The difference between an employee and a contractor: online chat

Introduction

It is important to understand the difference between an employee and an independent contractor. This is an area which has gained prominence in the Australian marketplace in 2014 and is particularly important for practitioners and SME business owners, both in terms of their own employment decisions and for advising clients.

Simply calling someone a ‘contractor’ does not protect a principal from liability for employment entitlements, should the person not satisfy the legal tests for an independent contractor.

Applying an incorrect label can result in significant liability, including liability for wages and entitlements, breach of award and workplace relations legislation, liability for unfair dismissal, unpaid superannuation and payroll tax.

This online chat is presented by McCullough Robertson Lawyers, which partners with CPA Australia in the provision of workplace guidance for members.

Expert panel:

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This transcript of the online chat covers legal and technical issues in a general way. It is not designed to express opinions on specific cases. The document is intended for information purposes only and should not be regarded as legal advice. Further advice should be obtained before taking action on any issue dealt with in this document.
Legal tests and employment label assessments

What are the legal tests used to assess whether someone is an independent contractor?

There is a fact sheet published on the CPA Australia website which summarises the legal tests. This can be found at cpaaustralia.com.au/humanresources.

In summary, courts apply a multi-factor test, and some of the elements that courts take into account are: the degree of control exercised by the principal/employer, whether the employee/contractor has the right to delegate, how the employee/contractor is paid (e.g. whether the employee/contractor is paid on an hourly basis or is paid to achieve a result) and whether the employee/contractor genuinely conducts their own enterprise as opposed to working in the business of the employer/principal.

What is the best and quickest procedure to determine if someone is a contractor or employee?

You need to apply the multi-factor test. We refer you back to the fact sheet on the CPA Australia website.

The question of control always arises. In today’s world, it is often easier to control a subcontractor than an employee. How relevant is the test and how do you reconcile it with work arrangements?

Control is still considered one of the most important indicators in determining whether someone is an employee or contractor. If an individual is subject to direction about when, where and how they perform work, this is usually indicative of an employment relationship. If an individual can decide how they perform the work (as long as they deliver the ‘product’ or ‘service’ the subject of the contract), and when and where they do so, it is indicative of a contractor relationship.

However, it is true that, in practice, principals often exercise a degree of control over their contractors. The courts have acknowledged that the existence of some control by the principal is not fatal, i.e. the fact that principals may exercise control does not automatically mean that the individual is not a genuine independent contractor.

Taxation Ruling TR 2005/16 (Income tax: Pay As You Go – withholding from payments to employees) refers to the case of Humberstone v Northern Timber Mills (1949) 79 CLR 389, where it was said: ‘The question is not whether in practice work was in fact done subject to a direction and control exercised by an actual supervision or whether an actual supervision was possible, but whether ultimate authority over the man in the performance of his work resided in the employer so that he was subject to the latter’s orders and directions’ (emphasis added). That is – the important thing is whether the employer had the right to exercise control, as opposed to the actual exercise of it.

Ultimately, although the control test is important, it is still only one of a number of factors that must be considered before a determination is made about the nature of the relationship.

What differentiates between an accountant employed casually as an employee and a sub-contractor accountant, both who perform the same work at your premises?

You would need to apply the multi-factor test to the sub-contractor accountant to determine whether they are genuinely a contractor.

For example, if they work as an individual (not through a company), if they work exclusively for your practice, if they are subject to the same level of control as the employed accountant, if you determine their hours of work,
and if they cannot advertise their services to the world at large or take on work for other clients, these are factors that might lead to a determination that it is an employment relationship.

Some factors that might indicate a genuine contractor relationship include: the person works for clients other than your practice or conducts their own business and you are only one of their clients; the person determines their own hours of work as long as they complete the work that you assign them; and the person uses their own tools to complete the work (e.g. their own computer and administrative support).

I have a client who meets some of the tests for independence and not others. How do you assess it when some tests say yes and others say no? Do you assign points to the different responses? Are some of the considerations more over-riding than others? Or is it a case of where you fail just one of the elements that means the individual is deemed to be in an employee relationship? Example, a client (a dentist) is paid as a contractor but he doesn’t produce a tax invoice but just uses the payment summary from the business.

Courts look at the ‘totality of the relationship’ between the parties. In practice, this means that you look at each of the relevant factors and decide, for each, whether the indicators point to a contractor or employment relationship. It is not unusual for you to end up with a mixed result – some factors point to a contractor relationship and others to an employment relationship. Courts have said that ‘the object of the exercise is to paint a picture from the accumulation of detail. The overall effect can only be appreciated by standing back from the detailed picture, by viewing it from a distance and by making an informed, considered, qualitative appreciation of the whole. It is a matter of the overall effect of the detail, which is not necessarily the same as the sum total of the individual details. Not all the details are of equal weight or importance in any given situation. The details may also vary in importance from one situation to another.’ (Hall (Inspector of Taxes) v Lorimer [1992] 1 WLR 939)

It has been said that the ultimate question, after looking at all the evidence, is whether the individual is, in reality, in business on their own account as opposed to working in the employer’s/principal’s business. Performing the multi-factor test is an exercise in balance and judgment. If in doubt, you should always seek legal advice.

Can we seek clarification from the ATO if the multi-factor test is not conclusive?

If a taxpayer or their tax agent is unsure of whether payments are being made to a contractor or an employee, then a private binding ruling can be sought from the ATO on behalf of the taxpayer.

Is the old 80/20 rule out the window?

