CONTRACTOR OR EMPLOYEE – WHAT’S THE DIFFERENCE?

An employee works in the business and is integral to that business. They have certain rights and entitlements under the Fair Work Act 2009. Their employer provides equipment, withholds tax and pays superannuation guarantee.

A contractor is actively running their own business. They have responsibility for their own equipment, insurance, relevant licenses and tax. Superannuation is dependent on the nature of the work relationship and may or may not be paid by the business that engages them.

There is no dominant factor that covers all the requirements a business has in meeting their obligations with regard to workers and how they are classified for different agencies and different legal obligations.

Each decision is based on the totality of the worker and business relationship and arrangement.

There are no rules as to the weighting given to each factor in the decision process. The main question is about whether the worker is acting for another or on their own behalf.

Is the worker an entrepreneur who operates their own business? In performing the work, is the person working in and for their own business or are they representing the other business? These are important factors but not the only considerations.

Fair Work Ombudsman Key Tests for Employee or Contractor

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| Test | Employee | Contractor |
| Degree of control over how work is performed | Performs work, under the direction and control of their employer, on an ongoing basis. | Has a high level of control in how the work is done. |
| Hours of work | Generally works standard or set hours (note: a casual employee's hours may vary from week to week). | Under agreement, decides what hours to work to complete the specific task. |
| Expectation of work | Usually has an ongoing expectation of work (note: some employees may be engaged for a specific task or specific period). | Usually engaged for a specific task or result. |
| Risk | Bears no financial risk (this is the responsibility of their employer). | Bears the risk for making a profit or loss on each task. Usually bears responsibility and liability for poor work or injury sustained while performing the task. Contractors generally have their own insurance policy. |
| Superannuation | Entitled to have superannuation contributions paid into a nominated superannuation fund by their employer. | Pays their own superannuation (note: in some circumstances independent contractors may be entitled to be paid superannuation contributions). |
| Tools and equipment | Tools and equipment are generally provided by the employer, or a tool allowance is provided. | Uses their own tools and equipment (note: alternative arrangements may be made within a contract for services). |
| Tax | Has income tax deducted by their employer. | Pays their own tax and GST to the Australian Taxation Office. |
| Method of payment | Paid regularly (for example, weekly/fortnightly/monthly) according to award or Fair Work Act provisions. | Has obtained an ABN and submits an invoice for work completed or is paid at the end of the contract or project. |
| Leave | Entitled to receive paid leave (for example, annual leave, personal/carers' leave, long service leave) or receive a loading in lieu of leave entitlements in the case of casual employees. | Does not receive paid leave. |

ATO Employee or Contractor Decision Tool

Use this tool to decide whether a worker is an employee or contractor for tax and super purposes.

“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”.

The tool generates a report that the business owner can keep for their records and rely on.

[ATO – Employee or contractor](https://www.ato.gov.au/business/employee-or-contractor/)

[ATO – Employee/contractor decision tool](https://www.ato.gov.au/Calculators-and-tools/Host/?anchor=ECDTSGET&anchor=ECDTSGET#ECDTSGET)

ATO Key Tests for Employee or Contractor

* Ability to subcontract or delegate
* Basis of payment
* Equipment, tools and other assets
* Commercial risks
* Control over the work
* Independence

BUSINESS OWNER RESPONSIBILITIES

Many business owners and contractors are under the impression that the contractor can decide whether they will be engaged as a contractor or employee. This is not correct—it is an *employer responsibility* to get this right. It is up to the business owner to consider the nature of the work engagement and the many factors involved in discerning whether the worker should be an employee or contractor. The business owner must then monitor the work arrangement and negotiate a different agreement if the work relationship becomes something more like ongoing employment rather than a contract.

From the Fair Work Commission: “the distinction between an employee and an independent contractor is rooted fundamentally in the difference between a person who serves his employer in the employer’s business, and a person who carries on a trade or business of their own”.

**The business owner must attend to many factors:**

* the nature of the work
* responsibility and risk
* informing the worker of the nature of the engagement
* documentation – contractor agreement or employment agreement
* review – employment relationships are not static but can and often do change over time
* employers need to continually monitor the status of their workers to make sure they are meeting their legal obligations as an employer
* ABN – check for active ABN and GST registration status
* valid tax invoices
* voluntary withholding agreement if required
* no ABN withholding of 47% and EOFY payment summary if relevant.

It’s all about the *sole trader*. If a company is invoicing the business this is generally considered minimal risk from an ATO and FWO perspective. The uncertainties occur when looking at a sole trader contractor and whether they should really be engaged as an employee—casual, part-time or full-time.

Business owners should assess contractors every six months to decide whether they should still be considered a contractor or if they should be engaged as an employee.

PAYGW, Superannuation, Entitlements, Payroll Tax and Workers Compensation Insurance

Once a business has confirmed workers as independent contractors there are a number of things to take care of.

* The ATO is concerned with taxation and superannuation for workers, both employees and contractors.
* The FWO is concerned with the rights and entitlements of workers and ensuring employers comply with workplace laws and modern award provisions.
* State revenue offices are concerned with payroll tax and when contractors should be included or excluded for calculating tax.
* State workers compensation schemes are concerned with when a contractor should be included in rateable remuneration for insuring relevant workers and calculating insurance premiums.

Each of these government entities have slightly different requirements regarding the definition of a contractor and inclusions/exclusions.

BOOKKEEPER BAS AGENT RESPONSIBILITIES

Whilst it is the business owner’s obligation to define the work relationship correctly, often it is the bookkeeper who is in a position to raise issues around the nature of the working relationship. Many business owners are not aware of the factors involved in deciding whether a worker is an employee or contractor and the bookkeeper can provide reliable information to the business owner.

A BAS agent may process superannuation, include voluntary withholding or no ABN withholding on the BAS, complete the workcover rateable remuneration and complete the payroll tax declarations. A bookkeeper may complete workcover and payroll tax processes under guidance from the business owner but may not advise or ascertain superannuation liability or amounts reportable on activity statements.

* Advise the business owner of the factors involved in the employee or contractor decision.
* Advise them of their responsibilities in relation to PAYGW, superannuation, payroll tax and workers compensation insurance.
* Advise them of potential penalties if they ignore the information.
* Advise them about the ATO employee/contractor decision tool.
* Discuss relevant factors but also put general advice in writing and supply links from the ATO, FWO, state payroll tax and workers compensation insurance.
* If the business owner wants you to advise them of the worker status, let them know it is their legal responsibility, not something you can ascertain for them. Provide the information and if they are still unsure, they may need advice from the FWO or an employment law specialist.
* Create relevant contractor groups in your software to make tracking and reporting efficient.
* Check your software for how best to track and enter contractor superannuation and voluntary withholding.

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| Bookkeeper Checklist  | Check |
| Provide ATO information on tests for employee or contractor | **[ ]**  |
| Provide ATO information on superannuation for contractors | **[ ]**  |
| Provide FWO information on tests for employee or contractor | **[ ]**  |
| Provide state payroll tax information for contractors included and excluded in calculations | **[ ]**  |
| Provide state workers compensation insurance for contractors included and excluded in rateable remuneration | **[ ]**  |
| Create groups in software to track contractors for voluntary withholding, superannuation, workers compensation and payroll tax | **[ ]**  |
| Check payroll software for how to track and enter superannuation for contractors | **[ ]**  |
| Check payroll software for how to track no ABN withholding  | **[ ]**  |
| Check payroll software for how to track no voluntary withholding  | **[ ]**  |
| Provide payment summaries or Single Touch Payroll finalisation for contractors with VWH or no ABN withholding at EOFY | **[ ]**  |