Contractors V Employees – Avoiding the Tax and Super Pitfalls 08/02/2024

CCH Learning:

Hi everyone. Welcome to today's webinar regarding Contractors versus Employees - Avoiding the Tax and Super Pitfalls. I'm Alison Wood from CCH Learning Wolter Kluwer and I'll be your moderator for today.

Just a few quick pointers before we get started. If you're having sound problems, and even if you can't hear that, hopefully you can see on the screen here, you can jump into the audio panel and toggle between phone call and audio and that will quite often fix your problem. And if you're looking for your PowerPoint, it's just saved here in the handout section. And shortly after the session today, we will send you an email letting you know when the recording is ready.

You can ask questions at any point during the session today, simply type them in the questions box. I will collate those questions and ask them at the Q&A at the end of today's session.

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Your presenter today is Mark Chapman, who is the director of Tax Communications for H&R Block Australia. Mark has over 25 years experience as a tax professional in both the UK and Australia, specialising in tax for small businesses and individuals. He is a member of the Institute of Chartered Accountants in England and Wales, the Chartered Institute of Taxation, and is a fellow of CPA Australia. I will now pass you over to Mark to commence today's presentation.

Mark Chapman:

Thanks, Alison, and thank you to everybody for coming along to today's session. This is a very topical issue because obviously there have been some significant court cases recently and they've been followed up by some quite chunky ATO activity in terms of a new ruling and a new professional and a newer practical compliance guideline, which came out towards the backend of last year. So we've got a lot to cover.

Basically, what I'm going to be talking about over the next hour is on the slide there, so the impact of structuring on PAYG(W), FBT and super guarantee liabilities. I'll be talking about the impact of those recent court cases. I'll be talking about that new ATO guidance. I'll be talking about why avoiding PAYG(W) doesn't necessarily mean that an employer also avoids super guarantee liabilities because obviously there's a different definition of employer for superannuation purposes. I'll be looking at the compliance and documentation that you need to avoid an ATO challenge, and I'll talk about the costs and penalties of getting it wrong.

So why does it matter? Well, it matters because the tax obligations that a hiring business faces for the two different types of worker are actually completely different, and the burden of getting the decision right rests with the hiring business. So it doesn't rest with the worker, it rests with the hiring business.

Now, if a worker is an employee, the hiring business needs to first of all withhold tax through the PAYG withholding system and report and pay the withheld amounts to the ATO. The business also needs to pay superannuation, at least quarterly, and it needs to report and pay fringe benefits tax obviously if the worker actually receives fringe benefits.

By contrast, if the worker is a contractor, a genuine contractor, they generally look after their own tax obligations. So there's no need to withhold tax from payments to them unless they don't quote their ABN to the hiring business. In addition, there's no requirement to pay superannuation on their behalf. But I'll heavily caveat that statement by just saying that they will still have to pay super for individual contractors if the contract is principally for their labour. So I'll talk about that towards the end of the presentation. And obviously if the worker is a contractor, there are no FBT obligations.

So the consequences of getting the decision wrong, which typically means treating somebody as a contractor when they're really, in substance, an employee includes some pretty punitive penalties and charges. In terms of PAYG withholding, there's a penalty for failing to account for tax from worker payments, which is equal to the amount that should have been withheld or paid. In addition, company directors actually have legal responsibility for ensuring that their company fulfils its PAYG withholding obligations and therefore if that doesn't happen by the due date, the director or directors automatically becomes personally liable for a penalty equivalent to the unpaid amount.

In relation to super guarantee, if anything, the penalties are even worse. So there's a super guarantee charge made up of 200% of super guarantee shortfall amounts plus the original amount. There's an interest charge of 10% per annum and there's an administration fee of $20 per employee per quarter.

Now if you look at that in the round, if you've got somebody, if you've got a business which hasn't accounted for PAYG and superannuation in relation to a contractor who is really an employee, that could work out to be very, very expensive, not just for the hiring business but also potentially for the director. So this really isn't a position that any company or any business wants to find itself in.

In addition, the Fair Work Act prohibits sham contracting arrangements where an employer treats a worker as an independent contractor in an attempt to avoid meeting their employee entitlements. So for the purposes of the Fair Work Act, those employee entitlements can include such things as sick leave, annual leave, work cover, minimum rates of pay, compensation for unfair dismissal. And in addition, there are a whole myriad of payroll tax issues which need to be considered as well.