The ‘80/20 rule’ relates to personal services income and how a contractor reports their income in their own tax return and determines if they can claim some business-like deductions. It is not a factor that must be considered when determining whether an individual is a contractor or an employee at general law. Further, the 80/20 rule has little relevance where specific legislative tests now apply, such as for payroll tax.

Who has the responsibility for determining whether someone is a contractor or an employee?

It is the responsibility of the employer/principal. This is because the obligations for employment entitlements (wages, leave, statutory rights) are the employer’s obligations, and the obligation to ensure compliance with workers compensation and taxation legislation are the employer’s/principal’s obligations. If an employer/principal fails to make a correct assessment of the relationship, they will be liable for their own non-compliance with legislation.
The best time to seek advice about a relationship is at the commencement of that relationship. However, if the employer/principal has not done that, and is concerned about non-compliance, notwithstanding that the relationship is on foot, they should immediately seek advice.

How frequently do labour hire agreements fail and people find out that contractors are actually employees?

There are a number of reported cases each year where ‘contractors’ are held by courts to be employees. Those are only the cases that proceed all the way to hearing and are the subject of a judgment. It is reasonable to assume that there are many more cases that are settled prior to proceedings being commenced or prior to hearing.

Is there any protection for microbusinesses where they have a contractor who may be deemed to be common law employees and the business owner is exposed to superannuation costs? Would a business be penalized for understating RESC when an employee is now a contractor? How would an individual – as opposed to a business owner – go about obtaining lost entitlements? Would the higher rates of pay received as a contractor be taken into account when assessing any superannuation shortfall and other liabilities? Are businesses still minimizing risks by assuming an employee relationship is in place?

Microbusinesses need to carefully evaluate the true relationship that exists with workers to determine if they are making payments to employees or contractors. Workers who regard their superannuation entitlements as not having been paid can lodge a complaint with the ATO. If the circumstances of the arrangement are unclear (for instance, because there is no written agreement) then the ATO will often regard the relationship as an employment relationship, which can result in the employer being exposed to penalties. Actual payments to the worker will be taken into account to determine RESC entitlements, irrespective of whether the higher rates of payment had been calculated with the intention the worker was a contractor.

If there is any doubt whether a worker is a contractor or employee, then the prudent approach would be to regard the payments as being to an employee and include these payments in calculating RESC.

Genuine rectification requirements seem to me to be one of the key indicators of a contractor relationship. OSR seem to dismiss this as an indicator especially in the building industry. In your view, how strong an indicator is this?

Genuine rectification requirements are a key indicator that a worker is a contractor and not an employee as an employee is generally not exposed to the risk/cost of rectifying defective works. It may, however, be difficult to provide appropriate evidence to satisfy auditors that the arrangements are not a sham and legal advice should be sought at an early stage to assist in compiling appropriate evidence to satisfy audit queries.

**Government compliance and contracting**

What about if their job is covered by compliance and government regulation as part of the nature of the job?

There are instances where workers are engaged due to compliance requirements or government regulations. However, practically, this is only one factor evidencing the relationship between the parties and revenue authorities may disregard or not place significant weight on this factor.
What should a tax agent do when they think a person should be an employee rather than a contractor (or vice versa), and the payer is treating the person as an ABN subcontractor? What should the client do?

Tax agents should document their advice and recommendations, given there is a real risk the client is exposing themselves to penalties should they come under audit. Where it is clear that the position taken by the client is incorrect and yet the client continues to instruct the tax agent to adopt such a position, then the tax agent must consider whether they can continue to act for the client in light of their duties under the Tax Agents’ Code of Professional Conduct.

Clients should take advice on complex matters concerning contractors/employees. If they disregard the advice received, then they should document why the advice is being disregarded. Such actions may help mitigate potential penalties for any non-compliance, which are often imposed having regard to whether the taxpayer (payer) has taken reasonable care in complying with their obligations.

In a situation where a client has a signed contract from an individual contractor stating that the want to be classed as a contractor and understand that they have negotiated a higher rate of pay than they would receive if they were an employee (in lieu of employment benefits such as superannuation) will the ATO give any credence to this contractual arrangement – and that it is desired by both parties - even if other employee / contractor tests may not be satisfied?

A written contract is strong evidence of what the parties intended the relationship to be. However, if the relationship has changed over time (for instance, implementation of set working hours, requirements to wear uniform etc.) and the factors indicate the nature of the relationship has changed to that of an employer/employee, then the ATO may regard the relationship as having changed so that payments to the worker should be included in determining RESC obligations. Clients should monitor their relationships with workers on an ongoing basis to determine if the nature of those relationships changes over time.

Delegation and contracting

But don’t they have to be able to delegate to be a contractor?

The ability to delegate is a key indicator of an independent contractor relationship. However, a distinction should be made between a right to delegate under the contract and whether the individual is actually able to delegate. Just because a contract gives an individual a right to delegate, the reality might be that the individual is told that they are expected to provide the services personally, or that the nature of the work makes delegation very difficult. In these circumstances, the fact that there is a power to delegate in the contract will not prevent a court from finding that the relationship is one of employment. If there is both a right to delegate in the contract, and there is a genuine expectation on the part of the parties to the contract that the contractor may delegate the work as they see fit, this is likely to be a contractor relationship.

From a superannuation perspective, according to Superannuation Guarantee Ruling SGR 2005/1 ‘where the terms of the contract in light of the subsequent conduct of the parties indicates that … the individual must perform the contractual work personally (there is no right of delegation)..’ this will contribute towards a finding that the contract is wholly or principally for the labour of the individual (thereby entitling them to superannuation). In other words, if there is a genuine right to delegate (both in terms of the contract and in light of the conduct of the parties), then the individual will be a contractor.

