CLR 21 at 47. The High Court was referring to the NSW Court of Appeal taxation decision in *Vabu v. FC of T* where it was held that the couriers engaged by Vabu (including those who provided motor vehicles and motor cycles) were independent contractors. The majority decision in *Hollis v. Vabu* overturned that decision insofar as bicycle couriers were concerned.

⁴⁶*Stevens v. Brodribb* (1986) 160 CLR 16 at 36-37, per Wilson and Dawson JJ

⁴⁷*Ibid*

⁴⁸*Ibid*

annual leave and sick leave will not, in itself, be an indicator of a principal/independent contractor relationship.

47. The requirement that a worker wears a company uniform is an indicator of employment relationship existing between the contracting parties. In *Hollis v Vabu*, the fact that the couriers were presented to the public and to those using the courier service as emanations of Vabu (the couriers were wearing uniforms bearing Vabu's logo) was an important factor supporting the majority's decision that the bicycle couriers were employees.⁴⁹
48. It is obvious then that no one indicia on its own can be taken as conclusive of an employer/employee relationship, or that of an independent contractor. It is rather determined on a case by case basis. It is therefore vital to assess each individual case according to its facts. In cases where most of the indicators are indicative of an employment relationship, it would most likely be an employer/employee relationship. Alternatively, in cases where the indicators do not support the employer-employee relationship, the relationship would most likely be that of an independent contractor.

Role of common law criteria in the Act

49. It is the Commissioner General's view that the cases and principles discussed above are a starting point in the determination of whether an individual has been engaged as an employee or as an independent contractor. This is because the term "salary or wages" in the Act has a much wider definition than that prescribed by common law.
50. In PNG, "salary or wages" includes any remuneration by way of fees or otherwise for professional services or services as an adviser, consultant manager where such remuneration is paid wholly or substantially for personal services rendered by that person in PNG.
51. Accordingly, there will be instances where an individual could be engaged as an independent contractor under common law principles and still be subject to salary or wages tax in PNG. This is particularly the case for individuals who provide professional, advisory, or consultancy services
52. Employment income is generally treated as PNG-sourced compensation where the individual performs the services while physically located in PNG
53. PNG has entered into double tax treaties with nine countries to prevent double taxation and facilitate cooperation between PNG and overseas tax authorities in enforcing their respective tax laws. There is relief in the double tax treaties by which residents of other countries would not be subject to salary and wages tax in PNG under certain conditions.

⁴⁹*Stevens v. Brodribb* (1986) 160 CLR 16 at 36-37, per Mason J. This is because in contracts that are structured to suggest a contract for services, leave entitlements are not provided. In *Roy Morgan*, the interviewers (who were held to be employee) did not receive any paid sick leave or annual leave, or amounts in lieu of those entitlements because they expressly agreed in writing between Roy Morgan and the interviewers that they were, in relation to the company, independent contractors.

All non-resident contractors, other than those deriving salary and wage income, undertaking installation and construction projects or providing professional or consultancy services in PNG and equipment leases and charter payments to non-residents are subject to foreign contractor withholding tax.

Other Indicia

54. There are some other indicia in PNG that may assist to determine whether a contracting party is contracting as an independent contractor. Where a person is truly an independent contractor, for example an accountant or lawyer practising in their own name, supplies by the person would be subject to Goods & Services Tax (GST). Consequently, registration for GST purposes is another indicator that there is an independent business. Thus, it is the Commissioner General's view that if the individual performing the work is not registered for GST, then payments to the individual for work done in PNG will generally be subject to salary or wages tax.
55. Expatriates carrying on business in their own right would also need to be registered to carry on business for the purposes of the *Investment Promotion Act 1992* and be able to obtain a work permit and a working resident visa, or hold a permanent resident visa, to enable them to operate in PNG as an independent business. Where the individual is not registered with the Investment Promotion Authority, payments to the individual for work done in PNG will generally be subject to salary or wages tax.
56. It is considered that there is to be a presumption that foreign contractor withholding tax only applies to payments to companies, while Salary Wages Tax (SWT) is presumed to apply to payments made to individuals.

