

Setting **Standards** Building **Trust**

What sets SCA Strata Management Professionals apart is their education, expertise & experience

Employment Laws – “the laws have changed, have you?”

Tom Meagher – Balfour Meagher Lawyers



Tom has over 30 years' legal and business experience including:

- > working for local and major national Law Firms;
- > being the majority owner and executive director of his former mid-tier Law firm;
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Tom is also a regular publisher of articles and is one of Australia’s leading presenters of legal seminars to and for various professional bodies, associations and government authorities on a wide range of business law and professional development-training topics including:

WA Department of Commerce	Institute of Public Accountants	CPA Australia
Chartered Accountants Australia & NZ (CAANZ)	Governance Institute of Australia	Mortgage & Finance Association of Australia (MFAA)
Law Society of WA	National Electrical & Communications Assoc (WA)	City Insolvency Discussion Group
Innovation Centre of WA	Australian Hotels Association (WA)	Forum for Directors of Indigenous Organisations (FDIO)
LegalWise CLE	Small Business Development Corporation	Australian Computer Society
The Tax Institute	Australian Institute of Conveyancers (WA)	Institute of Certified Bookkeepers
Western Suburbs Business Association	Business Foundations Inc	WA Business Assist
WA Reckon Partners	Australian Digital Transformation Association	Australian Institute of Business Brokers (AIBB)

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Overview of this Session

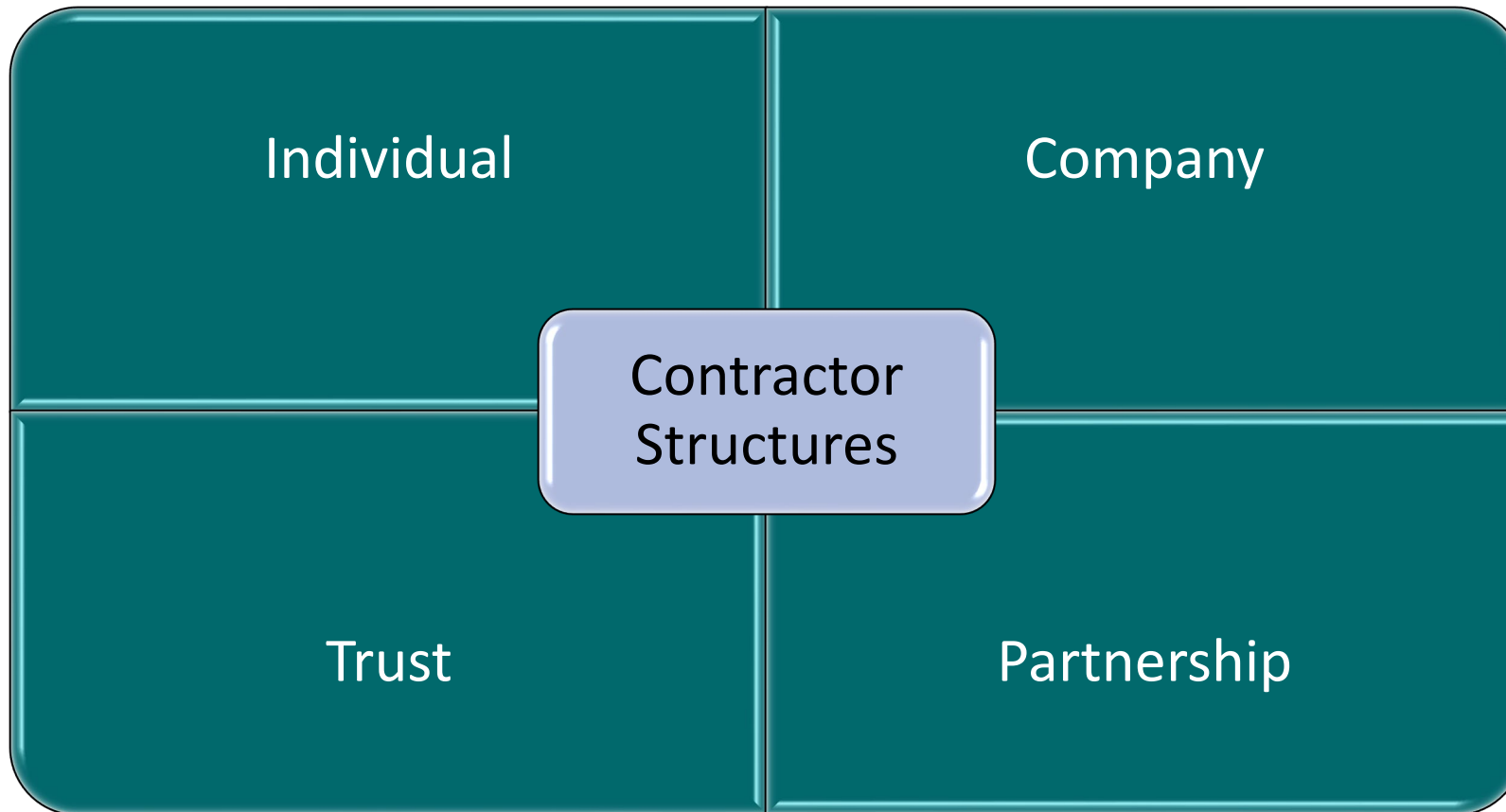
- i. Structures and definitions
- ii. Key differences between Employees and Contractors
- iii. Employee or Contractor: Guiding Principles
- iv. Employee or Contractor: Tests
- v. Sham Contractor
- vi. Common Contractor Myths
- vii. Personal Business Services (80/20 Rule)
- viii. Business Sale Considerations



