

PAYG Withholding Guide No.2

– How to determine if workers are employees or independent contractors

Introduction

This guide provides information to help payers determine whether their workers (payees) are employees or independent contractors (for example, an individual, partnership, trust or company).

It is important to determine the status of workers as payers have different tax obligations under the pay as you go (PAYG) system depending on whether they engage a worker as an employee or an independent contractor.

The information is intended as a guide only. Please refer to *Taxation Ruling TR 2000/14* for more detailed information. You can download the ruling from our website at www.ato.gov.au (see the 'Legal database' option).

Employee or independent contractor?

There are a number of factors to consider in determining whether a worker is an employee or an independent contractor, with no one factor necessarily conclusive. A payer must examine all the facts in each case, including the terms of their contract with the worker showing the intent of both parties.

A key factor in deciding if a worker is an employee is the *degree of control* that can be exercised over the worker. If the payer has the right to direct how, when, where and who is to perform the work, the worker is likely to be an employee. These directions may be verbal or in writing, or simply understood between the parties.

Another key factor to consider is whether the worker is being paid for the *time* they work, or being paid for a *result*. Workers being paid by the hour are more likely to be employees. Workers being paid for a result are more likely to be independent contractors.

The main factors to consider in determining whether a worker is an employee or an independent contractor are outlined below and summarised in the table on page 3.

Employee

Generally, a worker is an employee if they:

- are paid for time worked
- receive paid leave (for example, sick, annual or recreation, or long service leave)
- are not responsible for providing the materials or equipment required to do their job
- must perform the duties of their position

- agree to provide their personal services
- work hours set by an agreement or award
- are recognised as part and parcel of the payer's business, and
- take no commercial risks and cannot make a profit or loss from the work performed.

If a worker is an employee, the payer must withhold an amount from any salary, wages, commissions, bonuses or allowances they pay to the employee. The payer determines the amount to withhold using the tax tables published by the Tax Office and information provided by the employee on a *Tax file number declaration* (and *Withholding declaration* if applicable).

An employer may also have obligations under fringe benefits tax and the superannuation guarantee laws. For more information about an employer's fringe benefits tax obligations see *FBT – Does it apply to you?* (NAT 1744), or contact the Small Business Infoline on **13 28 66**. For more information about superannuation guarantee obligations see *Superannuation guarantee – How to meet your superannuation guarantee obligations (an employer's guide)* (NAT 1987), or contact the Superannuation Infoline on **13 10 20**.

Independent contractor

An independent contractor is an entity (such as an individual, partnership, trust or company) that agrees to produce a designated result for an agreed price. In most cases an independent contractor:

- is paid for results achieved
- provides all or most of the necessary materials and equipment to complete the work
- is free to delegate work to other entities
- has freedom in the way the work is done
- provides services to the general public and other businesses
- is free to accept or refuse work, and
- is in a position to make a profit or loss.

If a worker is an independent contractor, a payer is required to withhold an amount from payments to them only where the contractor:

- has entered into a voluntary agreement with the payer to have amounts withheld
- provides their work or services for a client of the payer under a labour hire arrangement, or
- has not quoted their Australian business number (ABN) to the payer.

In some cases the superannuation guarantee laws may apply to payments for work or services by an independent contractor. For more information about superannuation guarantee obligations see *Superannuation guarantee – How to meet your superannuation guarantee obligations (an employer’s guide)* (NAT 1987), or contact the Superannuation Infoline on **13 10 20**.

Most independent contractors provide for their tax obligations through the PAYG instalments system. Contractors should also consider whether they need to apply for an ABN and register for goods and services tax (GST). Contractors who come under the contractor tax rules must include their personal services income in their individual tax return and cannot claim some tax deductions. Those operating through a company, partnership or trust may also have PAYG withholding obligations.

For more information about these rules see *Alienation of personal services income: Important information for contractors and consultants* (NAT 4788), or phone **13 28 66**.

Use the information in the following table to help you determine if your workers are employees or contract workers. The factors listed are not exhaustive and you will have to consider all the terms of each contract.

Is your worker an employee or a contractor?

Factors to consider	Employee	Contractor
Control over work	The employer has an implied right within industrial law to direct and control the work of an employee. The employee works in the business of the employer and the employer is free to manage their business as they see fit.	A payer has a right to specify how the contracted services are to be performed. However, such control must be specified in the terms of the contract, otherwise the contractor is free to exercise their own discretion.
Independence	An employee performs work for the employer in accordance with an employment contract.	A contractor performs services as specified in a contract with the payer and provides additional services only by agreement.
Payment	Payment is often based on the period of time worked, but an employee can also work on ‘piece rates’ or commission.	Payment is dependent on the performance of the contract services.
Commercial risks	An employee generally bears no legal risks in respect of the work, since the employee works in the business of the employer the employer is legally responsible for any work performed by the employee.	A contractor bears legal risk in respect of the work. They have the potential to make a profit or loss, and must remedy any defective work at their own expense.
Ability to delegate	An employee performs the work personally and generally cannot subcontract the work to someone else.	Unless otherwise specified in the contract a contractor can subcontract or delegate the work.
Tools and equipment	The employer, except when specifically agreed otherwise, usually provides tools and equipment.	Generally, a contractor provides their own tools and equipment.

Need more information?

If you have any questions, need more information, or wish to obtain copies of the publications listed below please:

- phone **13 28 66**, or
- visit our website at **www.ato.gov.au**

Publications

- *PAYG voluntary agreements* (NAT 3063) (Fact sheet)
- *PAYG bulletin no. 3 – PAYG withholding and labour hire firms* (NAT 3473)
- *Should your suppliers quote their ABN? ... a guide for business* (NAT 3346) (Fact sheet)
- *PAYG instalments for individuals* (NAT 4269) (Fact sheet)
- *Who is entitled to an ABN?* (NAT 2942) (Fact sheet)
- *Alienation of personal services income: Important information for contractors and consultants* (NAT 4788) (Booklet)
- *Superannuation guarantee – How to meet your superannuation guarantee obligations (an employer's guide)* (NAT 1987) (Fact sheet)
- *FBT – Does it apply to you?* (NAT 1744) (Booklet)

Disclaimer and guarantee

The information in this publication is current at April 2003 and we have made every effort to ensure it is accurate. However, if something in the publication is wrong or misleading and you make a mistake as a result, you will not be charged a penalty. You may have to pay interest, depending on the circumstances of your case. If you feel this publication does not fully cover your circumstances, please seek help from the Tax Office or a professional tax adviser. Since we regularly revise our publications to take account of any changes to the law, you should make sure this edition is the latest. The easiest way to do this is by checking for a more recent version on our website at **www.ato.gov.au**

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