

> Employee or Contractor

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It is very important to be clear about whether the person to be engaged is an employee or an independent contractor. Employers have legal responsibilities towards their employees that are quite different from their obligations to contractors.

Employees are those workers engaged under a contract of employment (a “contract of service”). The employer is obliged to provide coverage for workers compensation, to comply with applicable awards and agreements, to withhold tax from the wage/salary, and to contribute superannuation and other employee related obligations.

Independent contractors are those workers who are self employed (i.e. run their own business) and have a “contract to provide services (a “contract for service). Contractors have an ABN and pay their own insurances and taxes. Where a contractor does not supply an ABN, the employer must deduct tax.

The Consequences

Classifying employees incorrectly as contractors can have a potentially serious consequences, opening the employer up to:

- Claims for entitlements, unfair dismissal, penalties from the Workplace Ombudsman, and vicarious liability.
- Potential prosecution and possible financial penalties in relation to legislation covering PAYG (income tax), Payroll Tax, Superannuation Guarantee, Workers Compensation and Fringe Benefits Tax. E.g. if an employee was incorrectly classed as an independent contractor and PAYG should have been withheld and remitted to the ATO, but was not, the ATO has wide ranging powers to recover funds which include winding up the organisation

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- Financial penalties on individual company directors regardless of whether failure to pay tax was due to a genuine mistake or not. (i. e. the directors of a company may be personally liable to pay an amount equal to the company's liability.)
- Financial penalties for sham contract arrangements. A sham contract arrangement is one where an employer attempts to disguise an employment relationship as an independent contracting relationship in order to avoid the responsibility for paying legal entitlements such as minimum rates of pay and leave entitlements to an employee.

An example of how far courts will go in deconstructing artificial arrangements can be seen in the decision of *Damevski v Giudice* [2003] FCAFC 252. In this decision the Full Court of the Federal Court of Australia overturned a decision of the Full Bench of the AIRC that no employment relationship existed between Mr Damevski and Endoxos Pty Ltd. Mr Damevski had been previously engaged by the company as an employee, however some 3 years into his employment he was informed that due to cost pressures the company had decided to move to a contracting system, whereby Mr Damevski would establish his own business and become a contractor to MLC Workplace Solutions Pty Ltd. Mr Damevski signed documents stating that he understood and agreed to the proposal, and some months later was told that he was being taken off the job. Throughout the period during which Mr Damevski was ostensibly engaged as a 'contractor', he continued to work under the same arrangement and was provided by Endoxos with a van, equipment, and company livery.

In determining whether a worker is a contractor or an employee the courts will not look at whether the employer has called the worker a contractor, rather it will look at the factors described below here as set out in the Full Bench AIRC decision *Abdalla v Viewdaze Pty Ltd t/a Malta Travel* 504. Essentially it is the 'control' over the work that is the major deciding factor on whether a person is an employee or a contractor.

What are the differences between an Employee and a Contractor?

It can be difficult to distinguish between an employee and an independent contractor. The usual way to determine whether a worker is an employee is by using the 'multi-factor' test as outlined in the explanatory memorandum to the Independent Contractors Act. The multi-factor test examines the relationship between the worker and the organisation against the criteria listed in the table below.

ITEM	EMPLOYEE	CONTRACTOR
Control over work	The employer has an implied right in industrial law to direct and control the work of an employee. The employee works in the business of the employer and the employer is free to manage their business as they see fit.	The employer has a right to specify how the contracted services are to be performed. However, such control must be specified in the terms of the contract, otherwise the contractor is free to exercise their discretion.
Independence	An employee works in the business of the employer. Their work is an integral part of the business.	Although the work of a contractor is done for the business, it is not integrated into it but is <u>ancillary</u> to it.
Appointment	An employee is generally recruited through an advertisement by the employer. A full time employee usually works for just one employer	An independent contractor is likely to advertise their services to the public at large. An independent contractor can provide services to many clients.
Payment, Taxes and Leave	Payment is often based on the period of time worked, but an employee can also be paid <u>'piece rates'</u> or <u>commission</u> . An employee is entitled to various types of paid leave and is covered by workers comp. An employee pays PAYG tax which the employer pays on behalf of the employee.	Payment is dependent on the performance of the contracted services. A contractor is responsible for their own taxes and insurances, and is not paid for any leave, nor covered by the employer's workers compensation insurance.
Commercial risks	An employee generally bears no legal risks in respect of the work; since the employee is part of the employer's	A contractor bears legal risk in respect of the work. They have the potential to make a profit or loss, and must remedy any

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	<p>business, the employer is legally responsible for any work performed by employees. Further, the employer is generally responsible for any loss resulting from poor work.</p>	<p>defective work at their own expense. Generally a contractor would be expected to carry her/his own insurance policy.</p>
Ability to delegate	<p>An employee performs the work personally and generally cannot subcontract the work to someone else.</p>	<p>Unless otherwise specified in the contract a contractor can subcontract or delegate the work.</p>
Tools, equipment and expenses	<p>The employer usually provides tools and equipment. An employee is generally reimbursed for expenses incurred in the course of employment.</p>	<p>Generally, a contractor provides their own tools and equipment. An independent contractor is responsible for their own expenses.</p>
Termination	<p>An employer reserves the right to dismiss an employee at any time (subject to any state or federal laws).</p>	<p>An independent contractor is contracted to complete a set task. The payer may only terminate the contract without penalty where the worker has not fulfilled the conditions of the contract. The contract will usually contain terms dealing with defaults made by either party</p>