Structures and Definitions

Contractor Engagement

Engaging contractors can be from various legal structures.

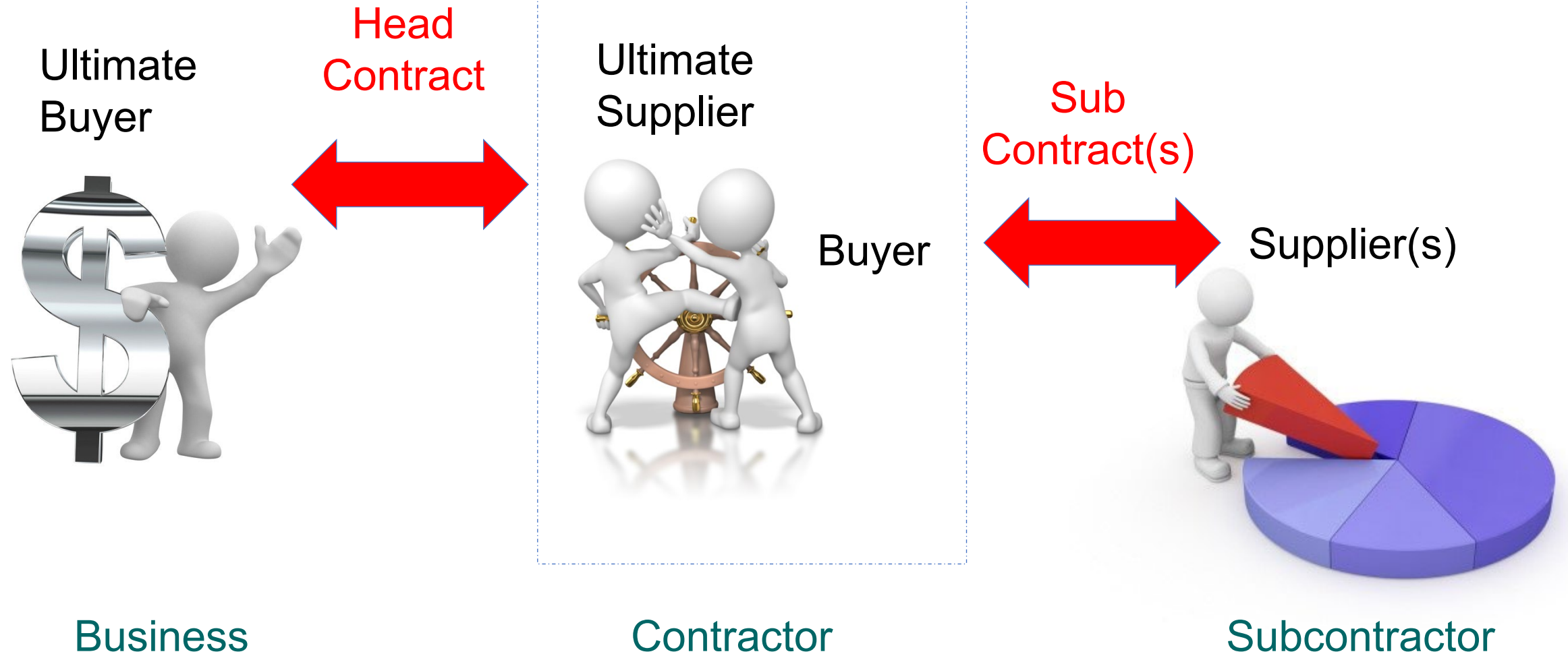


- **Employee** - a person that's hired to provide a service to a company either on a full-time, part-time or casual basis in exchange for payment;
- **Independent Contractor** - a person who is self-employed and provides services to clients. They operate differently to employees and are seen as owners and run their own business; and
- **Sham contract** - an attempt by an employer to misrepresent or disguise an employment relationship as an independent contracting arrangement.

Contract Type

Worker	Party A	Party B	Contract
Employee	Employer (Business)	Employee (Worker)	Employee Agreement: Contract <i>of</i> service
Contractor	Business (Principal / Buyer)	Contractor (Supplier)	Supply Agreement: Contract <i>for</i> service
Subcontractor	[Head] Contractor (Buyer)	Subcontractor (Supplier)	Supply Agreement: Contract <i>for</i> service

Buyer – Supplier Relationship



Typical Contractor Agreements

- Subcontractor's Duties and Responsibilities
- Consideration
- Reporting
- Directions
- Completion of works
- Warranties
- Variations to the Works
- Performance
- Term
- Invoicing and payment
- Insurance
- Confidentiality and Intellectual Property
- Termination
- Force Majeure/ Act of God
- Sub-Contracts
- Conflicts of interest
- Statutory compliance
- Principal's instructions
- Maintenance of Works Site
- Relationship and Limited Agency
- No Competition
- Covenant not to solicit Principal's employees
- Access to records
- Indemnity
- Retention
- Liquidated Damages
- Dispute resolution
- Special conditions
- Miscellaneous



Key Differences between Employees and Contractors

Liability: Employee or Contractor

A longstanding principle of the common law is that an employer will be vicariously liable for the tortious acts of an employee, but not for the acts of an independent contractor.

Employee

An employer is vicariously liable for negligent acts or omissions by their employee during the course of employment.

They are liable independent to the employer giving their permission for the employee to act (or not to act) in the way that caused the damage.

Contractor

A contractor is generally liable for their own work.

PAYG: Employee or Contractor

An employer is required to manage 'Pay As You Go' (PAYG) payments for employees where they withhold tax on income payments and pay the ATO, although a business may need to apply this to contractors.

Employee

The Employer must withhold tax (PAYG withholding) from an employee's wages and report and pay the withheld amounts to the ATO.

Contractor

The Contractor generally looks after their own tax obligations.

The Business only withholds (at 47%) payments where they don't quote their ABN, or where a voluntary agreement with them to withhold tax from their payments exists.

FBT: Employee or Contractor

Fringe benefits tax (FBT) is paid by employers for certain benefits they provide to their employees or their employees' family or other associates.

