

NSW payroll tax case has implications for financial services organisations

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The decision of the NSW Supreme Court of *Bridges Financial Services Pty Ltd v Chief Commissioner of State Revenue* [2005] NSWSC 788; BC200505727, handed down by Gzell J on 9 August 2005, could expose some financial service organisations across Australia to payroll tax for amounts paid to authorised representatives (representatives) by way of commissions, brokerage and fees.

The decision examines the common law meaning of 'employee' and 'deemed employee' under the NSW *Payroll Tax Act 1971* (the Act) as it applies to the representatives of a financial services organisation.

The decision also raises questions about what constitutes an adequate financial planning model and the language used in standard dealer/representative agreements.

Facts

Bridges Financial Services Pty Ltd (Bridges) was an Australian financial services licensee and, at the time in question between 1 July 1995 and 31 March 2000 (the relevant period), it held a securities dealers license under the *Corporations Law*. It was a duly appointed agent of various life insurance companies and was authorised to deal in securities as a stockbroker.

During the relevant period, Bridges had 79 representatives based in NSW and paid commission, brokerage and some fees with respect to transactions initiated by those representatives.

These amounts were not included in Bridges' returns of wages and, as a result, it did not pay payroll tax with respect to those amounts under the Act. Pursuant to s 7 of the Act, payroll tax is chargeable on all taxable wages.

The Office of State Revenue (OSR) issued notices of assessment to Bridges on the basis that the amounts were wages paid to employees or deemed employees under the Act. Bridges applied for a review of the decision under the *Taxation Administration Act 1996* (NSW).

In all, the offices and business operations of seven representatives were the subject of specific evidence.

The dealer/representative relationship

The Bridges financial planning business model at the time included entering agreements with representatives who wanted to build their own business. Most representatives brought existing client bases with them. Two or more representatives were encouraged to establish an office so as to cover the workload and share expenses. As these

businesses grew, the representatives retained para-planners and/or other advisers to assist in the business.

Early in the relevant period there were no pro forma written agreements between Bridges and its representatives. In early 1997 most representatives signed a tripartite dealer/representative/agent agreement, but some did not. Of the ones who signed, those who did not have an agent signed the agreement as both agent and representative.

The agreement, among other things, outlined the following.

- The representative wished to establish an independent business while relying on, and taking advantage of, Bridges' reputation, goodwill, credit union and other referral source relationships.
- Bridges would be directly responsible for the actions of the representatives pursuant to obligations it had under its securities dealer's license, and Australian Stock Exchange (ASX) regulation and to protect the goodwill and reputation of Bridges.
- To this end, from time to time, Bridges supplied compliance and procedures manuals and issued minimum service standards and policy statements that it expected would be followed.
- In return, the representatives would be authorised to arrange contracts of life insurance and other risk insurance, recommend superannuation products, act as an insurance intermediary, provide securities recommendations to clients, and seek and place investment products on Bridges' approved products list.
- Telephone listings gave the offices of the representatives as branches of Bridges and business cards, letterhead and other advertising material carried the Bridges logo.
- Each party agreed to conduct their respective businesses to the mutual benefit of the other.
- To that end, cl 2.5(a) stated that the relationship between them would be that of independent business contractors.
- Clause 5.1 provided for a sharing of brokerage and commissions between Bridges, the representative and agent. Any fee for service charged to a client

was to be paid directly to Bridges to be shared also. However, it was up to the representative whether a client would be charged a fee for services and the level of that fee.

- After deduction of agreed amounts, Bridges would pay the balance to the representative.

In some instances, Bridges also executed office agreements with the person or entity providing accommodation and services to the representatives.

That agreement provided for the office to receive brokerage, commission payments and fees from Bridges on account of, and for the benefit of, the representative, who in turn agreed to conduct business from the premises and share the expenses via a formula agreed by the parties.

Arguments

The OSR argued that the representatives were either employees (in the traditional meaning) or deemed employees under a relevant contract (under the Act).

The OSR's primary argument was that the commissions, brokerage and fees generated by the representatives were wages paid or payable by Bridges as employer to the representatives as employees.

The OSR's secondary argument was that the amounts paid were deemed to be wages pursuant to s 3 of the Act on the basis that the arrangements between Bridges and the representatives under which they generated commissions, brokerage and fees constituted a relevant contract under which Bridges, as the designated person, was supplied with their services in relation to the performance of work. In consequence, Bridges was deemed to be an employer — the representative's employees.

The OSR relied on the level of control that Bridges was entitled to exercise over representatives in support of its arguments, including the detailed content of the compliance manual, the minimum service standards and the procedures manuals.