Further information can be obtained from the ATO website, including a Contractor or employee decision tool. <http://www.ato.gov.au/businesses/content.asp?doc=/content/00095062.htm> and <http://law.ato.gov.au/atolaw/view.htm?docid=SGR/SGR20052/NAT/ATO/00001> which also provides guidance for determining employee vs. contractor decisions.

Australian Business Number (ABN)

The mere fact that a person has an ABN does not preclude that person from being an employee. Before engaging a person (or company as the case may be) as an independent contractor, always undertake an ABN search (or company search) of the person or company. There have been a number of cases where independent contractors (for example cleaners) have been engaged as companies but subsequent ABN searches have shown that such companies do not exist, and thus the principals are in fact employers engaging individuals as employees without intending this to be the result.

Regarding the employer/employee relationship, implications for the employer may include:

Taxation

Tax implications for the employer are:

- The employer is required to withhold PAYG from employee's salary and wages and remit same to the ATO;
- The employer will be required to pay Payroll tax in respect of salary and wages where the threshold is reached.

Prosecution and financial penalties apply if an employee is incorrectly classed and paid as an independent contractor, regardless as to whether this was the result of a genuine mistake.

Failure to pay Payroll tax means the primary tax must be paid. In addition, interest and penalties as assessed may be payable.

Superannuation Requirements

The employer is required to pay superannuation guarantee of 9% if the employee earns more than \$450 per calendar month.

However, if an independent contractor is engaged, and the contract is principally for labour (i.e. more than 50% of the cost of the contract is for labour), then the employer must pay superannuation. In this case, 'labour' includes physical labour, mental effort or artistic effort.

Further information is available on the ATO website, including a superannuation eligibility tool.

<http://www.ato.gov.au/superfunds/content.asp?doc=/content/85201.htm&mnu=43181&mfp=001/003>

Failure to pay the Superannuation Guarantee by the due dates will result in financial penalties as follows:

- a) the total of the employer's individual superannuation guarantee shortfalls for the quarter; and
- b) the employer's nominal interest component for the quarter; and

- c) the employer's administration component for the quarter-\$20 for each employee there is a 'shortfall' for per quarter

Workers Compensation Requirements

Some people working as contractors are also treated as workers for workers compensation purposes, depending on the individual circumstances. For this reason, their employer must cover them for workers compensation and declare any payments made as wages. This means that if there is a workplace injury the contractor may be entitled to receive workers compensation for a work-related injury.

Each State has differing legislation on what constitutes a worker or "deemed worker" and WorkCover in each state provides guidelines as to whether someone is considered a worker or contractor for workers compensation purposes. Employers should check their responsibilities in these areas prior to engaging the worker.

The criteria for determining whether a contractor is a deemed worker for the purpose of determining whether they should be covered by the employers Workers Compensation policy is similar to the multi-factor test.

New South Wales

WorkCover NSW has a private ruling and self assessment tool online. Employers can apply online for a private ruling on whether a person or entity is considered to be a worker or contractor for wage record and premium calculation purposes.

http://www.workcover.nsw.gov.au/WorkersCompensation/PrivateRulings/Self_Assessment_Tool/Pages/default.aspx

ACT

Workers in the ACT whether employed under a 'Contract for Service' or a "Contract of Service" who works on a regular and systematic basis are deemed to be Workers for the purposes of workers compensation and must be covered by an employer's workers compensation policy.

VIC

Worksafe Victoria has its own assessment tool which can be obtained from their website

http://www.worksafe.vic.gov.au/wps/wcm/connect/af14d4004071f4fba342ffe1fb554c40/contractor_guidelines.pdf?MOD=AJPERES

If an employer fails to undertake these checks they may be liable for the subcontractor's unpaid workers compensation premiums.

To protect themselves, employees should request:

- a copy of the contractor's Certificate of Currency for workers compensation insurance
- a written statement by the subcontractor that all workers compensation premiums applicable for that work have been paid.

Further Information

Australian Taxation Office: <http://www.ato.gov.au>

WorkCover NSW: <http://www.workcover.nsw.gov.au>

Office of Regulatory Services: <http://www.ors.act.gov.au/workcover/index.html>

Worksafe Victoria: <http://www.worksafe.vic.gov.au>

The Office for Employment Relations can provide you with sample documents and assistance on this and other employment related matters. Please visit our website: www.employmentrelations.org.au or contact Jane Bashiruddin at the Office for Employment Relations on 03 9934 3355

This document is written as a general guide only. It is not intended to contain definitive legal advice which should be sought as appropriate in relation to a particular matter.