Employee

An employer must report and Fringe Benefits Tax (FBT) applies if the employer provides an employee with fringe benefits.

Contractor

A contractor does not have Fringe Benefits Tax (FBT) obligations.

Fringe benefits tax (FBT) examples include:

- allowing an employee to use a work car for private purposes;
- giving an employee a discounted loan;
- paying an employee's gym membership;
- reimbursing an expense incurred by an employee, such as school fees;
- providing entertainment by way of free tickets to concerts; and
- giving benefits under a salary sacrifice arrangement with an employee

Fringe benefits tax (FBT) exclude the following:

- salary and wages;
- shares purchased under approved employee share acquisition schemes;
- employer contributions to complying super funds;
- employment termination payments (including for example, the gift or sale at a discount of a company car to an employee on termination);
- payment of amounts deemed to be dividends under Division 7A;
- benefits provided to volunteers and contractors; and
- exempt benefits such as certain benefits provided by religious institutions to their religious practitioners.

Superannuation: Employee or Contractor

An employer is responsible for paying superannuation to their employees, however it may also apply to contractors.

Employee

The employer must pay super, at least quarterly, for eligible employees.

Contractor

The employer may still have to pay super for individual contractors if the contract is principally for their labour.

Superannuation Payments

Below is some criteria the Australian Taxation Office looks at in determining whether a contractor should be paid super contributions:

- **Contractor is an individual:** The agreement must be between an individual who provides the service and a customer who receives the service. If the individual works on behalf of another company, that company is responsible for paying the contractor's super (not the customer);
- **Contractor performs their own work:** This means the written contract stipulates that work must not be delegated to a subcontractor. If the arrangement does not prohibit delegation or subcontracting, this means delegation is possible and the contractor is not required to do the work by themselves; and
- **Contractor is paid for hours worked, rather than paid to achieve a result:** Most independent contractors are paid to perform a specific task, as opposed to employees who are paid for their time. However, if the contractor is being paid an hourly rate this means they are being paid for their time and labour. If the arrangement makes it clear the contractor is being paid to achieve a result, regardless of how much time is spent, then the contractor is typically not entitled to superannuation.

If a contractor meets all of the above criteria they may be entitled to be paid superannuation contributions. Under the Super Guarantee (SG) rules the minimum amount of super to pay each contractor is 9.5% of their ordinary time earnings, as long as they earn \$450 or more before tax per calendar month.

Leave Entitlements: Employee or Contractor

An employer is responsible only for providing leave entitlements to employees. Leave entitlements change in accordance to employee types (e.g., casuals).

Employee

An employee is entitled to receive payment for leave, including sick leave, annual leave and long service leave.

Contractor

Contractors do not have any entitlement to leave.

Insurance: Employee or Contractor

An employer typically only needs to cover their employees for workers' compensation insurance.

Employee

An employee is covered by the workers compensation insurance.

Contractor

Contractors require their own insurance cover.



Employee of Contractor? The Guiding Principles

An **employee** works in your business and operates as part of your business, whereas a **contractor** is running their own business and operates independent to your business.

Companies, trusts and partnerships
are always **contractors**.

The *Independent Contractors Act 2006 (Cth)* in conjunction with the *Fair Work Act 2009 (Cth)* protect the rights and entitlements of independent contractors.

(from the Australian Taxation Office):

“It's against the law for a business to incorrectly treat their employees as contractors. Businesses that do this are illegally lowering their labour costs by:

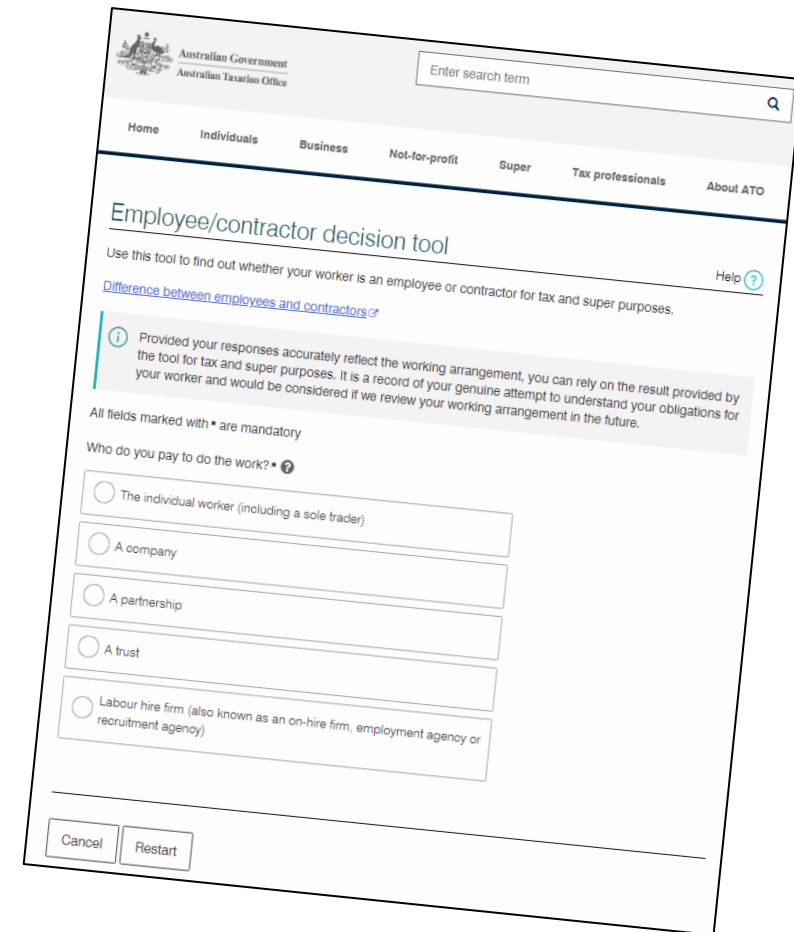
- not meeting their tax and super obligations
- denying workers their employee entitlements.”



Employee of Contractor?

- the 6 ATO Tests
- the 9 FWO Tests

The Australian Taxation Office provides an online **Employee or contractor decision tool**.



The screenshot shows the Australian Taxation Office website interface for the 'Employee/contractor decision tool'. At the top, there is a search bar and a navigation menu with links for Home, Individuals, Business, Not-for-profit, Super, Tax professionals, and About ATO. The main heading is 'Employee/contractor decision tool' with a 'Help' link. Below the heading, there is a brief instruction: 'Use this tool to find out whether your worker is an employee or contractor for tax and super purposes.' A link for 'Difference between employees and contractors' is provided. A note states: 'Provided your responses accurately reflect the working arrangement, you can rely on the result provided by the tool for tax and super purposes. It is a record of your genuine attempt to understand your obligations for your worker and would be considered if we review your working arrangement in the future.' A warning indicates that all fields marked with an asterisk are mandatory. The primary question is 'Who do you pay to do the work?'. The options are: 'The individual worker (including a sole trader)', 'A company', 'A partnership', 'A trust', and 'Labour hire firm (also known as an on-hire firm, employment agency or recruitment agency)'. At the bottom, there are 'Cancel' and 'Restart' buttons.

<https://www.ato.gov.au/Business/Employee-or-contractor/How-to-work-it-out--employee-or-contractor/>

ATO Test - Employee or Contractor?

Test Number 1

The ability to subcontract / delegate.

Employee

The worker can't subcontract / delegate the work – they can't pay someone else to do the work.

Contractor

The worker can subcontract / delegate the work – they can pay someone else to do the work.

ATO Test - Employee or Contractor?

Test Number 2

Basis of payment

Employee

The worker is paid either: for the time worked, a price per item or activity, or a commission.

