Employee or independent contractor?

Practical tips for categorising workers for superannuation purposes

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In 2022, the High Court of Australia decided two cases in which it clarified the approach to determining whether workers are employees or independent contractors under common law. In 2023, the Full Federal Court gave further guidance on the meaning of 'employee' for the purposes of common law and superannuation law, and the Australian Taxation Office (ATO) released draft guidance on the categorisation of workers and its compliance approach.

The High Court, in February 2022, handed down two decisions concerning whether workers were employees or independent contractors: *Construction, Forestry, Maritime, Mining and Energy Union v Personnel Contracting Pty Ltd* [2022] HCA 1 (*Personnel*) and *ZG Operations Australia Pty Ltd v Jamsek* [2022] HCA 2 (*Jamsek*).

In March 2023, the Full Federal Court considered the extended meaning of 'employee' under *section 12(3) of the Superannuation Guarantee (Administration) Act 1992* (SGAA), as this issue was remitted by the High Court to the Full Federal Court in relation to the *Jamsek* decision in *Jamsek v ZG Operations Australia Pty Ltd (No 3)* [2023] FCAFC 48 (*Jamsek No. 3*). In May 2023, the Full Federal Court considered whether the right to subcontract or assign, and the right of control, are indicative of an independent contracting relationship in *JMC Pty Ltd v Commissioner of Taxation* [2023] FCAFC 76 (*JMC*).

These decisions are important as employees are entitled to leave, redundancy pay, and superannuation—among other employee entitlements, while independent contractors are not entitled to these benefits.

In deciding *Personnel* and *Jamsek*, the High Court applied a new approach to determining whether workers are employees or independent contractors for common law purposes, which emphasised the primacy of the contractual relationship between the parties. This new approach was adopted by the Full Federal Court in deciding *JMC*.

In deciding *Jamsek No. 3*, the Full Federal Court confirmed the existing ATO guidance on the status of individuals as independent contractors if they perform work for another party in a capacity other than their individual capacity.

This paper sets out a revised approach for business to consider when determining whether workers are employees or independent contractors for superannuation law purposes by:

- summarising the key changes to the approach to categorising workers as employees or independent contractors, arising from the High Court and Full Federal Court decisions and the latest draft guidance from the ATO
- summarising relevant considerations when classifying workers as employees or independent contractors for superannuation law purposes

- noting the circumstances under which superannuation is not payable, even if a worker is considered an employee.

Key changes to the approach to categorising workers

Workers may be classified as either employees or independent contractors. Workers are only entitled to superannuation if they:

- are an employee under common law, the determination of which requires a characterisation of the relationship, determined with reference to the "totality of the relationship between the parties", identifying the legal rights and obligations which constitute the relationship
- meet the extended definition of 'employee' under section 12(3) of the SGAA, which notably includes persons who "work under a contract that is wholly or principally for the labour of the person".

  Other persons who are deemed employees under the SGAA, include persons who:
  - are members of a company's executive body
  - work for various state or federal governments
  - work in creative or performing industries, such musicians, athletes, or who work in other activities involving the exercise of intellectual, artistic, musical, physical or other personal skills.

Previous approach

Historically, courts have determined whether workers were employees or independent contractors by taking a very broad view of the relationship between the parties, known as the 'multifactorial approach'. In applying the multifactorial approach, the courts looked to post-contractual conduct such as the day-to-day relationship between the parties and gave weight to factors that go towards (or against) a finding that a worker is employee or independent contractor. Under the multi-factorial approach, the written contract between the parties was just one of a variety of factors which determined whether a worker was an employee or independent contractor.

New approach

In deciding *Personnel* and *Jamsek*, the High Court adopted a new approach in determining whether a worker is an employee under common law. The High Court emphasised the primacy of the contractual relationship in characterising the relationship between the parties as one of employment or otherwise, where the contract is not challenged as a sham, varied or otherwise displaced by the conduct of the parties. Therefore, an analysis of the incidia of employment should generally proceed by reference to the rights and duties established under the parties' contract.

In *Jamsek No. 3*, the Full Federal Court confirmed the ATO guidance that a worker is not an employee within its common law meaning and under the extended definition of 'employee' where an individual performs work for another party through an entity such as a company, trust or partnership.

