

INDUSTRY WHITE PAPER

Information & Communications (IT) Industry
September 2020

SCOPE:

Due to significant legislative changes and considering the complexity of the Industrial Relations landscape in Australia, the purpose of this white paper is to explore opportunities to use the ContractRight System to compliantly engage contracted IT professional service providers.

This white paper compares ContractRight to several contracting models in common use today and also considers the business risk inherent in the continued use of those models.

Research has been carried out with companies using professionals to provide computing technology services, such as networking, hardware, software installation, software design, Internet connectivity and security. We also interviewed contractors who provided wholly or principally labour based services when deployed to work with these technologies.

BACKGROUND:

The Australian Taxation Office (ATO), Fair Work Australia (FWA) and the Federal Government via the Black Economy Taskforce have investigated issues such as the abuse of the ABN system and are targeting the use of individuals who are incorrectly classified as contractors when providing personal services.

The Government has researched the industries where non-compliant engagement of labour based contractors is rife, and are slowly working their way through each segment and introducing mandatory reporting of all payments made to contractors.

A reporting requirement has been enacted within the IT sector and if you're running a business providing information technology (IT) services (even if it's only part of the services you provide), you must lodge a *Taxable payments annual report* (TPAR) for each financial year that you make payments to contractors or subcontractors for the services they have provided. :

The reporting regime is designed to locate payments you have made to contractors who are providing largely or wholly labour based services where the arrangements don't consider a variety of regulations such as:

- The Australian Tax Act.
- The Personal Services Income (PSI) Legislation.
- The Fair Work Act.
- The WorkCover and Payroll tax state deeming provisions.
- The superannuation Guarantee charge legislation.

The reason for taking this action is that labour based independent contractors invariably alienate their income (reduce tax) via invoicing through entities such as companies and/or trusts. Frankly in many cases the relationships could actually be construed as employment which brings about significant mutual liability between the parties.

The activity reporting requirement could have significant impact on many IT companies and their business model when they utilise contractors rather than employees as service providers.

Our research reveals there are a range of contracting models used for the purposes of engaging contractors to provide their services within the Information & Communications (IT) Industry

The following Types 1 and 2 are the most prevalent engagement models and are also widely used in other industries to establish contracting relationships.

The difference between the two engagement types are:

Type 1, the user company contracts with an entity owned by the contractor.

Type 2, the user company contracts with an individual who holds an ABN.

In conducting our research we found some businesses actually prefer to utilise contractors as they believe it is a "norm" within the industry. Some businesses have been advised against engaging contractors, this is due to the issues involved in validating the independent contractor relationship in terms of the rigid and difficult to pass tests required under the Personal Services Income (PSI) legislation.

None of the businesses or their advisors were aware that an alternative robust, tested and lawful common law based contractor engagement model actually existed. Many of the businesses using contractors engaged via interposed entities such as Companies or Trusts for invoicing purposes knew these arrangements actually fall foul of the PSI alienation rules.

There was a perception of mutual financial value to the participants with little appreciation of the risks involved. In many cases contrived agreements were being utilised in an effort to "contract out" of the regulations. Case law along with actions by the ATO, Fair Work Ombudsman and State Revenue Offices have subjected many of these agreements to their "look through" provisions proving them to be deficient. The reality is that saying an individual is a contractor does not remove the obligation for the contractor to actually be running a business enterprise under the various regulations.

Part IVa of the Tax Act can also be an issue here. It could be claimed the parties have agreed to enter into the arrangement to void the provisions of the Tax Act via alienation of Personal Services Income.

ISSUES LIKELY TO AFFECT COMPLIANCE:

While many contracting arrangements are not illegal, the differences in how the agreements are structured and how they *actually operate* on a day to day basis means in many cases they do not protect the parties involved.

Many agreements have been viewed by various authorities as an attempt to work around the regulations. There is also some disagreement about how statutory arrangements apply to these contracts which affects the overall and real cost of the service.

Some businesses pay payroll tax on the value of the service provision based on the fact it is a labour only contract - and some do not.