Payments to other parties

57. Section 13 of the Act applies *inter alia* where an amount of income is applied or dealt with in any way by an entity on another entity's behalf, or as the other entity directs. In other words, section 13 attributes receipt of a payment to the beneficial owner of the payment, regardless of the beneficial owner's lack of physical receipt or possession of the payment. Accordingly, where a payment does not pass directly between an employer and an employee, (For example where a payment is made to a third party for some reason) the constructive payment rule in section 13 will apply and the payment will still be treated as a payment of salary or wages subject to SWT. For example, an amount will be taken to have been paid to an employee when the employer pays, at the employee's direction, an amount to a relative, a creditor, a financial institution, or some interposed entities.
58. In *Southern Group Ltd v Smith*,⁵⁰ the Full Court of the Western Australian Supreme Court considered an arrangement whereby an individual's remuneration as managing director of a public company was paid to the individual's private company. Making payments to the

⁵⁰ (1997) 37 ATR 107.

individual's private company was a continuation of the practice required under an earlier short term consultancy contract between the two companies. The Full Court found that the individual's appointment as managing director was as an employee, and the payments to the individual's private company were made under an administrative practice. In circumstances such as this, there would be a constructive payment of salary or wages to the employee. Alternatively, section 361 of the Act may apply to cancel any tax benefit sought under such arrangements.

TAX IMPLICATIONS FOR THOSE WHO ENGAGE EMPLOYEES AND CONTRACTORS

59. Once the nature of the relationship has been determined according to the principles set out above, the Act imposes a variety of responsibilities on payers and recipients to enable the effective collection and administration of the tax system in PNG.

Collection of Salary or Wages Tax

60. The manner in which salary or wages tax is to be collected is set out in section 299D of the Act which states that:

For the purposes of enabling the collection of salary or wages tax from employees, where an employee receives or is entitled to receive from an employer in respect of a fortnight, or part of a fortnight, salary or wages, the employer shall make a deduction from the salary or wages at such rate as is declared by this Act.

61. In other words, the employer is required to withhold and remit tax on the salary or wages of its employees.

62. An employer must register with the Internal Revenue Commission ("IRC"). A registered employer, referred to as a "Group Employer" has a number of important responsibilities under the Act including:

- Registering with the IRC within 7 days of becoming an employer;
- Deducting tax from salary or wages paid as per the relevant tax table;
- Remitting such tax to the IRC by the seventh day of the following month;
- Preparing an annual Statement of Earnings for each employee in the following year; and
- Submitting annual tax reconciliation to the IRC at the end of the tax year. The total value shown as tax deducted from the salary or wages of the employees on all the Statement of Earnings issued by an employer in respect of a year must equal the total amount paid to the IRC in respect of that year.

63. If an amount of salary or wages tax is not remitted to the IRC by the due date by a group employer, an additional tax as penalty for late payment may be imposed. Further guidance

in relation to these obligations can be found in the current edition of the *Source Taxes Guide* available from the IRC.

Contract for services

64. Even where a payment under contract for the provision of services does not fall within the definition of salary or wages and is therefore not subject to salary or wages tax, a payer may still have withholding obligations under the Act.

Management Fee (Withholding) Tax

65. Management Fee (Withholding) Tax (“MFWT”) is the collection of income tax on “management fees” paid to a non-resident by:

- a PNG resident; or
- by a non-resident where the management fee relates to an outgoing incurred in carrying on a business through a permanent establishment in PNG

66. The Act defines a “management fee” to mean:

A payment of any kind to any person, other than to an employee of the person making the payment and other than in the way of a royalty, in consideration for any services of a technical or managerial nature and includes payments for consultancy services, to the extent the Commissioner is satisfied the consultancy services are of a managerial nature.

67. A person who is liable to pay a taxable management fee, (i.e. that part of a management fee that is an allowable deduction under section 68AD or section 155M as the case may be) must register with the Commissioner General and withhold 17% of the management fee at the time of payment.
68. A person who is required to deduct MFWT must lodge a remittance advice form and pay the amounts withheld to the Commissioner General within 21 days after the end of the month in which the management fee was paid. A payer must also complete and lodge with the Commissioner General an annual reconciliation statement within two months of the expiration of the financial year in which the deduction was made.
69. Management Fee Withholding Tax clearly has a broad ambit and to the extent that there is an overlap between the provisions of the MFWT and the Foreign Contractor (Withholding) Tax (in particular, paragraph (d) of the definition of prescribed purposes), then MFWT will take precedence.

Foreign Contractor (Withholding) Tax

70. Foreign Contractor (Withholding) Tax (“FCWT”) is the collection of income tax from Foreign Contractors in relation to certain types of income derived by them. A foreign contractor is any person who is a party to a prescribed contract and is not a resident company in PNG or a person other than a company, who is ordinarily resident in PNG. It

does not include an employee under the salary or wage provisions of the Act, or a person who derives a management fee to which the provisions of the MFWT is applied.

