

Determining employee/contractor status for Superannuation Guarantee purposes

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With the economic downturn clearly influencing employment (or unemployment), many employers may be weighing the question of whether to hire an employee or to engage a contractor. Therefore, it is timely to review the classifications of “employees” and “contractors”, as both have different outcomes for superannuation guarantee purposes. More relevantly, independent contractors are broadly excluded for superannuation guarantee purposes. This issue has long been the subject of considerable debate by the courts and tribunal and was the subject of a recent AAT hearing in *AAT Case [2009] AATA 482, Re Griffiths & Ors and FCT (Griffith's case)*.

The case

In *Griffith's case*, the Tribunal upheld superannuation guarantee charge (SGC) default assessments against a printing partnership for failing to make minimum superannuation guarantee contributions in respect of an individual operating within the taxpayer's business.

After examining the indicators of an employer-employee relationship, the Tribunal held that the relevant individual was clearly an “employee” of the partnership according to ordinary concepts. In rejecting the taxpayer's contention that the individual was an independent contractor, the Tribunal said he was an “employee” in any event under s 12(3) of the *Superannuation Guarantee (Administration) Act 1992* (SGAA) as it found he was clearly remunerated either wholly or principally for his personal labour.

The Tribunal also rejected the taxpayer's argument that the individual had agreed that he would not be paid superannuation as a term of his engagement. In this respect, the Tribunal noted that parties cannot “contract out” of their obligations under the SGAA. Furthermore, the Tribunal upheld the Commissioner's decision to only partially remit to 15% the additional SGC assessments under s 59 of the SGAA for failing to lodge SG statements for the respective years.

Who is an employee?

The definition of an “employee” for superannuation guarantee purposes is contained in s 12 of the SGAA. The term is defined by its ordinary meaning (see section 12(1)) and sections 12(2) to 12(10) extend the meaning of an employee to include:

- members of executive bodies of bodies corporate (eg directors of companies);
- individuals who work under a contract that is wholly or principally for the labour of the relevant individual;
- members of Federal Parliament;
- members of state and territory Parliaments;
- individuals who are paid to:
 - perform or present, or to participate in the performance or presentation of, any music, play, dance, entertainment, sport, display or promotional activity or any similar activity involving the exercise of intellectual, artistic, musical, physical or other personal skills;
 - provide services in connection with an activity referred to in the above point;
 - perform services in, or in connection with, the making of any film, tape or disc or of any television or radio broadcast;
- individuals who are employed by the Commonwealth, state or territory; and
- members of an eligible local governing body.

However, individuals who are paid to do work wholly or principally of a domestic or private nature for not more than 30 hours per week are not regarded as employees in relation to that work.

Commissioner's views

In Superannuation Guarantee Ruling SGR 2005/1, the Commissioner explains when an individual is considered to be an “employee” under s 12 of the SGAA. In addition, the

Commissioner discusses the various indicators the courts have considered in establishing whether an individual is an employee within the common law meaning of the term.

The Ruling states that whether an individual is an employee of another is a question of fact which is determined by examining the terms and circumstances of the relevant contract having regard to the key indicators expressed by case law. It also states that one indicator is *not* determinative but rather the totality of the relationship between the parties must be considered.

According to the Ruling, if an individual performs work for another party through an entity (eg a company or a trust), an employer-employee relationship between the individual and the other party for superannuation guarantee purposes does not arise either at common law or under the extended definition of employee.

Chalk and cheese

It is well-known that a relationship between an employer and employee is a contractual one, that is commonly referred to as a “contract of service”. In contrast, a principal-independent contractor relationship is a “contract for services”. In the Commissioner’s view, an independent contractor is contracted to achieve a result. Conversely, an employee is contracted to provide his/her labour which enables the employer to achieve a result.

The Ruling states that, in determining whether a contract of service exists, it is important to consider the relevant facts and circumstances of the contract. It also states that no single indicator is determinative of the contractual relationship but rather the totality of the relationship must be considered to determine whether an individual is an employee or independent contractor.

In SGR 2005/1, the Tax Office also states that the first step to determine the true nature of a contract is to examine the way in which the contract was formed. In the Commissioner’s view, the terms and conditions of the contract, in light of the circumstances surrounding the formation of the contract, will always be of considerable importance to the proper characterisation of the relationship between the parties. However, it is important to realise that the classification of an individual as an employee or independent contractor is based on the economic substance of the contract and not the legal terms ascribed in the contract.

Who’s in control?