Some businesses pay workers compensation premiums on the contractor earnings - and some do not. In some cases there is a risk of employment being formed giving rise to additional costs. This outcome is highly probable, even more so in the following Type 2 model.



COMPLIANCE OPPORTUNITIES:

The ContractRight (CR) system provides a framework whereby companies can engage individuals to provide services as independent contractors without the need to set up an interposed company and/or have an ABN, as required in the following Type 1 and 2 models.

Our research clearly indicates many IT businesses and other professional service providers would like to entertain a contracting model, but legal and accounting advice has suggested this is not possible. Some have been given conflicting advice and thus we believe the industry needs some clear guidance on what is, and what is not feasible and lawful.

The ContractRight model is highlighted as Type 3.

The model offered via ContractRight is an alternative to the ABN/interposed entity system of engaging contractors. Scrutiny is welcomed as this provides an opportunity to discuss the framework with industry leaders, accountants and advisors who specialise in this field.

The ContractRight offering is an effective alternative for contractors to reduce the costs of compliance, risk and business administration. ContractRight offers an alternative that removes barriers of entry and exit to the business using contractors, while providing a lawful and compliant model that reduces the risks associated with direct engagement of the individuals. See the following section on Type 3 ContractRight alternative for more information

CURRENT SITUATION FOR ABN OR PTY LTD CONTRACTORS:

For established contractors, the ContractRight System allows businesses and contractors to provide services without the risk of income alienation (PSI rules) or the costs associated with using ABNs or companies.

While many contracting arrangements start out on the right basis, as time passes the vast majority end up “looking like” employment, and as such can create compliance issues with state statutes (Workers Compensation and Payroll Tax) and also federal regulators (the ATO and Fair Work Commission).

These compliance issues can include but are not limited to the following outcomes:

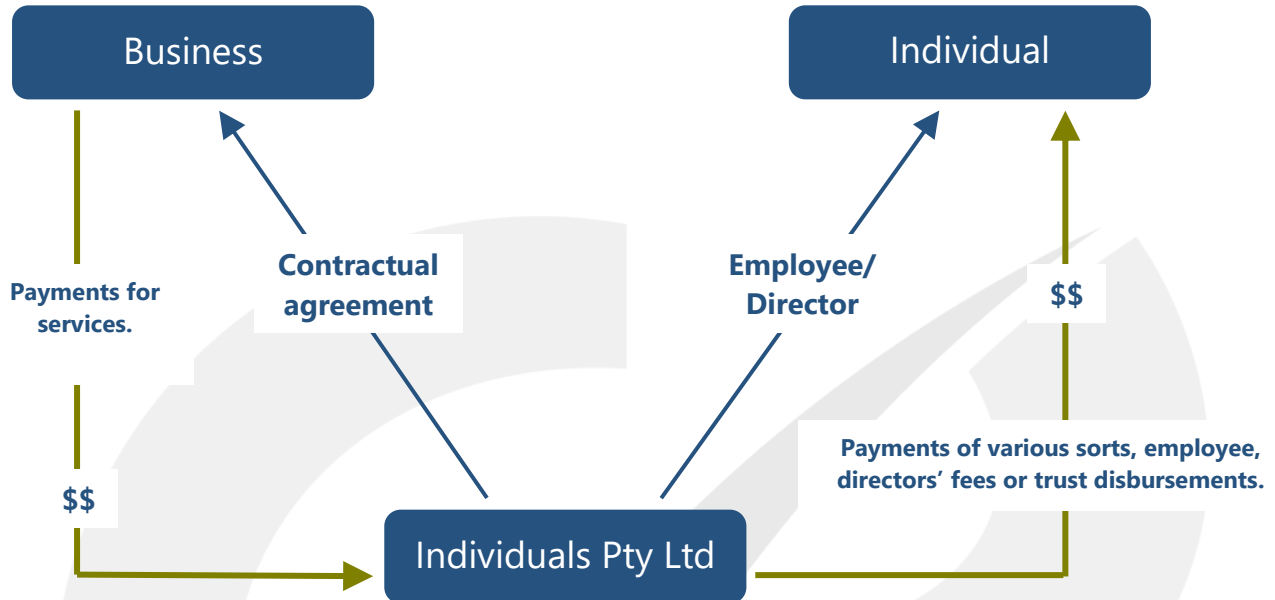
- ABN and Pty Ltd contractors deemed employees for the purposes of Workers Compensation premiums and Payroll Tax payments.
- Liability for a business to pay for PAYG deductions and Superannuation contributions for ABN holders.
- Pty Ltd contractors (and ABN holders) when receiving income from one source, can fail the PSI tests creating significant compliance and co-employment problems.
- Pty Ltd structures are expensive to run and under tighter regulations may not be worth the time, effort and potential risk involved.