71. An “eligible payment,” for “prescribed purposes,” for the purposes of FCWT (also known as Non-Resident Withholding Tax) is a payment made under a contract that is in whole or in part for the carrying out, or the provision of work involving any of the following activities:
- a) *the installation, maintenance or use in PNG of substantial equipment or substantial machinery; or*
 - b) *the construction in PNG of structural improvements or other works, including–*
 - (i) the construction of roads, including bridges, culverts or similar works forming part of a road; and*
 - (ii) the erection of buildings, fences or similar improvements; and*
 - (iii) the clearing or draining of land; and*
 - (iv) the construction of ports or port facilities; and*
 - (v) the construction of facilities for the provision of water, light, power or communication; and*
 - (vi) the provision or improvement of transport facilities of any kind; or*
 - c) *the use of, or right to use, in PNG, any industrial, commercial or scientific equipment including any machinery or apparatus or appliance, whether fixed or not, and any vehicle, shipping vessel or aircraft; or*
 - d) *the provision in PNG of professional services or services as an adviser, consultant or manager, including services in conjunction with the purposes set out in Paragraphs (a), (b) or (c) of this definition.*
72. Any person carrying on business in PNG, who enters into a contract for prescribed purposes with a Foreign Contractor is considered to be the agent of that Foreign Contractor, and is then required to provide the Commissioner General with a copy of the signed contract or written notification of an agreement within 14 days of signing; and not make any payment to the Foreign Contractor or transfer out of the country any such payment until written confirmation is received from the Commissioner General.
73. Currently 25% of the gross payment, including all benefits, is treated by the Act as if it were Taxable Income to be taxed at the rate of 48 %, which is equal to a 12% withholding tax rate on the gross payment. Tax is to be deducted at the time that payment is made to the Foreign Contractor and paid to the IRC by the 21st day of the following month. Late

payment of tax deducted may lead to additional tax being imposed by way of penalty at a rate of 20% per annum on the amount remaining unpaid.

74. A Foreign Contractor may, with the express approval of the Commissioner General lodge an Income Tax Return showing income derived from PNG operations and expenditure relevant to that income. Where approval to lodge a return has been granted, the Foreign Contractor is required to pay income tax assessed on the actual profit disclosed in the return at the relevant rate.

Business Payments Tax

75. Part VI Division 2 of the Act applies to a payment that is a “Business Income Payment” under the Regulations. A paying authority or the payer is required to register with the IRC within 14 days of entering into a prescribed contract. After the paying authority is registered with the IRC, they will be sent a paying authority number and required to maintain details of payments made including:

- Name and address of payee,
- The date and amount of payment,
- Income tax file number,
- A valid certificate of compliance,
- Number of payee (if held), and
- The amount of any tax deducted.

76. This applies to any eligible payment made whether it exceeds the K500, limit or not.

77. A party to a contract who makes a business income payment is required to register with the IRC and withhold 10% of that payment *unless* the payment does not exceed K500, or the payee can produce an original certificate of compliance.

78. Regulation 10C defines a business income payment to be:

- (1) any payment (other than the exceptions listed in (2)) paid to a businessman, contractor, subcontractor, etc. (referred to as a ‘payee’) by a company, business group, business institution or body for work or services in the following industries :-
- building and construction, including repairs, painting, fitting of built-in furniture and any other building or construction activity;
 - road transport of any goods or materials;
 - repair or maintenance of any motor vehicle or any motor vehicle component, including painting, panel beating etc..
 - construction of any items of joinery which will become a fixture in any building;
 - provision of architectural services;
 - provision of surveying services;
 - provision engineering services;

- provision of cleaning services, including cleaning of buildings, offices, roads, parks, sporting venues, etc.
- provision of security services
- provision of advertising services;
- provision of entertainment of any kind;
- provision of sign writing services; and
- provision of professional services, including services as an advisor, manager or consultant;

(2) but does not include the following payments:

- a payment of a private or domestic nature for which a deduction is not available under any provision of the *Income Tax Act*;
- a payment of salary or wages;
- a payment to a contractor which is taxable under the FCWT provisions of the Act;
- a payment of exempt income, or a payment to an exempt person or business;
- a payment to or by the trustee of a bankrupt or the liquidator of a company; and
- a payment to a person holding a valid certificate of compliance, exempting his payments from the tax.