In addition, the worker individually will need to consider their GST obligations. So if they are genuinely a contractor and they are earning a turnover in excess of $75,000, then they do need to potentially register and pay GST. And the personal services income rules will also be relevant. I'm not going to go into those in this session, but they are specifically designed to put individual contractors who are basically providing an employee-like service to a hiring business back in the position that they would've been in in if they'd been employees.

Now, if the worker is treated as an employee of the engaging entity, then the consequences that arise for both the engaging entity and the worker are set out on this slide. So the consequences for the engaging entity, so the hiring business, is they need to report any wages or salary via Single Touch Payroll. They need to withhold amounts under the PAYG(W) regime. They need to make superannuation contributions or be liable for the superannuation guarantee charge, they need to meet fringe benefits tax obligations for benefits provided, and they're not entitled to claim input tax credits for wages paid.

And the consequences for the worker of being an employee, well, they're not entitled to an ABN in relation to that employment. They might be entitled to an ABN in relation to some other activity elsewhere in the economy, but not in relation to that employment, and they're not entitled to register for goods and services tax and they don't have any GST reporting obligations in relation to that employment.

By contrast, if the worker is treated as a genuine independent contractor, then once again, there are consequences for the engaging entity and some consequences for the worker, and they're set out on this slide. So in terms of the engaging entity, there's a necessity to report via the Taxable Payments Annual Reporting System as legislated or on a voluntary basis, if they satisfy the turnover-threshold test.

If the worker satisfies the extended definition of employee, I'll come to that towards the end of the presentation, they need to make superannuation contributions or be liable for the superannuation guarantee charge. If the engaging entity and the worker are both registered for GST, they can claim eligible input tax credits. And if the worker doesn't quote an ABN when they're required or the parties enter into a voluntary agreement, they do need to withhold amounts under the PAYG withholding regime. But that strictly only applies where the worker doesn't quote an ABN. And the consequences for the worker, well, they need to make provision for their own income tax through PAYG instalments, if necessary, they're entitled to apply for an ABN, they need to register for and pay GST, if required, and obviously those personal services implications do need to be considered.

So we've talked about the consequences of getting the decision wrong. So what sort of factors do we need to take into account in order to actually come to a conclusion about whether somebody is an employee or a contractor? Well, the ATO can argue that there's actually a deemed employer-employee relationship if the relationship indicates it is essentially employee-like.

Now, the difficulty is that there isn't actually any definition of the term employee in any tax legislation, and therefore we need to go back to common law. We need to look at the results of various tax cases going back through the years in order to understand exactly what the common law definition of an employee is, and that is the one that's used for PAYG withholding purposes.

Now, traditionally, the courts have tended to apply what we call the multifactorial approach to work out the distinction between employees and contractors, which basically consisted of a wide-ranging review of all aspects of the work arrangement, whether they were reflected in the contract or not. So relevant factors both before, during, and after the time the contract was entered into were considered including, for example, the mode of remuneration. If somebody is receiving an hourly rate for their work, that is an indication that somebody is an employee. The right of a person to delegate work to others. So if there is no right to delegate, that's generally taken to be an indication of employment. Whereas if there is a right, that's generally taken to be an indication that there's a contractor relationship. And also things like representation as part of the payer's business, that can be something like wearing a uniform with the business's logo. That could be indicative of an employee relationship.

So basically, the traditional approach was to look at all of the circumstances surrounding the relationship between the worker and the hiring business, of which the contract was one, but it certainly wasn't exclusively focused on the contract. However, just recently there've been a series of court cases such as the Personnel Contracting case and also the Jamsek case, of which I've emphasised that the contract between the business and its workers is the most important element.

Now, the Personnel Contracting case dealt with a labour hire company which engaged workers to supply labour to building industry clients. Now, in 2016, the Personnel Contracting engaged the services of a Mr. McCourt and offered him work at a building site operated by Hanssen Pty. Ltd. which was one of Personnel Contracting's major clients.

