

ETRS/SRTL Public Ruling 2001/3

Public Ruling: When is there employment in East Timor?

Relying on this Ruling

This is a public ruling within the meaning of Section 66 of Regulation 2000/18. Information in this ruling may be relied upon by taxpayers as the basis for determining their tax liability.

Introduction

1. Regulation 2000/18 imposes wage income tax on taxable wages in respect of *employment in East Timor*. The term “employment in East Timor” is defined in section 3 of the Regulation as follows:

“employment in East Timor” means the provision of personal services in *East Timor*:

- (a) in the course of an *employer* and *employee* relationship;
- (b) as director of a company;
- (c) as the holder of a public office; or
- (d) as an official of the government of East Timor posted overseas”

2. This Public Ruling explains four aspects of the definition. The next (second) part of this Ruling explains what the provision of “personal services” means.

3. The third part of the Ruling explains when personal services are provided “in the course of an employer and employee relationship”.

4. The fourth part of the Ruling explains when services are provided “in East Timor”.

5. The fifth and final part of the Ruling explains when a person “provides” wages in respect of employment in East Timor and is thus liable to withhold and deliver wage income tax under section 30 of Regulation 2000/18. It explains the difference between the person who provides the wages and the person who actually makes payment, which might be a different person from the person providing wages.

What are personal services?

6. The phrase “employment in East Timor” is defined in terms of the provision of “personal services”. Personal services in the sense of

service based on a natural person's exertion or labour is the first key element of employment.

7. The clearest case in which a natural person provides personal services is where the person provides only personal exertion or labour for another person. There are, however, three situations in which characterisation of the services provided arise. In some cases, a distinction must be made between:

- the provision of personal services and a business structure;
- the provision of personal services and business assets; or
- the provision of personal services and the sale of an intellectual property right.

8. The distinction between personal services and a business structure may be illustrated with the example of a business that acquires accounting services from a natural person and another business that acquires accounting services from a large accounting partnership. In the former case, the natural person is providing *personal services* since the business contracted with that person to actually perform the accounting tasks required. In the second case, the business contracted for services from another business. The firm needing the accounting services does not care who actually does the work, so long as the accounting firm ensures it is done properly. By contracting with a firm, they are leaving it up to the firm to decide who will actually do the work.

9. The first case may give rise to an employment situation (subject to other tests discussed later in this ruling being satisfied) while the second case cannot give rise to an employment relationship between the business needing accounting services and the accountants who work for the accounting firm. The accountants may be employees of the accounting firm but they will not be employees of the first business since it has acquired services from a business structure rather than personal services.

10. The second distinction is between cases involving the provision of labour and equipment where the labour portion is predominant and those where the equipment portion is predominant. The former is a provision of personal services, while the latter is the provision of equipment.

Example 1:

Café Deluxe contracts with Paula to deliver lunches and drinks to its customers. The contract requires Paula to supply her own bicycle to use to deliver the food and drink. While the bicycle is necessary for the delivery, the service provided is a personal service since the pay provided to Paula is mostly for her services, not for the cost of the bicycle.

Example 2:

East Timor Building Company has won a contract to rebuild three bridges. It contracts with Roberto, who owns a large earth mover and a large semi-trailer he uses to transport the earth mover to construction sites. Roberto personally drives the truck to transport his earth mover and operates the earth mover. While the payment made to Roberto is partly for his operating skills, most of the payment is for the use of the specialised and expensive equipment. As the labour component of the payment is not as great as the equipment part, Roberto is providing a service other than a personal service. Since he is not providing personal services, his status will be that of a contractor but not an employee.

11. The third distinction is between cases where a natural person provides labour that leads to the creation of property and where a person actually provides the property. The former is the provision of a personal service, while the latter is the provision of property.

Example 3:

Susanna receives a commission from a large bank to paint a large mural on a canvass to be hung inside the bank. Susanna is told she may work to her own design. From the time it is started until completion, the painting belongs to the bank. Susanna is only providing the labour to produce the final product. Susanna is providing personal services to the bank and may be an employee of the bank if the other conditions for employment discussed below are satisfied.

Example 4:

Samuel worked for one month to produce a large sculpture. When he completed the sculpture he invited representatives from several businesses to view the work. He sold the sculpture to the bank, which sat it underneath the mural created by Susanna. As there was no commission from anyone to create this work, Samuel created his property independently of any particular client. He provided property to the bank, not a personal service. While the property was the result of his personal labour, the labour was provided before the bank acquired any interest in the product of the labour. He is a vendor to the bank but he would not be an employee of the bank.

When are personal services provided “in the course of an employer and employee relationship”?