79. An independent contractor also has important tax obligations including registering as a taxpayer, lodging returns and paying tax. Contractors who would be subject to withholding on a business income payments may also seek to register for a certificate of compliance.

Arrangements to Avoid Tax

80. Section 361 of the Act deals with arrangements to avoid tax. An arrangement is defined as any contract, agreement, plan or understanding including all steps and transactions by which it is carried into effect and tax avoidance includes directly or indirectly altering the incidence of any income tax, dividend (withholding) tax, specific gains tax or salary or wages tax directly or indirectly, relieving any person from liability to pay any income tax, dividend (withholding) tax, specific gains tax or salary or wages tax or to make any return required and directly or indirectly defeating, avoiding, evading, reducing, or postponing any duty or liability imposed on any person and finally preventing the operation of the Act.

81. Where an arrangement purports to structure an employee's pay package and the purpose or one of those purposes or effects of such arrangement is to avoid the payment of salary or wages tax, the employer who is a party to such arrangement is liable to a fine. The employee for whom the arrangement is made is assessable to tax on the full amount of the benefit without regard to the exempt amounts stipulated under the Act.

82. A sham is an arrangement that creates an appearance of rights and obligations that differ from the actual rights and obligations that exist between the parties. The parties must have

a common intention that the arrangement is a mere façade, disguise or false front for a sham arrangement to exist.

83. Where payments are made to a PNG incorporated entity which provides the services of an individual, is registered for GST, is able to provide the principal with a certificate of compliance and otherwise appears to be a compliant taxpayer, it will generally be reasonable for a contracting party to accept these interposed entity arrangements are effective for income tax and employment law purposes.
84. IRC would generally not seek to lift the cooperate veil in order to impose salary and wages tax on an individual providing personal services through a company where there are genuine commercial reasons driving the contractual arrangement and where the interposed company is itself registered for Group Tax, pays the individual a salary commensurate with the work they are performing and continues to meet its reporting and payment obligations to the IRC.
85. Where however, a corporate entity has been interposed between the contracting parties and there appears to be little commerciality to the arrangement (for example where there are no other clients, or where the individual is subject to a high degree of control by the principal party, or is seen as being integrated into the principal's business) and one effect of the arrangement is the avoidance of SWT, then the Commissioner General would seek to look through the interposed entity and would require the collection and remittance of SWT from the principal contractor.
86. Of particular concern are arrangements whereby an employee ceases work on a Friday, but recommences as a contractor shortly thereafter, providing his services through an interposed entity to the former employer.
87. Where payments are made to a foreign company with a permanent establishment in PNG, it will generally be reasonable for a contracting party to accept that these arrangements are effective for income tax purposes, provided that:
 - the foreign company is registered under the *Companies Act* and *Investment Promotion Act*, and
 - relevant withholding taxes are levied as appropriate by the principal contractor.
88. Where a contract is to be fulfilled by an expatriate working in PNG, the expatriate must have a work permit showing the foreign company as the employer (this would of course also mean the company would have to be registered as a group employer for salary and wages tax purposes). Where the work permit and employment visa are sponsored by the principal contracting party, the arrangements would not be effective and payments to the foreign company will be treated as salary or wages.

EXAMPLES

1. Haus-Meri – Employer/Employee

Facts	Application of the Law to the Facts
<ul style="list-style-type: none"> • Rachael works for Mr John Wesley as a housekeeper. • Mr Wesley is an expatriate who is contracted by Kondan Limited as a consultant. His wife is also a teacher and she is engaged on a voluntary basis to teach in Gordons International School. • Both of them are very busy and do not have the time to clean and keep the house. • Mr Wesley engages Rachael to do his house-keeping and pays her K400 on a fortnightly basis. He tells her to come in at 8am in the morning and finish at 3pm in the afternoon. • She is then required to work a total of 7 hours each day on working days and 3 hours on weekends. • Mr Wesley asks Rachael if she can bring along her own broom, mop and bucket to work. • Mr Wesley provides a schedule of jobs which Rachael must complete on a regular basis. Rachael is required to personally perform these services and is not able to delegate these tasks. Her work is regulated and controlled. • Mr Wesley has exclusive right to Rachael's time and services from 8am until 3pm. • Mr Wesley also has the right to suspend her. • Mr Wesley hears from the IRC that Rachael is an employee and that he will be required to register with the IRC, deduct and remit Group Tax and fulfill other tax obligations as an employer. 	<ul style="list-style-type: none"> • Although they attempt to recast the relationship as a private contractor with Rachael providing her own tools of trade, she is an employee. • It is clear that the arrangement is wholly or substantially for the labour of the person to whom the payments are made. • Rachael is subject to a high degree of control by Mr Wesley in her work and would remain as a common law employee in any event. • Mr Wesley will be required to register for Group Tax, provide Rachael with a Salary or Wages Tax Dependent Declaration Form for completion, deduct tax from Rachael's wages and remit this to the IRC. • Mr Wesley will be required to fulfill other obligations set out in the <i>2011 Source Taxes Guide</i>.