Bridges argued that the representatives were independent

contractors and not employees, on the basis that they conducted their own businesses in addition to providing services, therefore payroll tax did not apply to the amounts paid.

It was also argued that if the Court found the representatives were employees or deemed employees, only amounts paid or payable for, or in relation to, the performance of work should be deemed to be wages under the Act, and in this instance the labour content was only a modest proportion of the commission, brokerage and fees paid.

Bridges further argued that the representatives or entities they controlled provided the services in conjunction with other persons, therefore an exemption in s 3A(1)(f) of the Act applied. That section said that the relevant contract provisions did not apply where the work to which the services related was performed by two or more people employed by the contractor, or in partnership with the contractor.

Key findings

Gzell J held that:

- the relationship between Bridges and the representatives was one of principal and independent agent, and not a common law contract of employment;
- the fact that representatives were able to sell a business and make capital payments to acquire existing businesses was a highly significant factor against a common law employment relationship;
- while the representatives were not employees in the traditional sense, the agreement between Bridges and the representatives constituted a '*relevant contract*' for the purposes of s 3A of the Act on the basis that the arrangements between Bridges and the representatives, under which they generated commissions, brokerage and fees, constituted a contract whereby Bridges was supplied with their services in relation to the performance of work;
- the designated recipient of the services for the purposes of the Act was Bridges, on the basis that services were delivered 'upstream' to Bridges rather than to the client — matters

such as financial plans being sent to Bridges to check before they went out to clients were relied on as evidence of this relationship;

- the vast majority of the representatives, however, fell within exemption (f), on the basis that the supply of services was being provided by two or more persons who were employed by, or in partnership with, the contractor — in these instances, the businesses were really distinct from Bridges — no payroll tax was payable in these circumstances;
- where the Bridges business model hadn't been followed and the representative was effectively a sole trader, they did not fall within an exemption and the relevant contractor provision applied;
- while not bringing vast physical assets to the relationship, the representatives by and large held a level of capital valued as a factor of trail commissions within the relationship — the entitlement to these trails was a saleable asset and formed a significant part of their earnings — accordingly, these trail commissions could not be characterised as wages paid by Bridges to a deemed employee;
- so, even where the relationship was caught, the provision was limited to the labour content of the amounts paid, and this content was deemed to be wages pursuant to s 3 of the Act and, therefore, subject to payroll tax; and
- further, only amounts paid as a result of services provided to new clients, not existing clients, could be considered amounts caught by the Act — this was because payment for most services provided to existing clients was usually by way of trail commissions, which were not wages or deemed wages for the purpose of the Act.

Other matters of interest

In support of these conclusions, Gzell J found, among other things, that:

- the representatives and agents' agreement did not deal with matters ordinarily found in an employment agreement, such as annual and sick leave, long service leave or hours of work;
- further, the representatives could select the clients they wished to serve and were under no obligation to provide services to all clients, nor did Bridges have an obligation to provide work or refer — thus there was no mutuality of obligation to provide work and perform it, as one would expect in a contract of employment;
- some representatives bore the entire cost and expense of their activity, others were subject to a significant ratio of business expenses represented by retentions by the offices of portions of the amounts paid by Bridges and by additional expenditure by the representatives themselves;
- the representatives determined the extent to which their operations required the services of others, they then employed others and were responsible for income and other taxes payable as a result;
- much of the control Bridges held over the representatives was directed to matters that were subject to regulatory restriction under the *Corporations Law*, ASX requirements, and Australian Securities Commission and

Australian Securities and Investments Commission pronouncements;

- Bridges was bound to exercise a high level of control commensurate with these regulatory requirements, but this was not inconsistent with a principal/agent relationship;
- while some of the work was constrained by procedure, there was still a wide area of judgment left to the representative and there was not the level of adherence that would be expected in an employment relationship — indeed, there were wide variations between the offices in work practice, office management and business structure in which the financial planning activities were conducted; and
- in the face of the evidence, and relying on the decision of *Australian Mutual Society v Allan* (1978) 52 ALJR 407, the agreement itself became the best material from which to gather the true legal relationship, and it stated that the relationship was that of principal and independent contractor. ●



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Implications

While the *Bridges* decision represented a significant win for Bridges in some respects, it does have implications for financial services firms. There may be potential business risk exposure for the payment of payroll tax, depending on the business model used.

It is important for financial services organisations, in light of this decision, to review:

- their relationships with representatives;
- the business models adopted by both

the licensee and the authorised representatives — consider matters such as the offices from which these representatives work, the number of employees or partners within these businesses and the degree of control that the licensee has over these businesses and their operations; and

- the agreements in place that document the different relationships, including the agreements between the principal and licensee and the entity which runs the office and the licensee/representative agreement.