What if the nature of your business is such that compliance means the contractor is legally unable to delegate the work?
The right to delegate is only one factor to be considered in the multi-factor test. After having conducted the multi-factor test, if many of the indicators point strongly towards a contractor relationship (e.g. working hours determined by the contractor, genuinely running their own enterprise), then the fact that they cannot delegate their work is unlikely to mean it is an employment relationship.

How someone is paid impacts on their status

Someone who does work on piece rate – e.g. an apple picker who is paid per bin - is that a contractor or employee? What if someone was paid on a results basis?

Being paid by piece rate does not conclusively determine whether someone is an employee or contractor. Although being paid for a result (which might include piecework), is usually an indicator of a contractor relationship, some awards contemplate that employees can be engaged as pieceworkers (albeit with conditions), e.g. Horticulture Award 2010. Pieceworkers can also be employees, even if they are not covered by an award. The Fair Work Regulations 2009 (Cth) define a (non-award covered) pieceworker as an employee who is paid a rate set by reference to a quantifiable output or task and who is not paid a rate set by reference to a period of time worked. For example, a pieceworker could be a person paid by reference to the number of articles they produce, the number of kilometres travelled, the number of articles delivered, the number of articles sole or the number of tasks performed by them.

Again, the multi-factor test must be applied and all aspects of the relationship considered before it is possible to determine the nature of the relationship.

From a payroll tax perspective, there are now statutory tests in most Australian jurisdictions. You would need to look at the specific contractor provisions in each jurisdiction. If an apple picker, the relevant exemption available in at least some jurisdictions is that their services are required for less than 180 days or the services provided by the picker are for not more than 90 days.

Are there multiple awards in each state covering piece rate workers?

For private sector employers in all Australian States other than Western Australia, there is only one award system – the Federal system. All awards can be found on the Fair Work Commission website at http://www.fwc.gov.au/awards-and-agreements/awards/find-award The starting point for identifying the correct award is to consider the industry in which an individual works (e.g. meat industry).

In Western Australia, private sector employers that are not constitutional corporations (e.g. partnerships) remain subject to State laws and awards.

Public sector employers and their employees are covered by State laws and awards.

If a contractor prefers to be paid as one, nominates voluntary PAYG withholding and superannuation is paid, is that situation compliant?

Courts have determined that just because parties agree about what label to attach to their relationship, this does not mean that courts will necessarily agree, and courts are prepared to look behind the words on the contract at the actual relationship to determine its true legal nature.

Having said that, the parties’ intention at the formation of the contract will be one factor that courts take into account as part of the multi-factor test in determining the nature of the relationship. If the parties’ clear intention was that it would be a contractor relationship, and there was no significant disparity in bargaining power, this will be persuasive but not necessarily determinative.
Can contractors be paid an hourly rate?

Yes.

Being paid an hourly rate can be an indicator of an employment relationship because it suggests that the individual is being paid for their own labour and skills, but of its own is not conclusive. It has been recognised that some genuine contractor relationships can be based on payment for time worked. If the contractor is an individual, and paid for time worked, there is a greater risk that the relationship will be found to be one of employment.

From a superannuation perspective, SGR 2005/1 one of the factors that will contribute to a contract being considered ‘wholly or principally for the labour of the individual engaged’ (thereby entitling the individual to superannuation) is that the ‘individual is not paid to achieve a result’. That is – if the contractor is an individual and is not paid on a results basis, but rather is paid by reference to a unit of time, then they will be an employee for superannuation purposes, assuming the other tests are also met (no right of delegation and remunerated for their personal labour and skills).

Would a remunerated independent director who invoices a company be regarded as a contractor or would they be deemed to be an employee?

From a payroll tax perspective, that distinction is no longer relevant. Payments to directors would still be taxable in most jurisdictions.

A company director can be an employee as well as an officer of the company. Whether an employment relationship exists will usually be obvious by reference to matters such as the duties performed by the individual, whether their service to the company is exclusive, whether they are entitled to leave. The situation may not be as obvious in the case of small private companies where the director is the only person engaged in company business. In this case, the multi-factor test would have to be applied.

If the individual issues invoices is a factor indicative of a contractor relationship, but not conclusive.

Regardless of the position at common law, from a superannuation perspective, an individual will be deemed an employee if they are entitled to payment for the performance of duties as a member of the executive body (e.g. a board) of a body corporate. This captures company directors.

I have a client who is paid as a contractor but I wish to get a second opinion as I am leaning toward employee. She is a myotherapist and signed a contract with a clinic. The clinic does all her invoicing and charges a fee that is equal to 50% of their fees. She does not supply any equipment, purely her labor. She has to have her own professional indemnity insurance but she has no other expenses whilst at the clinic.

It is always best to seek legal advice on particular scenarios. No determination could be made unless all the factors in the multi-factor test are applied, and this is best done by a lawyer. A review by lawyers should be able to identify what the parties intended their arrangements to be and ensure these are properly documented. Depending on the circumstances, it may be that payments to the myotherapist are not subject to a range of taxes and statutory obligations.

However, in this case the fact that that the individual supplies only her labour would tend to indicate an employment relationship, regardless of the fact that she invoices and maintains insurance.