12. Even if it is decided that a person is providing personal services, payment for those services will constitute wages only if the person is providing the services "in the course of an employer and employee relationship". The actual nature of the relationship between the person providing services and the person receiving the services will determine whether the relationship is one of employee and employer or is one of independent contractor and customer. The form of the contract between the parties will not determine the character of their relationship. That is, if the relationship amounts to an employee and employer relationship, the fact that the parties may have called the arrangement a contract for independent contractor services will have no effect on the actual character of the relationship for tax purposes.

13. The concept of an employee and employer relationship is used in many areas of law. In tax law it is used to determine whether the remuneration paid to a person is a wage and subject to wage income tax. In labour law it is used to determine whether the person providing services is entitled to various rights and subject to various obligations of employees set out in the labour law. And in negligence law it is used to determine vicarious liability – that is, to decide whether a negligent person is an independent contractor and is personally liable to compensate the victim of negligence or whether the person is an employee, in which case the person's employer may also be liable to compensate the victim. While there are similarities between the tests used to determine the nature of a personal services relationship in these three different areas of law, each seeks to characterise the relationship for different reasons and caution must be exercised when applying tests from one area of law to another area of law.

14. As mentioned, in tax law the "employer and employee relationship" is used to determine whether the remuneration paid to a person is a wage and subject to wage income tax. If the relationship between the parties is that of independent contractor and customer rather than employee and employer, the remuneration paid to the person will not be subject to wage income tax. Instead, the person providing the services will be responsible for paying income tax on the income.

15. Wage income tax is normally collected by means of a withholding tax subtracted from the wages paid to an employee and delivered by the employer. Income tax is paid by the recipient of income, the person who provided personal services. A key difference

between the wage income tax and the income tax is the fact that wage income tax is levied on gross payments with no deductions allowed for expenses that might be incurred to earn the income. Income tax, by way of contrast, is levied on net income, after deductions for expenses incurred to earn the income.

16. Because of the difference between the wage income tax levied on gross payments and the income tax levied on net income, the term "employee" should be interpreted so it applies to persons who incur little or no expense in order to provide personal services. The term should not be interpreted to apply to persons who incur significant expenses in the course of providing their personal services.

17. Historically, the test used in negligence law to identify an employer-employee relationship looked to see if the parties were in what was known as a "master-servant" relationship. This test looks to see whether the person providing personal services works under the direction and supervision of the person for whom they are working or whether the person is left to work independently provided they complete expected tasks or produce desired results. In the first case they would be characterised as an employee while in the second they would be treated as an independent contractor.

18. The master-servant test is logical for negligence purposes because it seeks to identify whether the "employer" was really in a position to control the "employee" and prevent negligent actions. However, it may not be appropriate for all tax purposes. Many persons who are independent contractors for tax purposes work under close and direct supervision while many persons who are employees are largely left to their own supervision provided they produce the employer's desired outcomes.

19. Another test that may be used in some contexts to distinguish employees from independent contractors looks at the method and frequency of remuneration for services. If a person is remunerated by way of regular "salary-like" payments, the person is more likely to be considered an employee while a lump sum payment at the end of a contract is often associated with payments to an independent contractor.

20. Once again, this test is unlikely to be definitive for tax law purposes. Employees can negotiate for lump sum payments at the end of an employment contract and contractors can negotiate for regular progress payments over the life of a contract.

21. Generally, if the person paying for personal services provides the equipment and other things necessary for carrying out personal services, the person who provides the services will be an employee. In these cases, the "employer" is responsible for the work environment and the "employee" is responsible only for carrying out the work. If, however, the person who provides the personal services also provides

all the equipment and other things necessary to carry out the services, the person will be acting in a capacity of an independent contractor, not an employee. The contract in that case is not only for services of an employee, but for services of a person and provision of the equipment required to provide the services, something not required of an employee in an ordinary employment situation.

Example 5:

Aid to Timor, a non-profit non-government aid organisation, has raised funds to build a hospital. It enters into contracts with a large number of persons to construct the facility. One of those persons is Eduardo, a plumber who is responsible for installing all pipes, a water heater, sewerage connections and a rainwater drainage system. To carry out his responsibilities, Eduardo will use his own oxy-acetylene welding equipment, a wide range of crimping and similar tools, and provide materials such as glues to install the plumbing required.

The fee charged by Eduardo for the plumbing services includes the provision of all the equipment he needs to provide the services. As a result, the fee is likely to be significantly higher than the fee an employee would be paid to provide services using equipment provided by the employer. In this case, if the contract between Eduardo and Aid to Timor described the relationship as one of contractor and customer, the Commissioner would accept the parties' characterisation of the relationship between the service provider and customer.