Contractor

the worker is paid for a result achieved based on the quote they provided.

ATO Test - Employee or Contractor?

Test Number 3

Equipment, tools and other assets

Employee

The business provides them, or where provided, an allowance or reimbursement is provided.

Contractor

The worker provides all or most of the tools. No allowance or reimbursement is provided.

ATO Test - Employee or Contractor?

Test Number 4

Commercial risks

Employee

The worker takes no commercial risks (the business is liable for the work done).

Contractor

The worker takes the commercial risks and is legally responsible for the work and liable for defects.

ATO Test - Employee or Contractor?

Test Number 5

Control over the work

Employee

The worker is directed by the business.

Contractor

The worker has the freedom in the way they work (subject to any contractual obligations).

ATO Test - Employee or Contractor?

Test Number 6

They are independent

Employee

The worker is not operating independent to the business. It is considered to be part of the business.

Contractor

The worker is operating a business independent to your business.

FWO Test - Employee or Contractor?

Test Number 1

Degree of control how work is performed.

Employee

The worker performs work under the direction and control of the business.

Contractor

The worker has a high level of control in how the work is done.

FWO Test - Employee or Contractor?

Test Number 2

Hours of Work.

Employee

The worker generally works standard hours (except casual).

Contractor

The worker decides what hours to work to complete the specific task.

FWO Test - Employee or Contractor?

Test Number 3

Expectation of Work.

Employee

The worker usually has an ongoing expectation of work (except casual).

Contractor

The worker is normally engaged for a specific task.

FWO Test - Employee or Contractor?

Test Number 4

Risk.

Employee

The worker bears no financial risk, which is carried by the business.

Contractor

The worker bears the risk for making a profit or loss, and carries responsibility and liability.

FWO Test - Employee or Contractor?

Test Number 5 Superannuation.

Employee The worker is entitled to super.

Contractor The worker normally pays their own super.

FWO Test - Employee or Contractor?

Test Number 6

Tools and Equipment.

Employee

The worker has the tools and equipment provided to them or has an allowance for them.

Contractor

The worker uses their own tools and equipment unless otherwise agreed.

FWO Test - Employee or Contractor?

Test Number 7

Tax.

Employee

The worker has income tax deducted by the employer.

Contractor

The worker pays their own tax and GST to the ATO.

FWO Test - Employee or Contractor?

Test Number 8

Method of Payment.

Employee

The worker is paid regularly.

Contractor

The worker submits an invoice for work completed.

FWO Test - Employee or Contractor?

Test Number 9

Leave.

Employee

The worker is entitled to paid leave or as a casual receives a loading in lieu of leave entitlements.

Contractor

The worker does not receive paid leave.



Sham Contractor

A **sham contractor** represents a worker who the employer misrepresents the nature of their relationship with the business (i.e., represents to the marketplace that the worker is an independent contractor when, in fact, they are an employee).

Sham contracts are often created for the purpose of an employer avoiding paying employee entitlements like superannuation, leave, penalty rates and notice of termination.

Engaging in sham contracting is prohibited under the *Fair Work Act 2009 (Cth)* and penalties apply if you are caught.

Under the sham contracting provisions in the *Fair Work Act 2009 (Cth)*, you are not allowed to:

- claim an employee as an independent contractor;
- force an existing employee to become an independent contractor;
- dismiss or threaten to dismiss an employee if they refuse to become an independent contractor;
- dismiss or threaten to dismiss an employee in order to engage them as an independent contractor to do the same work; or
- mislead an employee in order to persuade them to perform the same (or mostly the same) work as an independent contractor.

The Fair Work Act 2009 (Cth) forbids sham contracting that ensures a employer cannot:

- **Misrepresent** an employment relationship or a proposed employment arrangement as an independent contracting arrangement
- **Dismiss** or **threaten** to dismiss an employee for the purpose of engaging them as an independent contractor
- Make a knowingly **False Statement** to persuade or influence an employee to become an independent contractor.