It would be interesting to know whether she works exclusively for that practice, whether she wears a uniform and whether she is considered an integral part of the principal’s business, because these matters are factors that would also point to an employment relationship.
In the above scenario, if she has her own clients would she be an independent contractor simply paying ‘rent’ in the form of administration fees?

If an individual has their own clients, this is a factor that may suggest they have ‘goodwill’ independent of the principal and are therefore running their own practice. However, an individual can develop client relationships with clients who may be willing to follow them should they change practice, and this will not necessarily exclude an employment relationship.

In this case, we recommend seeking specific legal advice because it sounds like there is a real mix of factors that may point either to an employment or contractor relationship. As stated above, a review by lawyers should be able to identify what the parties intended their arrangements to be and ensure these are properly documented. Depending on the circumstances, it may be that payments to the myotherapist are not subject to a range of taxes and statutory obligations.

Carpenters in the building industry who work on a set rate for a house frame - are they a contractor or employee? They work exclusively for one builder and are trading as a sole trader.

In each case, the multi-factor test needs to be applied to determine the nature of the relationship. If the person is an individual and working exclusively for one builder, this would tend to point towards an employment relationship, however, if they are paid for a result (a particular sum for the completion of a frame) that would tend to point to a contractor relationship. The fact that they are currently working for only one builder may not mean that they don’t have the capacity to take on extra work should the opportunity arise.

From a payroll tax perspective, there is a real risk that the payments would be taxable and payments to contractors in the construction industry are being targeted for audit by several revenue authorities.

If an individual who was paid as a contractor and claimed expenses on their tax return was later found to be in an employee relationship, are they required to amend their tax returns and remove the expenses already claimed?

This would depend on the circumstances and whether deductions could still be claimed for the items, if income was earnt as an employee (not a contractor).

How does personal services income (PSI) fit into independent contractor scenarios?

The personal services income (PSI) rules are a specific statutory test for income tax purposes. Whether a relationship is a principal/contractor or employer/employee relationship is a separate issue and depends on the particular circumstances of each case.

Contracting through entities

If you have an employee who contracts through a company or trust, what are the issues? i.e. they invoice us through their company as a contractor, but would generally be considered an employee.

Based on current case law, the risk of that contractor being found to be an employee is typically considered to be low. This is because the company is a distinct legal entity, and there can be no employment relationship between an employer and a Pty Ltd company.

Courts have acknowledged, however, that if the Pty Ltd company is merely a corporate vehicle which allows fees to be received by the company and the entity contracted to perform work is actually an individual, then because
the Pty Ltd company is not the entity engaged to perform the work, the individual could be an employee (see for example ACE Insurance Ltd v Trifunovski [2011] FCA 1204). That is - if a ‘contractor’ relationship is, for all practical purposes, a traditional employment relationship, other than that the individual works through a Pty Ltd company, there is a risk that the relationship could be found to be a sham, notwithstanding the existence of the Pty Ltd company.

To try to avoid such an inference being drawn, we recommend always ensuring that a written contractor agreement is in place, and that contractor agreement should include, among other things, a term specifically appointing the Pty Ltd company as the contractor who will be providing services and a term allowing delegation of work by that contractor. The more indicators of a contractor relationship that genuinely exist and are represented in the written contract, the more likely it will be that the principal will be able to argue successfully that the relationship is one of principal and independent contractor.

The Fair Work Act 2009 (Cth) contains prohibitions against sham contracting. For example, section 357 provides that a person (employer) who employs, or proposes to employ an individual must not represent to the individual that the contract of employment under which the individual is, or would be, employed by the employer is a contract for services (i.e. a contractor agreement) under which the individual performs, or would perform, work as an independent contractor. It is uncertain whether this provision (and others like it) is capable of applying to a contract with a Pty Ltd company, as the provision refers to an individual and to a contract of employment with that individual.

From a superannuation perspective, note that there is a specific provision in Superannuation Guarantee Ruling SGR 2005/1 (paragraph 13) that provides that ‘where an individual performs work for another party through an entity such as a company or trust, there is no employer-employee relationship between the individual and the other party’ for the purposes of the superannuation guarantee legislation.

From a payroll tax perspective, in most jurisdictions with specific contractor provisions, all payments to companies would be taxable unless one of the specific exemptions apply.

**What are those specific exemptions?**

Not all jurisdictions recognise the same exemptions for payroll tax purposes that potentially apply to payments to contractors. Accordingly, an analysis needs to be undertaken of which jurisdiction payments are potentially taxable in and then determine whether an exemption applies. Most jurisdictions recognise payments as exempt if the contractor engages labour to provide services under the contract; if services are required for less than 180 days by the payer; and if the worker provides services on less than 90 days. Revenue authorities in each jurisdiction generally publish useful summaries of the available exemptions, which should be reviewed on a case by case basis.

**How do they determine a sham contracting arrangement?**

When considering whether an arrangement is a sham contracting arrangement, the court will consider whether an employer has attempted to disguise an employment relationship as an independent contracting relationship. There are specific provisions in the Fair Work Act 2009 (Cth) prohibiting certain ‘sham’ behaviour.

Generally speaking, a contracting agreement would be considered a sham if acts done or documents executed by the parties are intended by them to give third parties or the court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intended to create.
If someone uses a company to provide a service, does this preclude the payer from having a SG obligation?