Example 6:

Aid to Timor also engages a lawyer, Fredricks, to assist it with a range of legal issues that arise as a result of its work in East Timor. Fredricks spends one half of each day at the offices of Aid to Timor, where he carries out the work required. Aid for Timor does not know what Fredricks does in the remaining part of the day. In this case, the relationship between Fredricks and Aid for Timor will constitute an employee and employer relationship as the work environment is controlled and provided entirely by Aid for Timor.

The situation can be contrasted with one where Aid for Timor might engage the services of a lawyer or legal firm and the work is carried out at the law office, under the control of and in a work environment provided by the lawyer or law firm. This relationship would be a contractor and customer relationship.

When are personal services provided in East Timor

22. The term “employment in East Timor” is defined to mean the provision of personal services *in East Timor*. “East Timor” in turn is defined as the land territory of East Timor and offshore territory recognised as belonging to East Timor under international law or treaties.

23. Personal services are provided in East Timor where the work is carried out in East Timor. The place of performance of the work is independent of where payment is made or where the contract for the provision of services is made. The phrase “the provision of personal services in East Timor” focusses on where the actual personal services are provided, not on remuneration arrangements or legal contractual arrangements.

Example 7:

Warney Brothers, a U.S.-based film studio, asks Robert Mitchell, a famous U.S. actor, to star in a new movie to be filmed entirely on location in East Timor. It signs a contract with Mitchell in the U.S.

Under the contract, Warney Brothers agrees to pay Mitchell a lump sum payment of \$200,000 for acting in the film and an additional \$150,000 for providing technical advice on the making of the film. In theory, the technical advice could be provided anywhere but as it turns out, it was provided entirely while Mitchell was in East Timor.

The agreement between Warney Brothers and Mitchell requires Warney Brothers to make the payment into the Swiss bank account of Mitchell Services Co, a company incorporated in Switzerland and owned by Mitchell.

In this case, all the personal services performed by Mitchell under the contract are performed in East Timor. Mitchell is performing those services in the capacity of an employee as he is providing services in a work environment controlled and provided by the employer. The fact that the contract was signed in the U.S. or that he has directed payment to be made to his company's bank account in Switzerland does not affect where the services are performed. Section 92 of Regulation 2000/18 will treat the payment to the Swiss company as an amount received by Mitchell.

When does a person "provide" wages?

24. Section 30 of Regulation 2000/18 imposes a withholding obligation on "a person providing wages, other than exempt wages, in respect of employment in East Timor". This obligation focuses on the person who "provides" wages as opposed to the one that may actually pay the amount that is wages. The obligation operates in conjunction with the meaning of wages, which are defined as any reward for services provided by an employee to an employer. Since wages are a reward for services provided to an employer, it will be the employer who provides the wages. This is the person who receives the services and thus must provide the reward for those services.

25. An employer can provide a reward for services (that is, wages) directly or indirectly by arranging for another person such as a related business or another part of the business to provide a benefit to an employee.

Example 8:

Vanuatu Construction Contracting Co (VCCC) is a company incorporated in Vanuatu that successfully bid for a contract to rebuild a government office in East Timor. To carry out the work, it ships equipment and supplies to East Timor and sends supervisors to the site.

Among the persons hired by VCCC to work on the construction job are Tom Slater, a roof tiler, and Graeme Sparks, an electrician, both of whom are normally resident in Darwin, Australia. VCCC agrees to provide both persons with accommodation and meals while they are in East Timor and to pay them a weekly rate for their services, with payment made directly into their Australian bank accounts. The actual payment is made by Australian Construction Contracting Co (ACCC), an Australian firm owned by the same people who own the Vanuatu incorporated company.

Under Article 2(5)(i) of *The Law on Income Tax*, the construction site in East Timor will amount to a permanent establishment in East Timor of VCCC. Since the personal services of Tom and Graeme are provided to VCCC through its permanent establishment, the permanent establishment is its employer in East Timor. This is the person that receives the benefit of the personal services and which thus provides the reward for those services. The fact that the persons who control the permanent establishment have arranged for another person, ACCC, to make the payment does not affect the fact that it is the permanent establishment of VCCC that provides

the wages. It simply arranges to provide them indirectly by having another person pay the wages rather than pay the wages directly itself.

The obligation to withhold and deliver wage income tax thus falls on the permanent establishment of VCCC. If wage income tax is not withheld from the wages of Tom and Graeme, the Commissioner may take action to recover the unpaid tax from the permanent establishment of VCCC.

Date of Effect

26. This Public Ruling has effect from 6 March 2001.

Thomas Story
Commissioner of East Timor Revenue Service
6 March 2001

Legislative references:

definition of "wages"	Reg 2000/18	s 3
"employment in East Timor"	Reg 2000/18	s 3
withholding wage income tax	Reg 2000/18	s 30
payments made at the direction of a person	Reg 2000/18	s 92