So Mr. McCourt commenced basic labouring work on site with Hanssen without actually signing a contract, but under its direct supervision. And then he subsequently ceased working with Personnel Contracting and Hanssen on 30th of June 2017. So Mr. McCourt and his trade union, which was the CFMMEU, commenced proceedings subsequently against Personnel Contracting for compensation penalties under the Fair Work Act, claiming that he was a common law employee of Personnel Contracting who hadn't paid him in accordance with industry entitlements.

Now, ultimately this case ended up before the High Court, which said that the court role was to characterise the relationship by examining the totality of this relationship having regard to the party's rights and obligations contained in the written contract. And the court said that where the parties comprehensively committed the terms of the relationship to a written contract and neither party disputed the validity of that contract, the characterization of their relationship must be based on the contract rather than the subsequent conduct of the parties.

So this is a very different interpretation of the employer employee relationship. So we're not looking at all of their conduct, we're purely looking at how that conduct is set out within the contract to determine whether somebody is an employee or a contractor.

So in the Personnel Contracting case, the High Court basically rejected the traditional multifactorial approach. It said that an examination of all of the dealings between the parties over the entire history of their relationship was unnecessary and inappropriate. The exception was where the contract wasn't in writing, or was only partly in writing, or whether terms of the contract were being challenged as invalid, such as in a sham situation, or where the written contract was varied. And in that situation, it was permissible to examine post-contractual conduct.

So the High Court concluded that a crucial factor was the extent and degree of control exercised by the employer, and when considering both the degree and nature of that control and whether the worker was performing work in the business of the employer as opposed to for the business. Basically, attention needed to be given to the following contractual aspects, so the way the worker was paid, the provision and maintenance of equipment to do the job, the obligation to work and the hours of work, the provision for holidays, the deduction of income tax, and the ability to subcontract the work.

Now crucially, how that is applied to the worker on a day-to-day basis is largely irrelevant unless there's no contract or there are indications that the contract was a sham. We're purely talking about how the contract actually says that relationship works in relation to those factors.

Now, you'll have noticed that this rate related to entitlements on the Fair Work Act, so the Commissioner wasn't actually a party to either case. Nevertheless, the ATO later released a tax ruling on this subject, which is TR 2023/4. And this provides guidance on the question of who's an employee for PAYG purposes. It replaces TR 2005/15, which was its former and now outdated review of the subject. Whereas TR 2005/15 largely favoured a multifactorial analysis of whether somebody was an employee or a contractor, TR 2023/4 basically reflects the High Court decisions in both the Personnel case and the Jamsek case, which I won't go through in any detail here, but it's basically another recent case which were decided along similar lines.

So the crucial paragraph of that tax ruling confirms that where the worker and the engaging entity have comprehensively committed the terms of their relationship to a written contract, and the validity of that contract has not been challenged as a sham, nor have the terms of the contract otherwise been varied, waived, discharged, or the subject of an estoppel or an equitable legal or statutory right or remedy, it is the legal rights and obligations in the contract alone that are relevant in determining whether the worker is an employee of the engaging entity. Evidence of how the contract was performed, including subsequent conduct work practises cannot be considered for the purpose of determining the nature of the legal relationship between the parties.

So that basically rules out the multifactorial approach and basically the ATO has committed themselves there to very much an analysis purely of the contract.

So whether a person is actually an employee is a question of fact to be determined by reference to an objective assessment of the totality of the relationship between the parties, having regard only to the legal rights and obligations which constitute that relationship. So basically, typically the place where those legal rights and obligations are actually set out is in the contract.

So the task is to construe and characterise the contract at the time of entry into it. Recourse may be had to events, circumstances and things external to the contract which were objective, known to the parties at the time of contracting, and assist in identifying the purpose or object of the contract. And the ruling then goes on to say that the contract will be a sham if it's not a legitimate record of the intended legal relationship between the two parties, but instead is a mere piece of machinery serving some other purpose, and that will typically be to act as a facade and deliberately obscure the true legal relationship for third parties.

So I'll just say again, the evidence of how the contract was performed, including subsequent conduct and work practises, cannot be considered for the purpose of determining the nature of the legal relationship between the parties. Obviously, notwithstanding that point, evidence of how a contract was actually performed can be considered to establish the contractual terms or to challenge the validity of a written contract.

So a useful approach for establishing whether a worker is actually an employee is to consider whether the worker is working in the business of the engaging entity based on the construction of the terms of the contract, rather than working for the business of the engaging entity which is indication of a contractor. Nevertheless, the ATO does say that this shouldn't be approached as a checklist exercise, therefore you can't simply go in with a list of factors, tick them off, and then come to a conclusion based on that.