2. Brick Layer (Sub-contractor)

Facts	Application of Law to the Facts
<ul style="list-style-type: none"> • John is contracted by National Capital District Commission (“NCDC”) to construct a sea wall at Ela Beach to control the sea and redirect it in a certain way so a children’s playground can be erected. • The sea wall is to be 60 metres long and 1 metre high. John is to complete the sea wall before December in time for the students vacation so they can enjoy the park. • The chairman of NCDC does not check on John regularly. • The contract can only be terminated if there is a serious breach of the substantive provisions. • John engages Etrisen and Ben to help him. He gives each of them a 20 meter segment of the sea wall to build. • They are required to provide their own cement mixers, tools, sand, gravel and cement powder. (The rocks have been provided by John to ensure a consistent look for the entire sea wall). • Etrisen and Ben also engage their own laborers to mix the cement and carry the rocks for them. John does not regulate their hours or manner of work, provided they are making consistent progress towards completion of their segments by the end of December. 	<ul style="list-style-type: none"> • John is a contractor to NCDC and payments made to him under the contract will not be subject to salary and wages tax. • The payments to John will be “Business Income Payments.” • NCDC will need to register for Business Payments Tax and withhold 10 % of the payments to John unless he can provide a valid certificate of compliance. • Etrisen and Ben will each be sub-contracted to John. • John will also need to comply with the provisions of the Business Payments Tax. • John has to register with the IRC withhold and remit to IRC 10% of the payments under the contract unless Etrisen and Ben can each provide a certificate of compliance from the IRC. • Etrisen and Ben will in turn each be employers of the labourers who are assisting them and will be required to fulfil the obligations of an employer set out above.

3. Management Consultant - Foreign Contractor (Withholding) Tax.

Facts	Application of Law to Facts
<ul style="list-style-type: none"> • The Commercial Bank of PNG has entered into a contract with Data Systems Ltd, a company from Australia. • Data Systems Ltd has offered to provide the services of Mr David Smith, a specialist database consultant. • Data Systems Ltd has agreed to provide the services subject to the terms and conditions outlined in the Terms of Reference. • Mr Smith will investigate and evaluate alternative development tools and methodologies which are likely to have the best prospects for long-term viability and standards acceptance, whilst being supportable in the relatively isolated PNG environment. • He recommends a cost-effective upgrade path to be taken by the Bank to replace current programming development tools. He also prepares a detailed implementation plan for the upgrade/conversion project • Furthermore, Mr Smith supervises and monitors the project up to the point where the local information technology staff are able to sustain it. • Mr Smith also investigates and recommends database systems documentation tools and supervises and monitors their initial adoption and implementation. Finally, he trains the Agency’s national IT staff to use the new development tools, languages, database administration and use of database systems documentation tools. • Mr Smith’s services require a high level of technical expertise. He is very competent and knowledgeable in this area of information technology. Because of that, he is the only one able to provide those services to the Bank. • The contract requires Data Systems to provide a total of 40 weeks of services of the 	<ul style="list-style-type: none"> • Data Systems Ltd will be a foreign contractor and Mr. Smith will not be an employee of the Bank. • The contract between Data Systems Ltd and the Bank will be a prescribed contract since it relates to the “provision in PNG of professional services or services as an adviser, consultant or manager” and all payments by the Commercial Bank of PNG to the company will be eligible payments under the FCWT provisions. • The Bank will need to provide a copy of the contract to the IRC for review and subsequently register with the IRC for FCWT, withhold 12% tax from any contract payments and remit these to the IRC, as well as fulfil other obligations set out in the 2011 Source Taxes Guide. • Although not an employee of the Bank, Mr Smith who is engaged by Data Systems Ltd will be caught within the salary or wages tax regime regardless of his attempt to be seen as a sub-contractor to Data Systems. • Even if Mr Smith is not considered to be an employee under common law rules , (perhaps due to his high technical skill, the limited supervision and control by Data Systems Ltd and the precise terms of his contract), he will still be subject to salary or wages tax in PNG. This is because of the extremely broad definition of salary or wages in PNG which includes, “any remuneration by way of fees or otherwise for professional services or services as an adviser, consultant, manager... where such remuneration is paid wholly or substantially for personal services rendered by that person in PNG.”

