

Contractor or Employee

This document is intended to raise an area of possible concern for discussion and to provide information about workers engaged as contractors but should be engaged as employees.

To remain compliant with PAYG Withholding, Payroll Tax, Workers' Compensation and Superannuation Guarantee (SG) legislation, an employer must check that an independent contractor (or subcontractor) is in fact a contractor and not an employee for tax and super purposes.

The essential difference between an employee and a contractor:

- An employee works in your business and is part of your business, they provide a 'contract of service'.
- A contractor is running their own business and providing a contract for service.

If a business tells the worker that they are an independent contractor when they know (or are reckless as to whether) the worker is an employee, then they may be in, what the Australian Taxation Office (ATO) refers to as, a 'sham contracting arrangement'.

Penalties for sham contracting can be imposed by the courts. The maximum penalty, per contravention, is \$13,320 for individuals and \$66,600 for corporations.

Penalties that apply if it is determined that the business has not been complying with relevant legislation and have not engaged workers on the correct basis include:

- **For PAYG not withheld:** The ATO will impose a penalty equal to the amount that should have been withheld.
- **For Workcover not paid:** Additional premiums plus penalties and interest.
- **For SG not paid:** The full amount of superannuation plus penalties and interest. No tax deduction is allowed for superannuation paid late.
- **For Payroll Tax not paid:** Unpaid tax, interest and penalties.
- **Fair Work:** Potential reinstatement of leave, allowances and other entitlements plus penalties.

Key Factors for Independent Contractor

These factors, taken together, will determine whether a worker is an employee or contractor for tax and super purposes:

- **Ability to Delegate:** The worker can subcontract or delegate the work. The agreement gives the worker/contractor the right to pay another person to do the work instead of them.
- **Basis of payment:** The worker is paid for a result achieved based on a quote or agreement. (A quote can be calculated using hourly rates or price per item to work out the cost of the work.)
- **Equipment, Tools, and other Assets:** The worker provides all or most of the equipment, tools and other assets required to complete the work, and does not receive an allowance or reimbursement for the cost of this equipment, tools and other assets.
- **Commercial risks:** The worker is legally responsible for their work and liable for the cost of rectifying any defect in their work.
- **Control over the work:** The worker has freedom in the way the work is done, subject to the specific terms in any contract or agreement.
- **Independence:** The worker is operating their own business independently of the business they're contracting to. The worker performs services as specified in their contract or agreement and is free to accept or refuse additional work.

There is no single or overriding deciding factor that covers all the requirements a business has in meeting their obligations regarding workers and how they are classified for different agencies and different legal obligations. Each worker's situation must be assessed individually.

Recommendations

- Review the nature of the work being done and the relationship of *each* worker in the light of the key factors stated above, and the [ATO Employee/contractor decision tool](#).
- If workers need to be re-classified as employees, re-negotiate terms and remuneration. Converting to a casual employee may be appropriate.