So for example, the label which parties choose to describe their relationship isn't relevant to the characterization of the relationship. And the fact that the worker is conducting their own business, including having an ABN isn't determinative. They may separately be an employee in the business of another entity. So just because somebody has an ABN that doesn't characterise a relationship as one of employer and contractor because that ABN may not be relevant when you consider the full terms of the contract.

Now the ruling basically lists the common factors that indicate employee or contractor status and it basically comments on each of those factors as it goes through. So at its core, the distinction between an employee and an independent contractor is that an employee serves in the business of an employer, performing their work as part of that business, whereas an independent contractor provides services to principal's business, but the contractor does so in furthering their own business enterprise, they carry out the work as principal of their own business, not as part of another.

With respect to control and the right to control, the ruling says that an employer generally has a right to control how, where and when its employee performs their work. But it does say that the importance of control in this context lies not in its actual exercise, but rather in the contractual right of the employer to exercise that control in the first place.

The ruling talks about the ability to delegate or subcontract or assign work. So where a worker has an entirely unfettered right to delegate, subcontract, or assign their work to others, in the absence of any other factors pointing the other direction, then the existence of this right will be a very strong indicator against the worker being an employee. Where the right is fettered, then obviously that points in the other direction and the other terms of the contractual relationship will need to be considered.

Whether the substance of a contract is to achieve a specified result. So the ruling says that where the substance of a contract is to achieve a specified result, there's a strong but not conclusive indication that the contract is one for services. So in other words, it's a contractor relationship rather than an employee relationship, which is it's a contract whereby the employee provides their services.

With the provision of tools and equipment, the provision of assets, equipment, and tools by a worker and the incurring of expenses and other overheads will possibly be an indicator that the worker is an independent contractor, obviously subject to the other terms and conditions. With risk, where the worker bears little or no risk of the costs arising out of injury or defect carrying out their work, then they're more likely to be an employee. On the other hand, an independent contractor bears commercial risk and responsibility for any poor workmanship or injury sustained in the performance of their work.

However, the ruling does say that a clause in the contract that requires a worker to take out public liability or indemnity insurance will typically be a neutral factor in determining the nature of the relationship between the worker and the engaging entity. And generation of goodwill. So where a contract between a worker and an engaging entity prevents any goodwill from accruing for a worker's possible business, then that will be an indicator that the worker is instead serving in the engaging entity's business. So in other words, he's an employee.

Now the TR 2023/4 came out towards the backend of last year, and simultaneously the ATO also released a practical compliance guideline 2023/2, which talks about how in practical terms, the ATO will actually apply these guidelines to businesses and how indeed those businesses can actually self-assess their risk. Now, unlike the tax ruling, which purely deals with PAYG, the practical compliance guideline actually also covers superannuation guarantee. So it also talks about the extended definition of employee, which I'll talk about in a few slides time, and it does also apply to that.

So this guideline outlines the ATO risk framework for worker classification arrangements based on the actions taken by the parties when entering into the arrangement. Therefore, parties can self-assess against this risk framework to understand the likelihood of the ATO applying compliance resources to review their arrangement.

Now, there could be two reasons for a review of this particular aspect of a business. First of all, a review can come about as a result of proactive case selection based on risk factors and information known to the ATO, that's basically an internally-generated review, or it can come about because of external factors such as an unpaid superannuation query received from a worker. And therefore, as I said a few minutes ago, unlike the ruling which purely focused on the common law definition of an employee for PAYG purposes, the guideline can be used both for PAYG(W) compliance and superannuation guarantee compliance.

Now the guideline works by setting out four risk zones and they determine the level of compliance resources which will be dedicated to that business. So those risk zones vary between very low, which is a white risk zone, all the way up to a high risk zone, which is red. The guideline assesses each of three factors in determining the risk scores. So first of all, it assesses the party's arrangements, their intentions and their understanding. Secondly, it assesses the conduct of the parties, and thirdly, it assesses advice received. Now there's quite an emphasis on advice received. So therefore, it is worthwhile that the business actually does get proper professional advice from an accountant or a lawyer who has some experience in this field, confirming whether indeed the worker is an employee or a contractor. In the absence of that, then obviously the ATO will regard that as potentially higher risk than where that advice is actually presented.