<p>Consultant during the Consultancy period.</p> <ul style="list-style-type: none"> • The services are to be provided in Port Moresby, unless otherwise agreed by the Data Systems Ltd and the Bank. • Data Systems Ltd is required to diligently and efficiently carry out or procure the performance of the services as agreed to in the contract and comply with the reasonable directions of the Bank. • Data Systems Ltd is able to sub-contract the services or performance of the services without the prior written approval of the Bank and attempts to do so in its agreement with Mr Smith by simply signing an agreement with Mr Smith which states that he is an independent contractor. 	<ul style="list-style-type: none"> • Data Systems Ltd, even though a foreign components must also register as a Group Employer and remit salary or wages tax to the IRC that has been deducted from the salary paid to Mr Smith whilst he works in PNG.
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4. Non Residential Fly- In Fly- Out Employees

Facts	Application of Law to Facts
<ul style="list-style-type: none"> • Mr Thomas Davidson is an expatriate who is an engineer by profession. • He is contracted by Blue Mountain Mining Ltd, a mining and exploration company in PNG • His family resides in Brisbane, his home town. • His contract with Blue Mountain Mining is such that he works for 2 weeks at the mine site and takes 2 weeks break. • He goes back to Brisbane to be with his family for 2 weeks in every 6 weeks. • After his two weeks break he returns to Blue Mountain in PNG. • He is paid on a fortnightly basis. He is advised by his employer that his salary is taxable only on the 4 weeks that he is working in PNG. • He is further advised that the income earned overseas when he is on his field breaks is not taxable in PNG. 	<ul style="list-style-type: none"> • Mr Thomas Davidson is an employee subject to salary and wages in PNG. He would be a manager or a consultant. • His income is taxable in PNG because his income is sourced from within PNG. • Mr Davidson salary is from work he did in PNG and his source of income is in PNG • Mr Thomas Davidson is subject to tax in PNG on the entirety of his income received from Blue Mountain. • Mr Davidson’s income is therefore taxable on both the 4 weeks working period and the 2 week break, because the payment for the two weeks is as a result of the work he undertakes whilst in PNG which remain the source regardless of the fact that he may be in Australia for 2 weeks when it is actually received.

5. PNG Company with Sole Employee

Facts	Application of Law to Facts
<ul style="list-style-type: none"> • Mr Steven Gagma is a highly paid economist working for Feliroses Ltd. After a discussion with their Human Resources division, it was agreed that Mr Gagma would resign from the company on the following Friday, but would consult back to the company in a similar capacity to his current role. • This new arrangement would enable Mr Gagma to increase his take home pay by “employing” various family members in his company, thereby reducing his tax at no additional cost to Feliroses Ltd. • Mr Gagma incorporated a new company (Melican Ltd) and appointed himself and his brother as directors and his wife as the company secretary. Mr Gagma’s wife has never been in paid employment and his brother is a driver for a local security firm. • Prior to his resignation, Melican Ltd enters into a consultancy agreement with Feliroses Ltd. The contract requires Mr Gagma to work from the premises of Feliroses Ltd for 40 hours per week and to personally perform all economic analyses required under the contract. Feliroses Ltd pays Melican Ltd K350,000 annually under the contract. • Melican Ltd purchases a house on Tauguba Hill for Mr Gagma and his extended family and provides a motor vehicle for himself and his wife as part of his salary package. • In addition, Melican Ltd pays Mr Gagma K100,000 annually and his wife and brother K70,000. • Mrs Gagma prepares a fortnightly invoice from Melican Ltd to Feliroses Ltd and her brother-in-law occasionally collects or delivers documents for their company. 	<ul style="list-style-type: none"> • Mr Steven Gagma will be treated as an employee of Feliroses Ltd for PNG tax purposes. • The remuneration received by Melican Ltd is remuneration by way of fees for professional services, or services as an adviser, consultant or manager and is paid substantially for personal services rendered by Mr Gagma himself and therefore fall within the definition of salary or wages. • The fact that he cannot delegate tasks and works from the premises of Feliroses Ltd further entrenches his position as an employee for tax purposes. • Feliroses Ltd will remain liable for salary and wages tax and will be subject to a 20% penalty on all amounts not withheld. It will further be subject to 20% per annum penalty for the late payment of salary and wages tax. • The manner in which Melican Ltd was established and the consultancy contract awarded indicates that this is a tax avoidance arrangement to which section 361 would apply. All of the various contractual arrangements will be ignored for tax purposes and Feliroses Ltd may in addition be subject to a fine of up to K50,000. • Further, the lack of any substantial role in the company by his wife and brother indicate that their employment with Melican Ltd is little more than a sham. • Even if Melican Ltd was registered for GST and obtained a Certificate of Compliance, this would not affect the conclusion in this scenario. • If however, Mr Gagma had established Melican Ltd without consulting back to Feliroses Ltd on a full time basis,

