



Internal Revenue Commission

PUBLIC NOTICE

APPLICATION OF SECTION 361 INCOME TAX ACT 1959 (as amended)

ARRANGEMENTS TO AVOID SALARY AND WAGES TAX

Diverging personal services income by structuring revenue earning activities through an interposed company is considered to be tax avoidance.

IRC compliance activity has identified arrangements whereby interposed entities, usually an "associated or related company", are being used to avoid salary and wage tax obligations on income derived from the personal exertion of a single individual.

The practise appears to be prevalent in many industries operating in the country.

In arrangements of this nature:

- a company will be incorporated with the taxpayer and other associated members as shareholders and directors;
- the taxpayer will become an employee of the company (the "interposed company");
- the interposed company negotiates with an employer for the provision of personal services;
- the employing entity will execute a contract with the interposed entity for the personal services of an individual that is associated both with the employing company and the company which executed the contract (interposed company);
- the income amount which would otherwise be paid to the individual as salary and wages for the professional services rendered will be paid to the interposed company that is also associated with the individual recipient of that income.

This allows the interposed company to then distribute the amount between the taxpayer and other associated members via an income treated as a 'salary' - generally much lower than the individual taxpayer might otherwise have received - and pay the balance to associated members as directors fees, etc. ("income splitting").

It is also a common feature of this sort of arrangement that income tax deductions are claimed in that interposed company's income tax return for a wide variety of expenditures which would not be allowable as deductions had the individual taxpayer not entered into the arrangement with the employing entity.

There are also advantages to the employer entity in these types of arrangements as there would no longer be any obligation to make employer superannuation deductions and to remit monthly salary and wages tax deductionson that income as a group employer to IRC. In some cases, the employer has also sought to escape the obligations for providing recreation, sick and long service leave that would otherwise will the legal entitlement of the individual under the employment laws.

The view of this office is that all such arrangements may be characterised as arrangements entered into primarily or predominantly to avoid salary and wage tax.

The IRC's position in regard to such arrangements is that income substantially generated by the direct personal skills, experience or labour of an individual should generally be subject to tax in the hands of that individual. They are not regarded as ordinary business or associated dealings.

IRC will apply Section 361 of the Income Tax Act to make such arrangements absolutely void — the practical result will be that the taxpayer doing the work will be liable to tax on the full amount paid to the interposed entity.

Employers or employing organisations that actively undertake such arrangements will also be subjected to tax and penalised accordingly.

The most appropriate action to be taken so as to counteract any tax advantage obtained under such an arrangement **is to require employers to make salary and wages tax instalment deductions from the gross amounts paid to the interposed entity.** Section 299G(7) & (8) of the Income Tax Act will apply to any retrospective deduction shortfalls, although these may be reduced where a voluntary disclosure is made.

Reconstruction deeming the income to have been derived by the individual as an employee of the payer of the remuneration best nullifies the arrangement and best reflects the standing of all parties to the arrangement. That is, it reflects the substance of the arrangement, being that the **individual taxpayer was an employee of the employing organisation not the interposed entity.**

IRC is aware that individuals who enter into such arrangements are often in official capacities of both the entity making the payment and receiving the payment, or otherwise not at arm's length, and is increasing efforts to appropriately address this issue.

Individuals or entities engaging or aware of, such practises are strongly advised to voluntarily disclose or inform the IRC at the earliest opportunity to the following email address Tax_Avoidance@irc.gov.pg.

Authorised By:

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Acting Commissioner General