Sham Contracting Penalties

The courts may impose a maximum penalty of **\$12,600 for individuals** and **\$63,000 for corporations** per contravention of the *Fair Work Act 2009 (Cth)* sham contracting provisions.

Fair Work Inspectors may also seek an injunction (or an interim injunction) if an employer acts or threatens to dismiss an employee for the purpose of engaging them as an independent contractor.

The purpose of the injunction aims to prevent the dismissal from occurring, or otherwise remedy the effects.

Courts can issue orders to have an employee reinstated or compensated.



Common Contractor Myths (from the ATO)

Myth: If a worker has an ABN they're a contractor.

Fact: Having an ABN makes no difference to whether a worker is an employee or contractor for a job.

Businesses sometimes request or pressure a worker who is an employee to obtain an ABN in the belief this will make the worker a contractor. Often these businesses attempt to disguise the employment arrangement and make it look like contracting to avoid their PAYG withholding and super obligations.

If the working arrangement is employment, an ABN will not make the worker a contractor.

Myth: Everyone in my industry takes on workers as contractors, so my business should too.

Fact: Just because other businesses treat workers as contractors doesn't mean they have got it right.

Ignore common industry practice when determining whether your worker is an employee or contractor.

Myth: Employees can't be used for short jobs or to get extra work done during busy periods.

Fact: The length of a job or regularity of work makes no difference to whether a worker is an employee or contractor.

Both employees and contractors can be used for:

- casual, temporary, on-call and infrequent work
- busy periods
- short jobs, specific tasks and projects.

Myth: A worker cannot work more than 80% of their time for one business if they want to be considered a contractor.

Fact: The 80% rule, or 80/20 rule as it is sometimes called, relates to personal services income (PSI) and can change how a contractor:

- reports their income in their own tax return
- claims some business-like deductions.

It's not a factor a business considers when they work out whether a worker is an employee or contractor.

Myth: My business has always used contractors, so we don't need to check whether new workers are employees or contractors.

Fact: Before hiring a new worker, you should always check whether the worker is an employee or contractor by examining the working arrangement.

Unless a working arrangement (including the specific terms and conditions under which the work is done) is *identical* to a previous arrangement you've already checked, the outcome could be different.

Hiring workers without checking the working arrangement could mean the business is incorrectly treating all future workers as contractors when they are employees

Myth: If a worker has a registered business name, they're a contractor.

Fact: Having a registered business name makes no difference to whether a worker is an employee or contractor.

Myth: If a worker is a contractor for one job, they will be a contractor for all jobs.

Fact: The working arrangement and specific terms and conditions will determine whether a worker is an employee or contractor for each job.

A worker could be an employee for one job and a contractor for the next job

Myth: My business should only take on contractors so we don't have to worry about super.

Fact: Businesses may be required to pay super for their contractors.

If you pay an individual contractor under a contract that is wholly or principally for the person's labour, you have to pay super contributions for them

Myth: Workers used for their specialist skills or qualifications should be engaged as contractors.

Fact: If a business takes on a worker for their specialist skills or qualifications it doesn't automatically mean they're a contractor.

A worker with specialist skills or qualifications can be either an employee or contractor depending on the terms and conditions under which the work is done.

Myth: My worker wants to be a contractor, so my business should treat them as one.

Fact: Just because a worker has a preference to work as a contractor doesn't mean your business can engage them as a contractor.

Whether a worker is an employee or contractor is not a matter of choice, but depends entirely on the working arrangement and the specific terms and conditions.

If you give into pressure and agree to treat an employee as a contractor, you can face penalties and charges for not meeting your tax and super obligations.

Myth: If a worker submits an invoice for their work, they're a contractor.

Fact: Submitting an invoice for work done or being 'paid on invoice' doesn't make a worker a contractor.

To know whether a worker is an employee or contractor, you need to look at the whole working arrangement and examine the specific terms and conditions.