Generally, under the ATO’s current administrative position, yes. In paragraph 13 of Superannuation Guarantee Ruling SGR 2005/1 the ATO accepts that in such a situation there is no employee/employer relationship between the payer and the individual providing the services under either the common law conception of an employment arrangement or the extended definition of an employee for superannuation guarantee purposes. It would be expected that the company would then have the superannuation guarantee obligations in relation to the individual who actually provides the services. But see our further comments below under ‘Superannuation’ in respect of the Hall plumbing contractors case.

What period of time does this ruling apply to?

SGR 2005/1 has an effective date from 23 February 2005. If you have any issues with superannuation before this date, it will be necessary to look to other guidance from the ATO discussed below.

So if I hire a bookkeeper who is a sole trader to do work on regular basis, would he or she be considered an employee?

You would need to apply the multi-factor test to determine this. In the fact sheet we have cited a case where a business engaged a woman to perform part-time bookkeeping, she had an ABN and issued invoices, however she was still found to be an employee.

I have found inconsistencies in the treatment of sole traders as either contractors or employees when dealing with the ATO, the Office of State Revenue and Workcover audits. How can we advise clients when different rules are being applied?

Whilst the common law test is the starting point for determining the nature of the relationship, you need to be aware of different tests adopted by different pieces of legislation. This does not necessarily mean that the agencies are being inconsistent. It means that clients will have different obligations under different pieces of legislation, all of which must be complied with.

An employer paying its workers via an ABN found that they may be liable for superannuation and, with advice from their accountant, made all workers set up family trusts and set up fees to be taken from the workers’ wages. Is there something the workers can do about this or is it too late now that the trusts have been established?

The workers could potentially make a complaint to the Fair Work Ombudsman under the sham contracting provisions in the Fair Work Act 2009 (Cth). However, as stated above, in the absence of case law on this point it is uncertain whether these provisions can be used to ‘look behind’ trusts and corporate entities. Given the ATO’s position in SGR 2005/1 that the family trusts would now have the superannuation guarantee obligations, it is may be difficult to challenge the arrangement on the basis that the payer is not paying the correct amount of superannuation guarantee contributions. Although please note our comments below under ‘Superannuation’ in respect of the Hall plumbing contractors case.

Superannuation

When should superannuation be paid to a contractor?

If, after applying the multi-factor test, you are able to determine that the contractor is actually an employee at common law, they are entitled to superannuation contributions.
If you cannot conclusively determine the nature of the relationship at common law, or you think they may be a contractor, you need to consider the extended definition of ‘employee’ under the Superannuation Guarantee (Administration) Act 1992 (Cth). In particularly, the Act provides that a person who works under a contract that is wholly or principally for the labour of the person is deemed to be an employee for superannuation guarantee purposes. An individual works under a contract that is wholly or principally for their labour if the individual is remunerated (wholly or principally) for their personal labour and skills, they must perform the work personally (may not delegate it) and where they are not paid to achieve a result (i.e. they are paid on some other basis, such as per hour of their time without regard to the quality of their work).

See Superannuation Guarantee Ruling SGR 2005/1 for further explanation and examples.

Can you define principally?

The ATO takes the view that ‘principally’ takes its ordinary meaning – i.e. ‘chiefly’ or ‘mainly’. The term is intended to restrict the types of contracts caught by the extended definition of an employee for superannuation guarantee purposes. To the extent that a contract is partly for labour and partly for something else (e.g. the supply of goods, materials or hire of plant or machinery), it will only fall under the extended definition if it is ‘principally’ for labour.

Can you voluntarily pay superannuation for a contractor as part of an agreement?

Yes. However, you still need to determine whether the contractor is an employee or an employee under the extended definition of an employee for superannuation guarantee purposes. This is because GST will apply to payments made to a contractor for their services including voluntary superannuation contributions that form part of those payments. However, GST does not apply to superannuation guarantee support provided to employees or a person who falls under extended definition of an employee for superannuation guarantee purposes: see ATO ID 2002/22.

Someone who is paid by an hourly rate, registered for GST and ABN, and payment is paid to the business name. Is he or she a contractor or employee for superannuation and workcover purposes?

Refer to answer above and to SG ruling. The fact that they are paid an hourly rate may mean that they are not ‘paid to achieve a result’, and may contribute towards a finding of an employment relationship. It should be noted that having an ABN does not prevent an individual from being found to be an employee.

If there is any doubt, in our experience, the ATO is likely to side on the behalf of the worker if there’s any doubt as to whether they are an employee or contractor.

From a workers’ compensation perspective, the laws are different in each state but generally workers’ compensation laws may capture individuals even if they are not common law employees.

Historically superannuation was not payable on workers who are contracting through their company or trust. This was because the company or trust was entering into the agreement rather than the individual. However, in light of the Hall plumbing contractors case (Case 3-2014), it appears that it is no longer appropriate to disregard superannuation for contractors solely on the basis that they may use a company or trust structure.

What is your opinion of the position of contractors given this recent case? Does it change the tests?

The Hall plumbing contractors case suggests that merely adopting a strategy of contracting through entities will not be enough to avoid superannuation guarantee obligations. This is despite the ATO’s current administrative position in SGR 2005/1 that no superannuation guarantee obligations should fall on the payer in this situation, since those obligations would fall on the contractor company or trust.
The plumbing contractors in this case were for all intents and purposes employees when one looked at the totality of their relationship with the plumbing business. This was because, amongst other things, the contractors all had the same contractual arrangements (which is unusual as you would expect there to be contractual differences if the contractors were truly carrying on their own businesses), their right to delegate was illusory because it was never exercised, the contractors rarely exercised their right to refuse work, the contractors were not required to correct defective work at their own costs and the contractors generally had similar hours as employees and represented themselves as employees. In such a situation one can understand the Administrative Appeals Tribunal’s (AAT) decision that they were common law employees. The entity structure factor was outweighed by these other factors.