The Full Federal Court also confirmed that the following factors are relevant in deciding that a worker does not satisfy the extended definition of 'employee':

- The worker receives payment based on hours worked, rather than items or results delivered.
- The worker is granted the right to delegate.
- The worker is required to use substantial capital assets to ensure delivery of the obligations under the contract—for example, the labour component to be performed by the worker is not the principal benefit to be provided by the worker under the contract.

In *JMC*, the Full Federal Court found that the existence of a right to subcontract or assign, along with the right to delegate, are important indicators of an independent contractor relationship.

Conversely, the Full Federal Court found that a contract would need to provide controls over how, when or where a worker was required to deliver the services, to be indicative of an employment relationship.

In light of the *Personnel* and *Jamsek* decisions, the ATO published Taxation Ruling TR 2023/4 *Income tax: pay as you go withholding - who is an employee?* and the draft Practical Compliance Guideline PCG 2022/D5 *Classifying workers as employees or independent contractors – ATO compliance approach*.

Taxation ruling TR 2023/4 includes an explanation of the ATO's views on the ordinary meaning of an employee for superannuation law purposes. It reiterates that the question of whether a person is an employee will depend upon the legal rights and obligations established between them and their employer—that is, the relationship established between the parties through contract.

The draft compliance guideline PCG 2022/D5 sets out the ATO's approach to allocating compliance resources based on the risk associated with the classification of workers as employees or independent contractors. Notably, it is possible for putative employers to structure their arrangements with workers such that they present a very low risk of misclassification of a worker as an independent contractor, in which case the ATO will not apply any compliance resources to determine whether the putative employer has made the correct classification.

Factors to consider when classifying workers

Where it is not possible for a putative employer to structure their arrangements such that there is a very low risk of misclassification of a worker as an independent contractor, the employer should carefully consider a number of factors when considering the classification of workers as employees or independent contractors for superannuation law purposes.

In relation to the common law meaning of employee, the ATO has indicated that a key question is whether a worker is carrying on their own business or whether the worker is carrying on the business of the employer. The ATO will look to whether the worker's service is subser-

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vient to, or dependent on, the employer's business. To this end, businesses wishing to ensure that their workers are independent contractors should take care that their contracts provide that the worker has the right to:

- generate their own goodwill and have ownership over the intellectual property they create
- have their own clients and not be subject to any exclusivity or restraint
- market their services to potential clients as part of their own business
- subcontract, assign or delegate their services or obligations under the contract, ideally without prior approval of the business
- exercise control over how, where and when the work is done.

In relation to the extended definition of 'employee', the ATO considers that a contract under which a worker is required to produce a result by personally providing services, is indicative of an employment relationship. The ATO also considers hourly-rate-based remuneration to be indicative of an employment relationship, as the worker is being paid for their labour, not to achieve a result.

As a result, businesses looking to maintain a principal-independent contractor relationship, should consider granting workers an unfettered contractual right to delegate and paying the relevant worker a lump sum to achieve a specified result.

Additionally, no employment relationship exists where an individual performs work for another party through an entity such as a company, trust, or partnership. This is because the company, trust, or partnership has entered into the agreement, not the individual. As a result, the company which contracts with a company, trust, or partnership, will not need to pay that entity superannuation.

When superannuation is not payable to employees

There are also certain circumstances under which superannuation is not payable to employees, as prescribed by the SGAA and associated regulations. For example, non-resident employees who do work outside of Australia—for resident employers—are not entitled to superannuation, except to the extent that employees are covered by a certificate of coverage and work in a nominated country which has a bilateral social security agreement with Australia. Additionally, employers are not required to pay superannuation where their payments to employees are not considered ordinary time earnings.

Recommendations

The decisions of *Personnel* and *Jamsek* have resulted in a new approach for businesses to consider when assessing whether superannuation must be paid to its workers.

The correct classification of workers as employers or independent contractors is an important issue going forward, especially in light of the continued growth of the gig economy in which individuals often perform work as independent contractors rather than employees. This has important implications on the superannuation entitlements of workers, for which businesses may be liable to pay significant penalties if they misclassify their workers.

Businesses engaging workers as independent contractors should review their work arrangements against the contract between the parties, to determine whether the work arrangements are comprehensively documented in the contract. If required, businesses should also consider amending their pro-forma contracts to better align the rights and duties established under a pro-forma contract with the appropriate worker classification. **FS**

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