Now, obviously a classic example of a very low risk employer is one where the employer voluntarily meets their employer obligations regardless of their view of the worker's classification. So basically if the employer employs everybody as an employee, then there's no possible area for non-compliance provided they actually do meet their obligations as an employer, and that will fall into the very low risk category.

In situations where there's been a significant deviation of the arrangement, basically the parties will then need to reassess their risk rating. So this could include ensuring that both parties understand the impact of the changes on their working arrangement and classification, ensuring that the contractual rights and obligations agreed by the parties reflect the changes in the working arrangement, ensuring that if the classification has changed, that all parties understand the tax, superannuation and reporting implications, and ensuring that new client specific advice, whether that's from the ATO, from in-house counsel of the business, or an appropriately qualified third party, such as accountants, such as you people on this presentation, has been obtained to confirm the classification in light of the new circumstances.

And the guideline contains six practical examples illustrating the application of this risk score approach, one of which is here on this slide. So this illustrates the way that the practical compliance guideline works. This is example one for the PCG. It's a very low risk client and it's basically sets out the various factors which taken into account in determining that this is indeed a very low risk employer.

So the facts are that the manufacturing business entered into a contract with a software engineer, Brett, to design, develop, test, and instal a new software programme. The business intended to engage Brett as an independent contractor and the terms of the comprehensive written agreement between the business and Brett support this.

The example then goes on to list a number of relevant facts which were taken into account in arriving at this very low risk score. So the business had a record of discussions with Brett in which it highlighted that he was being engaged differently from the business's employees, and why he was a contractor and not entitled to superannuation. The business had procedures in place to ensure that the terms of the contract and the tax and superannuation implications for its workers, including Brett, were explained, understood and acknowledged. Thirdly, neither Brett's nor the business's subsequent actions suggested any deviation from the contracted arrangement. Brett actually consistently with that arrangement, including invoicing for his work using an ABN and charging GST.

Fourthly, the business had obtained professional advice from an employment lawyer regarding the arrangement with Brett and the resulting tax and superannuation obligations, which indicated that the classification was correct. Brett did not satisfy the extended definition of employee for superannuation purposes. And finally, the business complied with all of the tax and reporting obligations arising from its engagement of Brett as a contractor. And therefore looking at those facts, the example does say that this arrangement is very low risk and no further compliance resources will be applied to scrutinise whether Brett should instead have been classified as an employee of the engaging entity.

Now while all of this was happening, while the tax ruling and the PCG were going through the internal machinations of the ATO and the tax ruling was going from draught to final, the broader government introduced the Fair Work Legislation Amendment (Closing Loopholes) Bill back in September last year. Now the purpose of this bill is simply to close loopholes that undermined paying conditions, and to improve work health and safety laws in the Commonwealth jurisdiction.

Now ultimately this legislation was given royal assent, however, the Act when it passed through parliament didn't include the originally proposed measure to introduce fair work purposes, a statutory definition of employee. However, the government has said that this will be looked at separately and will be considered by parliament in 2024 and therefore there's a very good chance that this is coming.

So we need to look at what that definition of employee and employer actually was in the Bill in order to understand this, because the original Bill basically stated that the meaning of employer and employee will be determined by reference to the real substance, practical reality, and the true nature of the relationship between the parties. This would obviously require the totality of the relationship between the parties, including not only the terms of the contract governing the relationship, but also the manner of performance of the contract to be considered working out whether there's relationship of employment or one of principal and contractor.

And therefore, this measure in effect has reintroduced the multifactorial test. In other words, it's looked at the totality of the employment relationship, not simply at one aspect of it, the contract to determine whether a person is an employee or contractor.

So therefore, what are the implications of that for taxation? Well, it does appear there aren't any implications for taxation, because at the same time this bill was introduced, the ATO actually finalised their draught ruling as TR 2023/4, and therefore there's no doubt that the ATO is now applying a purely contract-driven approach. But purely from a compliance perspective, it does mean that employers do need to keep sufficient evidence of their workers' status to take account, first of all, of the potential fair work assessment, which is the one here, which relies on the multifactorial test. Secondly, the common law assessment, which is largely contractual, which is going to be relevant for PAYG(W) particularly, and the extended definitions which are relevant for, say, superannuation guarantee purposes. So the amount of paperwork that employers are potentially going to have to keep in light of this is quite intimidating.