Myth: If a worker's contract has a section that says they are a contractor, then legally they're a contractor.

Fact: If a worker is legally an employee, a contract saying the worker is a contractor will not make the worker a contractor at law.

Businesses and workers will sometimes include specific words in a written contract to say that the working arrangement is contracting in the mistaken belief that this will make the worker a contractor at law.

If a worker is legally an employee, a contract specifying the worker is a contractor makes no difference and will not:

- override the employment relationship or change the worker into a contractor
- change the PAYG withholding and super obligations a business is required to meet.



Personal Services Business and the 80 / 20 Rule

The 80/20 rule requires a contractor to have more than one client (no more than 80% of their income from one client) during a tax year to avoid being assessed as a Personal Services Business where the Personal Services Income (PSI) applies.

Other options:

- A PAYG contractor means they get taxed like a permanent employee, however receive none of the associated benefits (e.g., sick leave, holiday pay, training and development); or
- Working for an umbrella company whom manage all aspects of invoicing, payment and tax reporting, where the contractors send in their timesheets.

The PSI legislation makes it clear that an entity or individual falling within the PSI rules would be limited to deductions available to an individual.

Regarding the alienation of income, (apart from the existing general anti-avoidance tax provisions of Part IVA of the ITAA 36), there are no specific rules to address the adverse revenue implications which can result when alienation occurs.

“PSI income” (whether ordinary or statutory income) is defined as that which is “gained mainly as a reward for the personal efforts or skills of an individual”.

Income that is gained by an entity (e.g., a company, partnership or trust) for the personal efforts or skills of an individual will still be PSI. hence the 'alienation' aspect.

By reason of this definition, income which is:

- ancillary to an entity supplying goods or granting a right to use property; or
- principally generated by assets an entity holds;
- is not PSI, as it is not paid mainly as a reward for an individual's personal effort.

Rather, it is paid mainly as consideration for the provision of the goods or due to the use of an asset.

Generally, if a person or the personal services entity:

- do not satisfy what is known as a "results test" (see below); and
- that person or the personal services entity get 80% or more of the personal services income from one source,

then they will be subject to the PSI rules.

The "results test" is satisfied where:

1. you work to produce a result; and
2. you provide the tools and equipment necessary (if any) to produce the result; and
3. you are liable for the cost of rectifying any defective work.

The PSI rules are structured so that an individual or a personal services entity carries on a personal services business (and so is exempt from the rules) if:

- the individual or, where the individual's PSI is included in a personal services entity's income, the entity meets the results test; or
- not more than 80% of the individual's or entity's PSI in an income year comes from the one client (and associates of the client) and the individual or entity meets at least one of the unrelated clients test, employment test and business premises test; or
- a personal services business (PSB) determination is in force. A PSB determination from the Tax Commissioner is necessary if the "80% threshold" and the results test are not met.

Businesses risk receiving penalties and charges, including:

- PAYG withholding penalty – for failing to deduct tax from worker payments;
- super guarantee charge comprising:
 - super guarantee shortfall amounts – the amount of super contributions that should have been paid into a complying fund;
 - interest charges; and
 - an administration fee.
- additional super guarantee charge of up to 200%.

In addition to the super guarantee charge, which imposes nominal interest and an administrative charge in all cases on top of the super guarantee shortfall, the ATO can impose additional penalties of up to 200% of the super guarantee charge.



Business Sales Considerations

Where the business being purchased has a high contractor use, you may need to consider:

- whether sham contracting exists (and the related liabilities);
- how they are presenting the business to the end client;
- the effectiveness of the workforce available (i.e., the employee capability) and requirement and cost for on-boarding and training;
- the accessibility to, and availability of, contractors for ongoing work, and the fact that they may also be working for competitor businesses;
- the access to, and ownership of, the key tools of trade; and
- who is carrying the corporate knowledge.

Thank You!

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