The Hall plumbing contractors case is not a binding legal precedent because it is a decision of the AAT. Whilst the AAT considered that the contractors were also employees under the extended employee definition for superannuation guarantee purposes, there was little detailed analysis on this point and in particular how the AAT’s position married up with view that the contractors’ family trusts should have had the burden of paying superannuation guarantee for the workers. For these reasons we do not consider that the case definitively means that a payer has superannuation guarantee even where they contract through an entity structure. Rather the case indicates that where the situation is that the workers are truly employees, then trying to dress up the situation as an independent contractor relationship by adding a few features is unlikely to be successful. For proper structuring of an arrangement you should seek appropriate expert advice.

How does SG ruling 2005/1 address the issues raised in The Trustee for the SR & K Hall Family Trust v Commissioner of Taxation [2013] AATA 681; and Roy Morgan Research Pty Ltd v Commissioner of Taxation [2010] FCAFC 52?

SG ruling 2005/1 was released prior to the handing of these cases and so does not address these issues. Both these cases highlight the fact that one needs to look at the totality of an arrangement to consider whether it is an employment arrangement or caught by the extended definition of an employee for superannuation guarantee purposes.

If someone is operating under a voluntary agreement (not a volunteer), are they classed as an employee for superannuation purposes?

A person who operates under a voluntary agreement for PAYG withholding tax purposes is not automatically classed as an employee for superannuation guarantee purposes. One must look at the totality of the facts surrounding the person’s arrangement to consider whether they would be regarded as an employee under the extended employee definition for superannuation guarantee purposes.

Are there any superannuation obligations for someone who is a non-resident and who performs work for you overseas?

Generally there are no superannuation obligations. There is an exception where the employee is temporarily seconded by an Australian employer to a country that has a bilateral superannuation agreement with Australia and the employee is covered by a certificate of coverage that provides that the Australian employer is not required to provide social security support in that foreign country, provided that the Australian employer continues to provide superannuation guarantee support in Australia.

If someone is deemed to be an employee under the Superannuation Guarantee Administration Act, can they enter into a salary sacrifice agreement with the employer?

Yes.
For salary sacrifice arrangements between employers and contractors, does the salary sacrifice amount need to be included in the invoice given to the employer?

Where the contractor is not a common law employee nor deemed to be an employee under the extended definition of employee for superannuation guarantee purposes, then the salary sacrifice amount should be included in the invoice given to the employer. This is because the superannuation contribution forms part of the consideration paid to the contractor for their services for GST purposes. That is, the contractor is not an employee and the payments they receive are payments for services for services and not ‘salary’.

Where the contractor is a common law employee or deemed to be an employee under the extended definition of employee for superannuation guarantee purposes, then the salary sacrifice amount should not be included in the invoice given to the employer. This is because the ATO does not consider superannuation guarantee support to form part of the consideration for the contractor’s services in this situation: ATO ID 2002/22.

For the salary sacrifice arrangement to be effective for income tax purposes the parties must have a prospective salary sacrifice agreement in place and the contractor would need to be regarded as an employee for SGC purposes. Provided these conditions are satisfied, then the employer would need to report these amounts as part of their SGC reporting to the ATO. It would be up to the parties to determine appropriate arrangements to document the amount paid on behalf of the worker.

For SGC purposes, does it matter if the employee or contractor also provides services to the general public?

Providing services beyond those provided to a principal/employer may indicate that the individual is operating on their own account and therefore a contractor. This would need to be considered in the context of whether these additional services were being advertised for, whether they were in a distinct trade or calling from the principal/employer and whether the remuneration being derived was anything more than incidental to their engagement by the principal/employer.

Do you have to pay superannuation to directors?

Directors who receive salary, wages or director's fees are entitled to receive superannuation contributions from the company, which is regarded as their employer for superannuation guarantee purposes.

What is the situation for an individual contractor who makes and deducts their own superannuation (i.e. not paid by the company contracting them) and the ATO decides that the superannuation should have been paid by the company? Will the contractor lose the tax deductions and have to pay additional taxes?

The individual contractor is likely to lose the tax deductions because they cannot meet the requirements for a tax deduction as a substantially self employed person. Broadly, amongst other things, the individual contractor can only claim a substantially self employed tax deduction for self made superannuation contributions where less than 10% of their assessable income, fringe benefits and RESC come from employment activities.

Where the individual contractor cannot deduct their superannuation contributions because they fail this 10% test, then the contributions become classed as non-concessional contributions for superannuation purposes. This is as opposed to concessional contributions if the deduction could be claimed. This re-characterisation of the contributions may cause the individual contractor to breach their non-concessional contributions limit if they have made other contributions to superannuation out of after tax income. Where this limit is breached the individual contractor may be liable to pay non-concessional contributions tax at the rate of 49%.
What happens if a company goes bust and doesn’t pay its superannuation obligations? Do contractors lose their entitlements?

The prospect of claiming outstanding superannuation from a company that goes bust is not high. Only contractors that are truly independent contractors (i.e. not common law employees or deemed employees under the extended definition for superannuation guarantee purposes) who have such superannuation entitlements in their contractual arrangements (which is unusual) can lodge a proof of debt against the liquidating company. However, in such a situation they would rank alongside other secured creditors for payment of this debt.