So businesses should note the importance of keeping proof, which is set out in Taxation Ruling 2023/4, not just by putting in place a written contract, but also establishing that the worker performs their duties in accordance with that written contract. And therefore, a written contract should be as comprehensive as possible and should align with the rights and responsibilities of both the worker and the business as practised on a day-to-day basis. So those written contracts should be available for inspection by the ATO and constantly monitored for accuracy, for example, making sure that the worker's actual performance doesn't deviate from the terms of the contract.

The business should also consider obtaining written professional advice on any proposed contractor arrangement because if you recall in the PCG, one of the factors which the ATO did take into account is indeed professional advice, just to make sure that the terms of the contract justify a contractor arrangement and that the tax and superannuation outcomes are being discussed and agreed, and the worker should also be made aware of that professional advice, preferably in writing.

So if you've got a client that wishes to engage a contractor, you do need to get the contract suitably robust. And indeed, the other legal agreements between the parties need to be in line with that. So first of all, there needs to be a clear statement of the relationship between both parties. The contractor's rights and obligations related to plant and equipment need to be set out, i.e., what equipment the contractor is expected to provide and what will be supplied by the contracting business and at what cost.

The contract should consider the question of who's going to be responsible for the big risks such as litigation. So obviously, it's recommended that the contract places this responsibility in the hands of the contractor to the extent that litigation arises from the performance of the contractor.

Some consideration needs to be included regarding liability for public indemnity. So obviously, it's recommended that the contractor has their own insurance covering these risks. In terms of PAYG(W), it should be made clear that the worker is a contractor, and therefore PAYG(W) will not be deducted.

Are there any guaranteed minimum hourly rates which are set out within the contract? Obviously, this isn't recommended because it could be inferred that there's an employee-employer relationship if the worker is actually remunerated according to a guaranteed minimum hourly rate.

The question of who has control needs to be addressed, so it's recommended that the contractor be given the power to subcontract out to their own employees or other contractors. And any restraints of trade. So are there any that may infer an employee or employer arrangement?

Now for superannuation purposes, obviously the definition of an employee is considerably wider. So the Superannuation Guarantee Administration Act 1992 requires businesses to make superannuation contributions on behalf of employees. However, this specifically captures both employees are common law, which is the PAYG(W) definition of employees, and persons who are captured by the extended definition of an employee, which is set out in the Act as if a person works under a contract that is wholly or principally for the labour of the person, the person is an employee of the other party to the contract. And obviously the purpose of this expanded definition is to reach beyond the traditional employment relationship and capture independent contractors who principally provide their own labour to meet obligations under a contract. And therefore, somebody who doesn't meet the definition of an employee for PAYG(W) purposes may well meet the extended definition of an employee for superannuation guarantee purposes. And therefore, although it isn't necessary for the employee to withhold tax, it may still be necessary for them to pay superannuation guarantee on behalf of that worker.

Now, the ruling, Superannuation Guarantee Ruling SGR 2005/1 explains when an individual is deemed to be an employee under the extended definition. So the ATO considers that an individual works under a contract that is wholly or principally for the labour of the person and therefore is a deemed employee, where the individual is remunerated either wholly or principally for their personal labour and skills, the individual must perform the contractual work personally, in other words, there's no right of delegation, and the individual isn't paid to achieve a result.

Now, obviously it's quite common for businesses to attempt to contract their way out of SG obligations. However, the ATO and the courts do take a much broader view of the situation, will always attempt to discover the true nature of the arrangement or the relationship, and therefore inserting clauses into a contract which state that the business isn't responsible for making superannuation contributions on behalf of the worker won't be effective at releasing the business from its SG obligations if the ATO classifies the worker as either an employee at common law or under the expanded definition, which I just talked about.

Now, if a business wants to avoid this liability for superannuation guarantee, then that can be done provided that they engage contractor to a company or a trust through the contractor's own company or trust. Now, this is because it's traditionally been the ATO's view that SG support would not be provided for an independent contractor engaged through an interposed entity, such as a company or a trust. Paragraph 13 of SGR 2005/1 supports that view. So that says, "Where an individual performs work for another party through an entity such as a company or trust, there's no employer or employee relationship between the individual and the other party for the purposes of the SG Act, either a common law or under the extended definition of employee. This is because the company or the trust not, the individual, has entered into an agreement rather than the individual."