	actively pursued a number of other clients, was registered for GST, held a certificate of compliance and was not involved in such blatant income splitting, then the Commissioner General would usually accept the arrangements at face value.
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Authorised By

Betty Palaso - Commissioner General of Internal Revenue Commission

Issued

4 June 2013

Application

This Tax Circular sets out the Commissioner General's view on the relevant provisions both prospectively and retrospectively.

Acknowledgments

The kind assistance of the Australian Taxation Office in permitting the use of published material is gratefully appreciated.

Subject References:

- Foreign Contractor (Withholding) Tax
- Management Fee (Withholding) Tax
- Business Payment Tax
- Double Tax Agreement
- Salary and Wages Tax

Legislative References

Income Tax Act 1959

- Section 4
- Section 13
- Section 68
- Section 155
- Section 165
- Section 299
- Section 361

Case References

- Abdalla v. Viewdaze Pty Ltd as Malta Travel* (2003) 53 ATR 30
- Australia Mutual Provident Society v. Chaplin and Anor* (1978) 18 ALR 385
- Bank Voor Handel En Scheepvaart NV v Slatford* [1953] 1QB 248.
- Bowerman v Sinclair Halveorsen Pty Ltd* [1999] NSW IR Comm 21
- Codelfa Construction Pty Ltd v. State Rail Authority of New South Wales* (1982) 149 CLR 337; (1982) 41 ALR 367; (1982) 56 ALJR 459
- Commissioner of Payroll Tax (Vic) v. Mary Kay Cosmetics Pty Ltd* 82 ATC 4444
- Commissioner of State Taxation v. The Roy Morgan Research Centre Pty Ltd* [2004] SASC 288; 2004 ATC 4933; (2004) 57 ATR 147
- Express & Echo Publications Ltd v Tanto* [1999] ICR 693
- FC of T v Barrett & Ors* 73 ATC 4147; (1973) 4 ATR 122
- Hollis v. Vabu* (2001) 207 CLR 21
- Humberstone v Northern Timber Mills* (1949) 79 CLR 389 1949 ALR 123
- Humberstone v Northern Timber Mills* (1986) 160 CLR 16
- Internal Revenue Commission v Hamidian Radd* [2002] SC 692
- McFarlane v Glasgow City Council* [2001] IRLR 7
- Massey v Crown Life Insurance Co* [1978] 2 All ER 576
- Montreal v Montreal Locomotive Works* (1947) 1 QLR 161
- Naele (Deputy Commissioner of Taxation) v Atlas Products (Vic) Propriety Limited* (1955) 94 CLR 419.
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- Reardon Smith Line Ltd v Yngvar Hansen-Tangen* [1976] 1 WLR 989
- Roy Morgan Research Centre Pty Ltd v Commissioner of State Revenue (Vic)* 96 ATC 4767; (1996) 33 ATR 361
- Southern Group Ltd v Smith* (1997) 37 ATR 107
- Stevens v Brodribb Sawmilling Company Pty Ltd* (1986) 160 CLR 29; 63 ALR 513
- Stevenson Jordan and Harrison Ltd v MacDonald and Evens* [1952] ITR 101
- World Book (Australia) Pty Ltd v FC of T* 92 ATC 4327
- Zuijis v Wirth Brothers Pty Ltd* (1955) 93 CLR 561; [1956] ALR 123