Superannuation guarantee entitlements of contractors who are employees or deemed employees is treated differently. Superannuation guarantee amounts rank equally with employee entitlements (such as unpaid wages and annual leave), and generally are to be paid to employees after priority creditors’ and liquidators’ fees are paid and before payments to ordinary unsecured creditors. Only the ATO has standing to prove a superannuation guarantee entitlement debt, and so contractors in this situation would need to contact the ATO.

The ATO has the capacity to issue director penalty notices to directors of companies with unpaid PAYG and superannuation obligations. The effect of these notices is to make the directors personally liable for the unpaid obligations, so that workers may not necessarily lose their superannuation entitlements.

SG Ruling 2005/1 only applies from 23 February 2005. What is the situation for contractors and employees prior to that date?

The issues dealt with in SG Ruling 2005/1 were previously addressed in Superannuation Guarantee Ruling SGR 93/1 which was withdrawn on 25 August 2004.

Insurance

What if a person has workers’ compensation insurance and other liability interest? He is paid on the completion of a specific job. Would this person be considered a contractor?

Holding insurances is an indicator that the person is a contractor, as is being paid on the completion of a specific job. However, you would still need to consider the other factors in the multi-factor test, because the court looks at the totality of factors in the relationship.

Audits

After having been through all three types of contractor audits in this last year on a few of my builder clients, the most frustrating part of using contractors is the inconsistencies between all the criteria between tax (PAYG/superannuation), workers’ compensation and payroll tax. Is there any light at the end of the tunnel of having this harmonised?

No.
Equipment

Does it matter if the equipment or tools of trade are provided by the party contracting the contractor?

Generally it would be expected that a contractor provides the tools, plant and equipment necessary to perform their work. If they are provided by the party engaging the worker, this is indicative of an employment relationship. Provision of equipment and tools of trade is still only one factor to be taken into account. Also, the significance of the equipment or tools provided must be considered in the context of the contract. If the equipment is substantial and valuable (e.g. items of plant), such that it would not be reasonable to expect that an individual contractor would have the means to provide this equipment themselves, the fact that the principal provides the equipment is likely to be of less significance (and therefore will not prevent a finding that there is a contractor relationship). However, if equipment is less valuable and more common (such as a work vehicle or carpenters tools), such that it would not be unreasonable to expect an individual contract to have the means to provide those items for his or her own business, the provision of these items of equipment by a principal is more likely to be considered a factor counting towards an employment relationship.

Employee versus contractor scenarios

A person delivers parcels for the post office, or contracts to service fire equipment for a company, they maintain their own work vehicle and supply their own tools. To a certain extent they have control and flexibility of their own time (but not 100%) as long as jobs get done within the required timeframe. They may need to wear uniform or have signage of the company's name on their vehicle. Are they an employee or a contractor?

You would need to apply the multi-factor test. Wearing company uniforms and logos can be indicative of an employment relationship, however, supplying their own work vehicle and tools is an indicative of a contractor relationship.

In Hollis v Vabu Pty Ltd [2001] HCA, it was held that bicycle couriers were employees. This was despite the fact that they were paid per delivery and supplied their own bike. They were required to wear company uniform. Other relevant factors in that case that contributed to the finding that there was an employment relationship, were that the couriers were not highly skilled in the sense that they were providing a specialised service, they had little control over the way in which work was performed and they could not refuse work and they had little control over their rates of pay. You may find this a useful reference point in considering your case. However, as always, we recommend obtaining legal advice on any specific situation.

A worker receives, and is required to wear, a uniform and drive a company vehicle in performance of their duties. They work regular hours and is supplied tools. The company deems them to be a contractor and requests an invoice with ABN. Is this actually an employment situation?

Again, you will need to apply the multi-factor test. The fact that the worker is required to wear uniforms, is supplied with a vehicle, works regular hours and is supplied with tools does point to an employment relationship. As we have said above, just having an ABN and providing invoices does not mean that the person is genuinely a contractor.
A person is employed as a contractor without having signed a formal contract; they have worked solely for that company for four years and have been paid contractor’s rates; the contractor has an ABN but never issued an invoice; the company pays Workcover but not superannuation and PAYG; tax returns have not been lodged for several years. Who is liable for the income tax for this individual if the contractor is actually deemed to be an employee?

The paying entity may have an obligation to withhold under the PAYG withholding provisions. If the payer has breached these obligations then it could be held liable for failing to comply with its obligations – particularly if it does not have any invoices to evidence the payments were made to the worker in their capacity as a contractor.

Separately, the worker will have an obligation to declare all income and pay tax on this income. This obligation is irrespective of whether invoices have issued for work provided.

We have a client who employed a contractor on a per unit basis; provides them with a truck for collection of units but the truck is maintained by the client. The contractor sources their own customers and schedules their own work/collection times. The contractor recently requested to be employed as an employee instead of on a contractor basis and is now requesting superannuation for the period they were employed as a contractor.

We would need to know more information to give a conclusive answer. The fact that the contractor sources their own customers and schedules their own work times does point to a contractor relationship. Refer to SGR 2005/1 as to whether they are entitled to superannuation, however, it appears that this contractor is paid to achieve a result rather than on a time basis and this may take them outside of that ruling such that they are not entitled to superannuation.

If the contractor is being paid to a registered business name and has an ABN and is registered for GST are they deemed to be an employee or a contractor? The role in question is one that was paid by an hourly rate but the actual nature of the job is dictated by both compliance and government regulations.

