



The contractor versus employee debate

A tax perspective

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Recent decisions by the High Court of Australia confirm that written contracts are the starting point when deciding if someone is an employee or a contractor. While the substance of the work should align with the contract, the terms of the contract take precedence over the conduct of the parties in determining this.

Getting worker classification wrong can lead to unpaid tax, superannuation, payroll tax or workers compensation, and the Australian Taxation Office (ATO) and state and territory regulators may apply heavy penalties.

Worker obligations are not the same everywhere. Payroll tax and workers compensation rules can vary, so it is important to check what applies in your state.

When engaging workers, businesses are responsible for ensuring that they comply with the relevant laws and obligations, including employment taxes. Failure to do so can result in significant financial and legal consequences, such as fines, lawsuits, and reputational impact to the business.

With an increased level of activity by state and federal revenue authorities, coupled with recent changes in the courts' views, the spotlight has never been brighter on worker classification and associated obligations.

We are aware that revenue authorities have data sharing arrangements and are able to analyse vast amounts of data from varying sources to identify potential risks. In such an environment, it is crucial that businesses understand the risks, as non-compliance can create uncommercial outcomes and, if not detected in time, can be costly to rectify.

Employee or contractor?

Two recent High Court decisions¹ held that the terms of a contract should take precedence over the subsequent conduct of the parties when distinguishing whether a worker should be considered an employee or an independent contractor.

These decisions confirm that in the first instance, the nature of the relationship is determined by the legal rights set out in a written contract between the parties. If there is a valid written contract between the parties which is not considered a sham or otherwise legally ineffective, the courts have stated that there is no need to look beyond the contract in order to determine the nature of the relationship.

From this, the ATO released Taxation Ruling 2023/4 *Income tax and superannuation guarantee: who is an employee?*² and Practice Compliance Guideline 2023/2 *Classifying workers as employees or independent contractors—ATO compliance approach* to provide guidance on the poten-

tial tax obligations for businesses engaging contractors. A non-exhaustive list of indicia is shown in Table 1.

Table 1. Determining if a worker is an employee or contractor

Indicia	Comment
Control	Control is a key indicator of employment, but also whether the principal actually exercises such control.
Hourly remuneration	While not necessarily a strong indicator (in its own right) of an employer-employee relationship, the ATO Commissioner still errs on viewing an hourly remuneration structure as more akin to an employer-employee relationship.
Ability to subcontract/delegate	The ability to subcontract and delegate is generally inconsistent with an employer-employee relationship.
Results contract	When the substance of a contract focuses on achieving a specified result, it strongly (though not conclusively) indicates a contract for services and not an employer-employee relationship.
Provision of tools and equipment	The provision of assets, equipment and tools by a worker, along with the incurring of expenses, can indicate that the worker is an independent contractor.

What are the tax considerations?

Broadly, if the worker is considered an employee, the employer is responsible for meeting pay-as-you-go withholding (PAYG-W), superannuation guarantee (SG), fringe benefits tax (FBT), payroll tax and workers compensation insurance. If a worker is engaged via a company, trust or partnership (provided it is not a sham arrangement), they cannot be considered an employee, for the purposes of PAYG-W, SG and FBT.

However, such workers can still be considered as deemed employees for the purposes of SG, payroll tax and workers compensation.

A high-level summary of the obligations, depending on the worker's classification, is shown in Table 2.

PAYG-W

PAYG-W obligations should only arise on payments to contractors if they do not provide a valid ABN or there is a voluntary agreement between the contractor and the principal engaging them.

Importantly, if a business fails to comply with any PAYG-W and reporting requirements, the payments made to a contractor could be treated as non-deductible for income tax purposes. Director penalties may be imposed in certain circumstances.

Table 2. Employers' tax and superannuation obligations: Independent contractors and employees

Worker classification	PAYG-W	FBT	SG	Payroll tax	Workers compensation
Independent contractor	Applies where a valid Australian business number (ABN) is not provided.	Does not apply.	May apply where the contractor is an individual or sole trader.	May apply in all states and territories, except for Western Australia.	May apply, dependent on the state or territory.
Employee			Applies in all instances		

SG

While SG obligations should not arise where the contractor engages through a company, trust or partnership (in most cases), they may apply where a contractor (individual or sole trader) is engaged wholly or principally for their own labour and:

- is remunerated for their personal skills
- must perform the work personally and have no right to delegate
- is paid by reference to time (e.g. hourly, daily rate) rather than for a specified result.

There are specific SG rules that apply to contracted performers and entertainers which should be considered separately to these points.

Where SG obligations are not met, the payer is liable for the superannuation guarantee charge (SGC) to correct non-compliance, and must self-report to the ATO. The SGC is currently not deductible, and further penalties of up to 200% of the SGC amount and director penalties can be imposed in certain circumstances.

With the anticipated introduction of Payday Super from 1 July 2026, employers should regularly review their obligations for future changes in the application of the SGC regime.

Payroll tax

The relevant contract provisions are mostly harmonised in all Australian states and territories except for Western Australia. The exemptions set out below are applicable in all states and territories except for Western Australia.

Common exemptions

Payments to a contractor are subject to payroll tax, unless at least one of the following common exemptions applies:

- Services are provided on no more than 90 days in a financial year.
- The contractor engages other persons to help perform the services.
- The provision of labour under the contract is ancillary to the supply of materials or equipment.
- The services are not ordinarily required by the business, and the contractor provides the same services to other independent clients.
- The services are of a type required by the business for less than 180 days in a financial year.
- The contractor renders the same services to other clients in the same financial year.



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Workers compensation

Contractor provisions in relation to workers compensation vary across the states and territories. In many states and territories, the contractor provisions rely on common law principles.

However, payments to a contractor in Victoria should be rateable wages for workers compensation purposes where the following criteria are met:

- The contract is mainly for labour (i.e. greater than 50% for the contract value is for labour)
- At least 80% of the work is performed by the same individual, and
- At least 80% of the contractor's gross income (from the provision of similar services) is earned from the employer in question. **FS**

Notes

1. *Construction, Forestry, Maritime, Mining and Energy Union v Personnel Contracting Pty Ltd* [2022] HCA 1; *ZG Operations Australia Pty Ltd v Jamsek* [2022] HCA 2.