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## INDUSTRY WHITE PAPER

### Professional and Consulting Services

April 2020

#### SCOPE:

The purpose of this white paper is to explore opportunities to use the ContractRight System to compliantly engage contracted individuals who are providing professional services.

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 predominantly carried out in the Financial Services, Information Technology, SAP, Engineering, Drafting, Mining, Facilities Maintenance and Allied Health Care segments.

#### BACKGROUND:

Currently the Australian Taxation Office (ATO), Fair Work Australia (FWA) and the Federal Government via the Black Economy Taskforce are investigating issues such as the abuse of the ABN system and are also cracking down on businesses that use individuals who are incorrectly classified contractors when providing largely labour based personal services.

The ATO's digital transformation drive has introduced an ongoing reporting, monitoring and matching process of contractor payments designed to distinguish between what is a "labour only" contract and those which are not labour only. This is regardless of the industry in which services are provided.

Extensive research reveals there are a range of contracting models used for the purposes of engaging contractors to provide their professional or consulting services within a wide variety of industry segments. We are aware 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 business contracts with an entity owned by the contactor.

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

In conducting our research we understand some companies would prefer to utilise contractors but have been advised against doing so. This is predominantly due to the issues involved in validating the independent contractor relationship in terms of the prescriptive and difficult to pass tests required under the Personal Services Income (PSI) legislation.

Contractor engagement models using interposed entities such as ABN's, Companies or Trusts for invoicing purposes automatically fall foul of the PSI alienation rules.

While there is a perception of mutual financial value to the participants, these arrangements can create some operating tension between the parties over the benefits of such an arrangement.

*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 avoid the provisions of the Tax Act via alienation of Personal Services Income.*

## ISSUES LIKELY TO AFFECT COMPLIANCE:

Whilst 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.

There is also some disagreement about how statutory arrangements apply to the contracts which affects the overall and real cost of the service.

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

Some companies pay workers compensation premiums on the 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.

## OPPORTUNITIES:

The ContractRight 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 outlined in the Type 1 and 2 models depicted.

Our research to date has indicated that many businesses and 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 industry needs some clear guidance on what is, and what is not possible.

The ContractRight model is highlighted as Type 3.

## ADVANTAGES OF CONTRACTRIGHT FOR BUSINESSES:

ContractRight is a legally tested, lawful, ATO compliant, 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.

There is a reduced barrier of entry for those talented people who do not wish to set up a company or other entity and its simple and cost efficient to use. Productive and focused professionals are fully engaged in providing services 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 IVa tax avoidance issues.

## ADVANTAGES FOR THE INDIVIDUAL ARE:

- No ABN or company required – less cost, better 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, BAS, GST or other cash flow or compliance issues.
- No invoicing or business administration required.



## **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, Companies or Trusts.

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”.

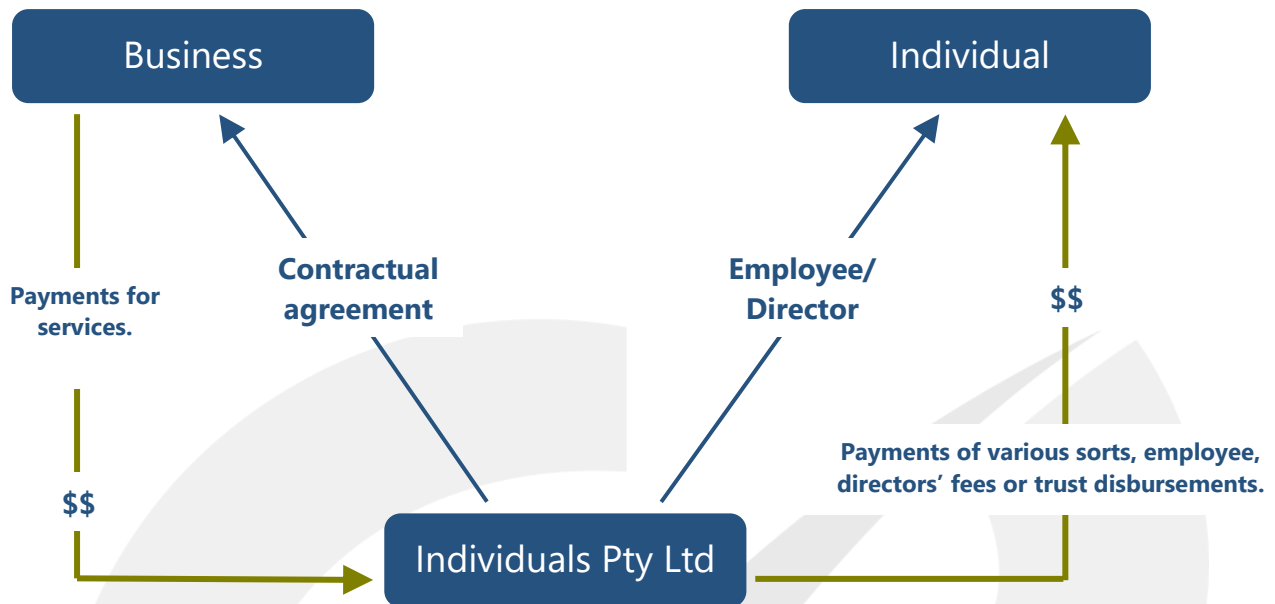
## **THE CONTRACTRIGHT ALTERNATIVE:**

ContractRight offers 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. For professional services providers, ContractRight offers an alternative that removes barriers of entry and exit to the business, provides a lawful and compliant model that reduces the risks associated with direct engagement of contractors.