Having a business name and being registered for the GST does not immediately mean that an individual is a contractor. Likewise, specific compliance issues are not of themselves determinative. The multi-factor test would need to be applied.

Are interpreters (who are registered with different agencies) classified as contractors or employees?

The relationship of the interpreter with any particular agency would have to be determined having regard to all the factors in the multi-factor test. The fact that the individual maintained their own business and worked for multiple clients would be a factor indicating a contractor relationship. However, of itself, it is not determinative.

Whether interpreters were independent contractors or employees was considered by the Federal Court in On Call Interpreters and Translators Agency Pty Ltd v Commissioner of Taxation (No 3) [2011] FCA 366. Ultimately the Court applied the multi-factor test and determined that the interpreters in that case were not independent contractors. The Court was not satisfied on the evidence that the interpreters were operating their own business.

What if the contractor is an individual; a contractors agreement is signed by both parties; the contractor may and can receive income from other contracts but the employer does not know whether the contractor has other sources of contracted income or whether the contractor has employees; the contractor has the ability to engage employees but chooses to do the work himself; is this an employee or contractor relationship?

The multi-factor test needs to be applied to determine the true nature of the relationship. The existence of a written agreement, and a mutual intention to create a contractor relationship, will be a factor in favour of a
contractor relationship but will not be conclusive. The ability to delegate and to perform work for other clients also are factors weighing in favour of a contractor relationship.

My client engages contractors to do insurance investigation work; they are paid on an hourly rate; they have their own licence; provide their own vehicle and any other equipment; the contractors produce a report which is provided to my client; the contractors can decline a job if they wish; they choose their own hours of work and when the jobs are done; the contractors have other clients; there is no scope for delegation; the contractors are contracted differently e.g. some via a corporate entity, some as partnerships; some as individuals. The payroll tax auditor has deemed them all to be employees for payroll tax purposes because they carry out the core activities of the client and are integral to the business. Is the payroll tax auditor correct in this assessment?

You should provide a copy of the reasons for decision issued by the relevant revenue authority, together with any associated assessments to a lawyer, so that they can properly advise on whether the amounts should be included as part of taxable wages and whether objections should be lodged (if still within the time limits set by statute for objections to be lodged within).

Are there any implications in a situation where an independent contractor becomes an employee due to a change in circumstances?

Apart from tax and superannuation issues, there will be employment ramifications. It will be necessary to look at the type of work performed by the individual and whether this would mean they are covered by an award. In addition to award entitlements (such as minimum rate of pay, overtime, allowances), the individual will be entitled to the minimum entitlements in the *Fair Work Act 2009* (Cth), such as annual leave, personal leave and parental leave. There are also record keeping obligations imposed on employers under that Act, such as keeping records of time worked and wages.

Best practice would include preparing an employment contract to formalise the employment relationship.

A builder only engages contract carpenters who operate under a company structure. Each carpenter company, however, works stipulated hours can’t delegate, is paid an hourly rate each week, are given the use of a motor vehicle and wear a uniform. Is this sham contracting or does the use of a company structure protect the builder?

The use of a company structure may provide a degree of protection, however, see our comments above under the heading ‘Contracting through entities’. It will depend on the terms of the written contract (if any) and whether the terms of the contract are a true reflection of the practicalities of the relationship. If a clear feature of this relationship is that the individual is engaged personally to perform the work and cannot delegate work, there is a risk that the company may be seen as merely a vehicle for payment of the individual, and courts have said that if this is the case, the individual can be held to be an employee.
An individual works for a mortgage broker as a finance manager; they set their own work hours; set their ownleave; are paid on commission basis; provide their own phone and laptop; are provided with a PA, desk andoffice phone by the broker. Are they a contractor?

A similar situation was considered in *ACE Insurance Ltd v Trifunovski* [2011] FCA 1204 and the court in that casefound that contractors acting as insurance brokers were in fact employees. This was despite the fact thatcontractors provided invoices for their commissions. You may find this decision a useful starting point.

In this case, as with all cases, you would need to apply the multi-factor test to the specific circumstances.

**Resources**

**Australian Taxation Office**

There are tools on the [ATO website](http://www.ato.gov.au) and commentary on other regulatory websites as well.

However, every website makes it clear that you should not rely on the outcomes of a website test as legal adviceand to be safe, you should always seek your own independent legal advice.

**Fair Work Ombudsman**

*Small Business Helpline*

T: 13 13 94

**Small business hub**


**Employment Hero Partner Program**

As part of your CPA Australia Member Benefits you can receive one complimentary HR live support call and a 30day free trial of Employment Hero. To learn more go to [http://www.employmenthero.com/cpa/](http://www.employmenthero.com/cpa/)

**AusIndustry**


T: 13 28 46 [Monday to Friday 8am-8pm (AEST)]

W: [live chat](http://www.business.gov.au) with a small business support line agent

**ASIC**

*Small business hub*

McCullough Robertson Lawyers

McCullough Robertson is available to provide specific advice on a paid consultation basis. Contact Angela Petie at apetie@mccullough.com.au or Lyndon Garbutt at lgarbutt@mccullough.com.au

CPA Australia

CPA Australia employment and workplace resources can be found at cpaustralia.com.au/humanresources

We would welcome your feedback on this and other live chat experiences as well as suggestions for future sessions. Please email publicpractice@cpaustralia.com.au

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McCullough Robertson Lawyers were the expert presenters at this live chat and were also commissioned by CPA Australia to supply the content of the fact sheet referenced, Deciding between an employee or contractor.

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