Now, there was a recent case which basically illustrated the issues around this. It was Dental Corporation Pty. Ltd. v Moffet case, which is about four years old. So the case dealt with a situation where a taxpayer dentist working as an independent contractor for a dental practise fell within the extended definition of an employee for SG purposes, and therefore was entitled to SG support despite not being considered an employee for common law purposes from the dental practise. And as a result of that case, the Federal Court actually held in favour of the taxpayer. In other words, he did have an entitlement to SG support.

So the facts of the case was that under the services agreement, Dr. Moffet's remuneration structure involved Dental Corporation paying him a percentage of patient fees monthly. So Dental Corporation operated on the basis that Dr. Moffet was engaged as an independent contractor rather than as an employee. And on this basis it didn't provide him with any accrued leave entitlements or SG support.

Now, although the court found that Dr. Moffet was not an employee for common law purposes and hence the claim for annual leave was denied, and indeed although it wasn't an issue which was discussed in the case, there wouldn't have been any liability for PAYG(W). The court agreed with Dr. Moffet's contention that he was entitled to SG support on the basis that he fell within the extended definition of an SG employee. And basically, there's that paragraph again. So if a person works under a contract that is wholly or principally for the labour of the person, the person is an employee of the other party to the contract.

Now in this case, the relationship between Dr. Moffet and Dental Corporation was direct. So there was no intermediary entity. And therefore in this situation, Dr. Moffet was entitled to superannuation payments to be paid on his behalf by Dental Corporation. And therefore, if you want to avoid that, it's essential that all of these relationships are actually indirect. So if Dental Corporation had engaged with a company owned and run by Dr. Moffet, then SG wouldn't have arisen. Similarly, if they're engaged with a trust of which Dr. Moffet was a beneficiary, SG would not have arisen.

You've just got to be slightly careful with that kind of arrangement. It isn't infallible. The Roy Morgan Research case, which is about 12 years old now, it does demonstrate that this approach does have problems because in that instance, the business was still actually engaging the individuals to perform the work even though the payments were being directed to a company. So therefore, it's essential for the business to first of all engage the taxpayer's entity as well as directing payments to it.

Now, gee, a quick word about penalties and remission. Obviously, I've already talked about it, what exactly the penalties are for not making a superannuation guarantee payment on behalf of a contractor or indeed anybody else, but the top half of the slide there basically outlines that again. There is a system of remission penalties. It's outlined in PSLA 2021/3 and it applies only for businesses which have a turnover of less than $50 million.

However, I'm slightly loathed to go through this because in a typical situation, these remission of penalties won't apply in situations where an employer doesn't pay superannuation guarantee at all. So they typically will apply in situations where a business pays superannuation guarantee late, but not in a situation where it doesn't pay at all. Therefore, they probably won't be relevant to this particular situation. However, the exact circumstances in which penalty remission is available are outlined at the bottom of the slide.

There's some more detail about penalty relief on this slide. Probably the key point is that an employer can't actually apply for penalty relief. So the penalty relief does have to be offered by the ATO in order for it to be available. In addition, an employee can't specifically object to a decision not to apply it. However, as I said that in situations such as this, it probably won't be available.

Now that is the end of the formal presentation. I'll make it to about five to 2. So I'm happy to take questions for a few minutes. Now, if you don't get the chance to have your question dealt with by me now or if you come up with an interesting question after the session has ended, you can contact me. My detail's on the slide there, so do please feel free to email me. However, I will deal with any questions that you have now, well in a few minutes. I'll just hand them back to Alison to wrap up today's session, and then we'll take questions.

CCH Learning:

Thank you very much, Mark. All right, we've just had two questions come through today. So I'm sure many more of you have some burning questions, so please pop those into the questions pane and then we can run through them in the Q&A. So just to give you a minute to think of those questions, I will run through our upcoming webinars.