## TYPE 1: Business engages a contractor using a Pty Ltd entity



### BACKGROUND:

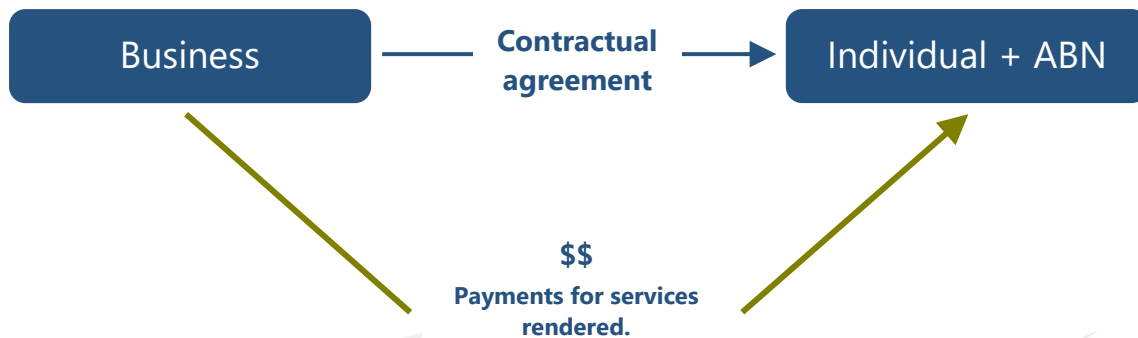
The business and the individual's company enter into an agreement for the provision of the service(s) to the business or end clients of the business.

The Business pays the contractors company for the services provided the individual (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. It seems that some businesses pay this and some do not.
- Is Workers Compensation being paid in these arrangements, either by the business or the individual's company? Some practices are paying, some are not, and sometimes both the business and the contractor are paying.
- Is this arrangement compliant within the PSI rules, and what affect does it have?
- Is there an employment or Part IVa risk here?

## TYPE 2: Business engages a contractor using an ABN only



### BACKGROUND:

The business and the individual enters into an agreement for the provision of the service to the business or its end clients.

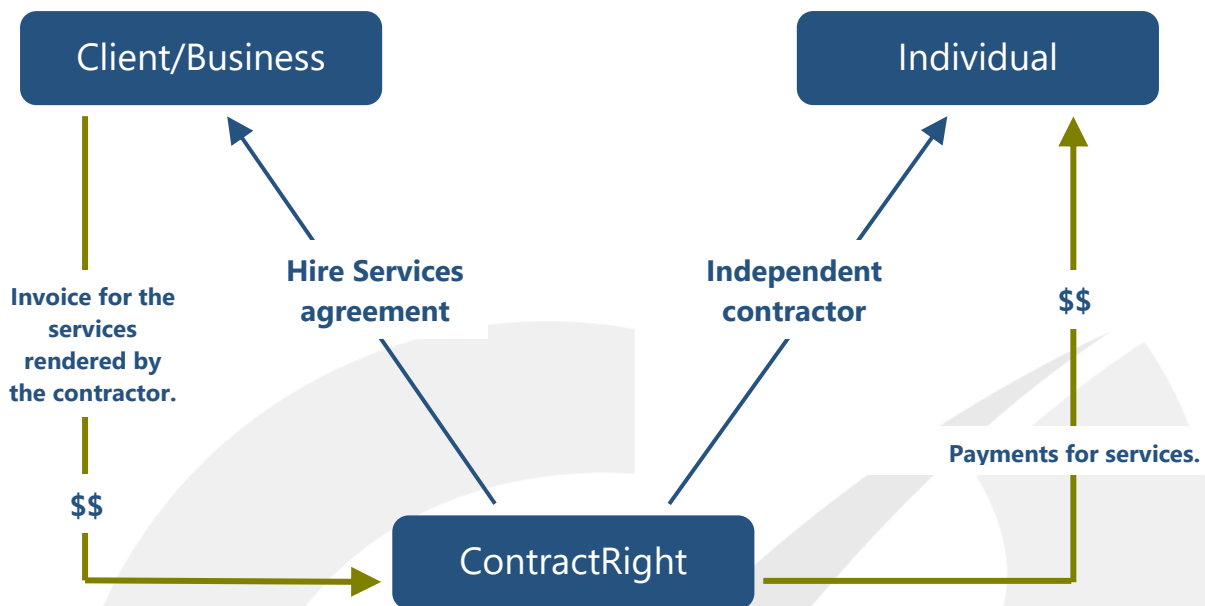
A direct contracting relationship between a business and a natural person (particularly when it is largely or wholly for the provision of labour services) is commonly considered to be an employment relationship notwithstanding the ABN.

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. for example hourly rate or fee percentage rates, these do not pass the Results Test and Superannuation is payable.
- Is this arrangement compliant within the PSI rules, and what affect does it have?
- Is there an employment or Part IVa risk here?

### TYPE 3: The ContractRight engagement model



#### THE CONTRACTRIGHT MODEL:

- A client/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 client/business for agreed terms as an independent contractor.
- The client/business receives an invoice from ContractRight for the services of the individual as agreed and ContractRight remits funds to the individual as agreed.
- ContractRight remits Payroll Tax, Workers Compensation and other statutory payments and other payments as requested by the individual.
- Fully compliant and fully insured system.
- No ABN, no interposed entity, no PSI regulations, no ATO instalments.

*ContractRight is a legally tested, lawful, agile and intelligent approach to independent contracting for individuals to provide personal services as consultants or professional services providers.*

Contractor Compliance Solutions Australia Pty Ltd markets the ContractRight product under licence and provides the compliance framework for independent contractor engagement within the professional services business segment.