The classic test regarding whether or not an employment relationship exists is the “control test”. Simply put, an employee is one who is under an obligation to obey the orders of his/her employer regarding the manner of the performance of a task. In recognition of a highly skilled workforce, the Commissioner says that the importance of control lies not so much in its actual exercise but rather an employer’s retention of a prerogative to direct the employee. Some indications of the control test include where the employer has a right to:

- control the employee’s activities during work hours;
- restrain the employee from working for others and engaging in other activities;
- set dress standards, behaviour standards and control other aspects of behaviour;
- control the hours of work, work allocated and performance standards; and
- remunerate the persons at an agreed level and not in respect of profits gained.

In SGR 2005/1, the Commissioner notes that it is not uncommon for contracts for services to specify a high degree of direction and control. So while the existence of control is significant, it is not the sole criterion by which to gauge whether an employee-employer relationship exists. Rather, the control test is one among a number of factors which must be considered when ascertaining whether a contract of service exists.

Working towards a common goal

Another test which may be applied is the “integration test”. Broadly, this test draws a distinction between individuals whose work is part of the core business of an entity and those whose services are engaged by the entity to perform peripheral functions. The integration test is likely to be satisfied if:

- the relationship between the worker and the employer is a continuing one;
- the worker's activities are effectively restricted to providing services to only one employer; and/or
- the worker does not generally profit commercially from the relationship.

The holistic approach

Following the High Court's decision in *Stevens v Brodribb Sawmilling Pty Ltd* (1986) 160 CLR 16, the courts have applied a "multiple indicia test". This test adopts an holistic view when determining whether or not an employee-employer relationship exists. That is, all factors in a particular circumstance are considered together to ascertain if it is more appropriate to treat an individual as an "employee" than as an "independent contractor".

These factors can include:

- the right to suspend or dismiss the individual engaged;
- the mode of remuneration;
- the provision for benefits such as annual and sick leave;
- the requirement for the individual to wear a company uniform;
- the deduction of income tax; and
- the provision and maintenance of equipment.

The murky waters of contracting

It is important to note that an individual can be deemed to be an employee for superannuation guarantee purposes, even where a contract of service does not exist. This is because s 12(3) of the SGAA prescribes that if the individual works under a contract that is wholly or principally for his/her labour, he/she is an employee of the other party of the contract. Simply put, this section must be considered where there is no common law employment relationship or where there is doubt as to the common law status of the individual: see *AATA Case [2002] AATA 218, Re Brinkley and FCT* (2002) 49 ATR 1178.

In SGR 2005/1, the Commissioner states that a contract is a contract for an individual's labour if the work must be done by that particular individual. If the contract is with a company, a partnership or a trust, the contract will not be a contract for the labour of an individual. However, the individual doing the work may be an employee of the company, trust or partnership.

If the contract leaves the individual completely free to delegate or subcontract the work then the contract is not a contract for the labour of a particular individual. The Commissioner considered that an individual would satisfy the requirements of s 12(3) of the SGAA if the contract was "principally" for the individual's labour.

The term "principally" takes on its ordinary meaning, that is, "chiefly" or "mainly". In *DCT v Bolwell* (1967) 1 ATR 862, the Court interpreted the term "labour" to include mental and artistic effort as well as physical toil of an individual.

The phrase "wholly or principally for the labour of" was examined by the NSW Court of Appeal in *World Book (Australia) Pty Ltd v FCT* (1992) 23 ATR 412. The decision of the Court was incorporated in SGR 2005/1 where the Tax Office states that "a person who has 'a right to delegate work' (whether or not that right is exercised) does not work under a contract wholly or principally for his or her labour and that a contract for labour must be distinguished from a 'contract to produce a given result'".

In SGR 2005/1, the Tax Office sets out 3 criteria which it considers are indicative of whether a contract which does not give rise to a common law relationship can be considered a contract wholly or principally for labour once the conduct of the parties has been assessed. These criteria are:

- the individual is remunerated (wholly or principally) for their personal labour and skills;

- the individual must perform the contractual work personally (there is no right of delegation);
and
- the individual is not paid to achieve a result.

In a nutshell

The classification of whether an individual is an “employee” or a “contractor” for superannuation guarantee purposes requires a consideration of all facts surrounding the particular circumstance. No one indicator is conclusive. But rather, each indicator must be weighed against the totality of the circumstance.

Furthermore, it is important to note that the Personal Services Income regime contained in Pt 2-42 of the ITAA 1997 is not determinative of whether an individual is an employee for superannuation guarantee purposes because of the operation of s 84-10 of the ITAA 1997.

*By Eugene Ng, BA PGCertBAdmin MAcc MTax MIntTax CPA
Tax Writer, Thomson Reuters
Tel: (02) 8587 7622
Email: eugene.ng@thomsonreuters.com*