So 13 Feb, we're looking at How to Charge your Worth. 14 Feb being Valentine's Day is How to Love Your Superannuation and SMSFs. Kicking off our FBT sessions, we have planning your 2024 FBT Return Preparation. And just mentioning, we also have some FBT workshops as well. So if you're looking for some full day training, jump on our website for those. 15 February, Financial and Sustainability Reporting. We also have our first tax technical update for the year, covering January and February, and another FBT session on getting the reporting right for mobile employees.

So there's a link on the left-hand side so you can see all the details of those. All right, Mark, we'll have a look at these questions here. So first one is from Michael. He said it's in relation to slide 31. "So please elaborate on this comment about using an imposed entity. Therefore, it is essential for businesses to engage the taxpayer's entity as well as directing payments to it?"

Mark Chapman:

That's in relation to superannuation guarantee. So if you've got somebody who is engaged principally for their labour, and the business wants to avoid paying superannuation guarantee on behalf of that contractor, then basically the hiring business needs to actually contract with the taxpayer's own entity. So instead of engaging with John Smith, it engages with John Smith Limited or the trust of John Smith. So the actual contractor themselves does need to form another entity. So in that situation, there is no direct relationship between the employer and the contractor and therefore the obligation to provide superannuation guarantee is broken. That's purely in relation to contractors who have an obligation to principally provide labour. So that's what that particular slide is about.

CCH Learning:

Thank you, Mark. A question from Eric, "Do the rules governing the definition of employees covered here extend to payroll tax?"

Mark Chapman:

By and large, no, they don't. Well, in Western Australia, they do. So the common law definition of employee does apply in Western Australia, I believe. So the common law definition is the same one which applies to PAYG(W) purposes. So in other words, as a rule of thumb, if you've got a PAYG liability, you've got a payroll tax liability.

Having said that, it doesn't apply in any other states. So each of the individual states has their own payroll tax legislation. And recently, there's been a tremendous fuss in relation to medical practitioners, for example, who now it does appear that medical centres have to pay payroll tax in regard to contracted medical practitioners. It's opened a real can of worms for medical practises. So no, the common law definition does not apply for payroll tax purposes. It's a big subject, so I won't go any further with it. But outside of Western Australia, you can't rely on that common law definition to avoid payroll tax.

CCH Learning:

Thank you. And there was another question from Mark, which is quite similar, but Mark, let me know if you require more information. And then this looks like it's the lucky last one at the moment. So from Rongul, "So if we want to pay a fixed fee to say inclusive of super for independent contractor, is this possible?"

Mark Chapman:

Well, a fixed fee is one of the indications of a employee-contractor relationship. So you need to look at the other common factors to indicate whether that person is actually a contractor or not. But certainly, payment of a fee for delivering a result is, generally speaking, an indication that somebody is a genuine contractor. And that would usually, unless there are other terms in the contract, indicate that PAYG(W) doesn't need to be paid.

However, in terms of superannuation, that could well be a different story, depend whether the person is principally providing their labour. If they are, then the hiring business does need to pay superannuation on their behalf, and putting a term within the contract saying that the business is paying so much to include superannuation won't necessarily cut it. So it is recommended that you do bear that in mind in that particular relationship.

CCH Learning:

Thank you, Mark. And one more here from Sean. This is a specific situation, so we'll see how we go. So PAYG withholding, "So there's a client that has yearly shearers that work one week a year and they're paid by the hour. This year, some turned up and said they would only work under an ABN. We pay super, but would there be a penalty for not withholding PAYG?"

Mark Chapman:

Well, quite possibly, yeah. I mean the fact that they're only working a week a year doesn't really alter the fact that their relationship seems to be one of an employee. So they're paid a fixed rate per year, per week, whatever, and therefore they do seem to be an employee and therefore there is actually an obligation on the business in relation to those employees. And the fact that the employee doesn't want to be paid by a PAYG(W), doesn't want to be an employee, doesn't really make any difference because the liability rests with the hiring business.

CCH Learning:

Perfect. Thank you very much, Mark. All right, that is all the questions that have come through for today. So we will just look at closing the session off here.

So in terms of the feedback survey, that will pop up for you all in a moment. And shortly after the session today, you will receive an email letting you know when the recording is ready. You'll also have access to a verbatim transcript, CPD certificate and of course this PowerPoint presentation. So thank you again to Mark for the session today, and thank you to everyone in the audience. We hope to see you back online for another CCH learning webinar very soon.