



INDEPENDENT CONTRACTOR OR EMPLOYEE WHY IS IT RELEVANT AND WHAT'S THE DIFFERENCE

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Over the last decade or more the Australian work environment has changed and adapted and continues to change and adapt as the Australian economy responds to internal and external pressures and demands. As a consequence there has been a movement away from the traditional employment relationship and toward the more appropriate and relevant modern day contractor relationship for large portions of the work force.

This movement has created tensions with various parties, including the Australian Tax Office (over loss of PAYG revenue and the responsibility for the payment of superannuation levies and resulted in the introduction of the personal services income (PSI) rules) the State Government (over loss of Pay-Roll tax) and the unions (over the loss of their potential member base and revenue).

To determine whether a person is an independent contractor or a employee is critical for various reasons including issues touching on:

- the Income Tax Assessment Act.
- the Superannuation Guarantee (Administration) Act.
- the Fringe Benefits Assessment Act.
- the Pay-Roll Tax Act.
- workers compensation.
- general insurance and liability considerations.
- traditional employee rights and protections (such as leave and award entitlements).
- industrial relations matters including termination rights and protections.

In determining whether a person is an independent contractor or an employee it must be recognised that there is a continuum of work relationships existing from traditional employee through to independent contractor. Modern work practices have given rise to relationships that do not clearly reflect the traditional distinction. In such cases the **totality of the work relationship** must be considered to classify the true nature of the relationship. The courts have clearly recognised in a variety of circumstances that if the true nature of a relationship is as employer/employee, the law will recognise this, notwithstanding any other description adopted by the parties. This has obvious ramifications for the business owner who, in reliance on the classification of a relationship as that of a “contractor”, is unlikely to have complied with the taxation, workers compensation, occupational health and safety, and other obligations of an employer.

Although it will not resolve all questions arising in relation to the classification of a given relationship, a well-drafted agreement can be critical as it can point to a particular desired result and enable the business owner to consider the true form of the relationship before it is entered. Accordingly, if the relationship of independent contractor is sought to be established a well drafted agreement can improve the likelihood of the relationship being confirmed rather than that of a traditional employment relationship.

Clearly, it is more desirable to ensure that a given relationship is truly one of independent contractor rather than one of employment if that is the end that is sought. To ensure this is the case the following interrelated considerations should be taken into account:

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1. The nature of the relationship should be determined when the contract is first entered into rather than subsequently (unless, of course, subsequent conduct suggests that the contract was not really what was intended). The proper drafting of the contract at the outset is of paramount importance. However, it should be noted that the true nature of the relationship cannot be altered by putting a different label to it. Further, the nature of the relationship is determined by considering the totality of the relationship.
2. Preferably the contract should be between the business owner and the contractor's business name or if a company vehicle is used then the company ("contractor entity"). The contractor entity should provide an ABN, be registered for GST (unless the earnings are less than the threshold) and provide tax invoices.

In this regard, however, the personal services income (PSI) rules as well as the anti avoidance provisions (Part IVA) of the Tax Act may impact on the arrangement if its sole purpose is accumulation of earnings in the contractor entity at the lower corporate tax rate.

3. The contract should clearly specify the task to be performed but not how it is to be undertaken. A primary indicia of the classification of employee is the employer's ability to direct the manner in which the task is performed.

The contract should expressly negate the right of the business owner to control the contractor entity. The contract should preserve as much discretion as possible as to the performance of the duties to the contractor entity.

The contract should also:

- (a) preserve the contractor entity's right to refuse a task that the entity feels might impair its objectivity, independence or integrity;
 - (b) reserve the contractor entity's right to withdraw if conditions beyond its control develop to interfere with the successful conduct of the engagement; and
 - (c) reserve the contractor entity's right to perform work for others.
4. It follows that the contractor entity may engage any person to perform any of the work that is necessary to fulfil the conditions of the contract.

However, for commercial reasons, that right may be limited to employing persons approved of by the business owner. Alternatively, the contract could contain an undertaking by the contractor entity that only persons suitably qualified by knowledge, experience and character will be assigned to the particular engagement.

The contract should be so expressed as to make it clear that it is for production of a particular result rather than for labour/work.

Engagement of a professional who traditionally works on the basis of an hourly rate requires special consideration. To address this consideration it may be possible for the contract to isolate payments that are not for hours worked as such. For example, an amount may be paid as a retainer, or for non-competition or non-disclosure of trade secrets, and the like.

5. It is preferable that expenses of performing the task be borne by the contractor entity. Expenses can be included as an identifiable part of the price for the job or may be specified generally. For example, a transport company may pay a contractor entity both a running rate per kilometre in addition to the parcel rate, in order to compensate for the expenses associated with operating the contractor entity's vehicles.

6. While, for commercial purposes, expenses incurred in a task will be built into the price paid, that rate is based on an average of expected expenses and, so, still leaves scope for expenses to be greater than the average - therefore leaving some element of risk with the contractor entity. It does not matter that in accepting that risk the contractor entity benefits from the ability to attract a bulk discount due to the contractor entity's buying power. Another alternative is to allocate payments by the business owner to the purchase of any necessary equipment that may be required to be used by the contractor entity in the engagement - and to then lease back that equipment to the contractor entity.
7. The contract should avoid the "language of employment". The language should refer to the engagement rather than employment and to performance standards rather than conditions of employment and the like.

The contract should also minimise the number of standards and criteria that impinge on the manner in which the contract duties are to be performed. For example, it is preferable that the contract merely state that the contractor entity will endeavour to dress and conduct its personnel in a manner consistent with the standards expected by the business owner.

Where the commercial circumstances are such that it is necessary to specify some uniformity in the conduct of the duties required under contract, it may be worth considering the inclusion in the contract of a clause acknowledging that the contractor entity undertakes to have its personnel supervised by the business owner for its own economic advantage.

8. The contract should not provide for annual leave or sick leave or any other conditions that are common to employment situations.

Finally, it should be appreciated that there is usually a relatively long lead time before a given relationship is put to the test. The trigger may be a complaint by a disgruntled former contractor or employee, a union audit or a Tax Office audit or the like where the consequences and repercussions of an incorrectly classified relationship can have significant financial repercussions.

This broad summary has been provided for your general information. Clearly there are many more issues that may be relevant to your individual circumstances. Should you require any particular advice please do not hesitate to contact any member of the Business Team at The Argyle Partnership on (02) 8263 6600.