Both ABN and Pty Ltd models may not deliver the intended outcomes they were originally designed to achieve and in many cases represent both a present and future liability with regard to statutory obligations.

In addition, due to tighter regulations via the ATO and other government authorities, the ability to financially gain from these and other structures is becoming harder, more expensive or in other words “not worth the risk”.



TYPE 1: Engagement using a Pty Ltd entity



BACKGROUND:

The business and the individual's company enter into an agreement for the provision of the service/s to the clients of the business. The client remains the client of the business and not of the contractor/service provider. The Business pays the company for the services provided by the individual (normally Director and principle shareholder). Anecdotally we assume the individual then takes earnings from their company in some form.

ISSUES:

- The contract may be deemed for Payroll Tax purposes as a labour only contract. Some businesses pay the payroll tax and some do not.
- Q: Is Workers Compensation being paid in these arrangements, either by the practice or the individual's company? Some businesses are paying, some are not; sometimes both the business and the contractor are paying.
- Q: Is this arrangement compliant within the PSI rules, and what affect does it have on the mutual obligations of all parties?
- Q: Is there an employment or Part IVa risk here?

TYPE 2: Engagement using an ABN only



BACKGROUND:

The Business and the individuals enter into an agreement for the provision of the services, generally to clients of the business. The client remains a client of the business and not of the contractor/service provider.

A direct contracting relationship between a business and a natural person (particularly when it is largely or wholly for the provision of labour services) is commonly considered to be an employment relationship notwithstanding having an ABN.

The business pays the contractor/service provider for the services.

ISSUES:

- This contract is deemed for Payroll Tax purposes as a labour only contract.
- This contract is deemed for the purposes of Workers Compensation cover.
- In spite of various payment methods being utilised i.e. hourly rate, daily rate or a piece rate, these do not pass the Results Test and Superannuation is payable.
- Q: Is this arrangement compliant within the PSI rules, and what affect does it have on the mutual obligations of all parties?
- Q: Is there an employment or Part IVa risk here?

TYPE 3: The ContractRight engagement model

Benefits for the Information & Communication (IT) Industry:

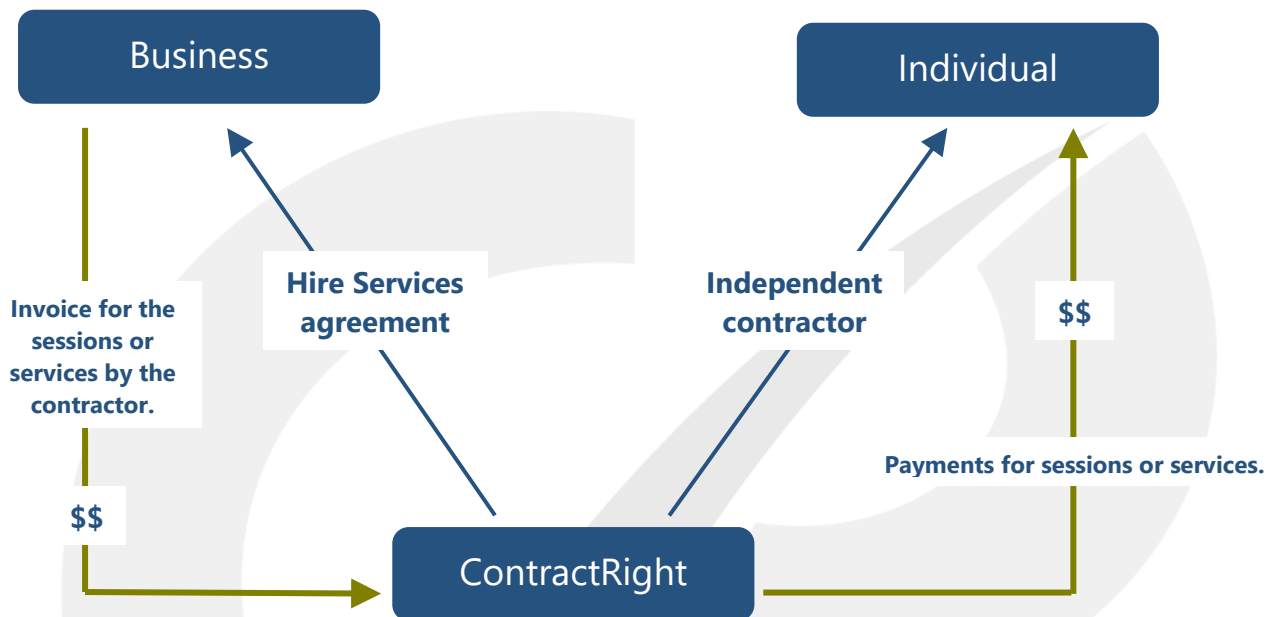
ContractRight (CR) is a legally tested, lawful, precedent based common law contracting system. This is a flexible framework ideal for the engagement of full time professionals or an ideal alternative for part time professionals e.g. those with children or those seeking a flexible work life balance.

The ATO have provided CR with a written Section 15 variation approval which outlines how contractors engaged via the ContractRight framework are treated for taxation purposes.

There is a zero barrier of entry for those talented people who do not wish to set up a company or other entity and CR engagement is simple and cost efficient to use. Productive and focused professionals are fully engaged in providing outcomes without having to deal with the issues associated with the Personal Services Income (PSI) legislation or completion of BAS statements, ATO instalment statements etc. There is no risk associated with statutory on-costs, employment deeming or Part IV a avoidance issues.

Benefits for the Individual Contractors:

- No ABN, company or trust required – less cost, good cash flow, fully insured for Public Liability and Workers Compensation.
- Self-employed for taxation purposes.
- Tax deducted at 20%, 25% or variations at contractor's choice (*conditions apply*).
- No PSI compliance tests, BAS, GST or other cash flow or compliance issues.
- No invoicing or business administration required.



THE CONTRACTRIGHT (CR) MODEL:

- A business enters an agreement with ContractRight to provide an individual to deliver specified services for the benefit of the business on agreed terms. **NOTE:** This is not a recruitment function.
- The Individual service provider enters into an agreement with ContractRight to supply service to the business under an Assignment to Service for agreed terms as an independent contractor.
- The business receives an invoice from ContractRight for the services of the individual as agreed and ContractRight remits funds to the individual contractor as agreed.
- ContractRight remits Payroll Tax, Workers Compensation and other statutory payments and any other payments as requested by the individual.
- Fully compliant and fully insured system.
- No ABN, no interposed entity, no PSI regulations, no ATO instalments.
- As all personal services income is attributed to the contractor, there is no income alienation involved so the PSI validation tests do not apply.
- There is no requirement for CR clients to report individual payments when contractor deployment is outsourced via third party engagement.

SUMMARY:

ContractRight is a legally tested, lawful, agile and intelligent approach to engaging individuals as self-employed independent contractors who want to provide their services to an IT business or to the end client of an IT business.

ContractRight provides a compliance framework for independent contractor engagement within the IT Industry.

For a no obligation assessment of your circumstances PH: 1300 358 431 www.contractright.com.au

