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Contractors vs employees: Can you tell the difference?

A recent decision by the Administrative Appeals Tribunal (AAT) should serve as a warning for any employer who employs independent contractors. In a case brought by the Tax Commissioner, a company that employs over 1000 contractors to provide interpretation and translation services is now potentially liable for superannuation guarantee payments to all of its contractors - now and retrospectively.

So what went wrong? The problem is that there is no conclusive definition of who or what an independent contractor is. The fact that an agreement might state that someone is a contractor is considered merely a 'label' by the court. Where the contractor primarily supplies their personal labour, the dividing line between an employee and a contractor is even harder to distinguish as the tools of the contractor's trade is their knowledge and expertise. The case before the AAT, *Associated Translators and Linguists Pty Limited and Commission of Taxation [2010] AATA 260* is a case in point.

Associated Translators and Linguists Pty Limited (ATL) provide interpretation and translation services in 90 different languages across the country. ATL has two full time interpreters and translators but the bulk of the service is managed through a 'panel of consultants'. The panel of over 1000 interpreters and translators fulfil between 1300 and 1500 client assignments per month. The panel of consultants are predominantly individuals who contract back to ATL when a job comes up in their area of expertise that cannot be fulfilled by the full time staff.

In this case, the Tax Commissioner singled out one panel member from ATL's pool, Mr Sani, who started contracting to the company in 2003. The Tax Office was of the view that Mr Sani was an employee of ATL not a contractor and issued ATL a superannuation guarantee assessment for a shortfall in superannuation guarantee payments to Mr Sani. ATL objected. The ATO held firm on its view.

The Superannuation Guarantee Assessment (SGA) Act requires that superannuation guarantee payments are made by the employer for employees (using the ordinary term for employee). Then, the Act goes one step further stating that *"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."*

The case before the AAT first had to determine if Mr Sani was an employee under its ordinary meaning. If not then the tribunal had to decide if Mr Sani was an employee under the extended definition of employee in the SGA Act. As it turned out, the case didn't get that far with the AAT deciding that Mr Sani was in fact an employee of ATL under its ordinary meaning.

Previously the courts have looked at a number of factors to determine if an independent contracting relationship exists:

- Whether the work involves a particular profession or skill set
- The level of control the contractor has over how the contract is executed
- The ability of the contractor to delegate work to another person
- Whether the contractor supplies his own tools or equipment
- Whether the contractor has his own place of business
- The contractor's ability to generate goodwill or saleable assets
- How the contractor is paid (for hours worked or a result)
- The level of risk the contractor bears, and
- Whether the contractor is independent or in reality, simply 'part and parcel' of the organisation they contract to

No single factor is determinative; it is the weight of evidence, on balance, across all of the factors. However, the last point, called the organisation test, was a significant factor in ATL's loss to the Tax Commissioner. But there were also a number of other factors considered during the tribunal:

- Procedurally, panel members complete the interpretation or translating assignments in the same way as employees: They agree to attend a particular assignment at an allocated time, complete the assignment, and report back on the time taken. ATL pointed out that unlike employees panel members have the right to refuse an assignment.
- ATL exercised strong controls over how work was completed. Panel members cannot delegate the assignment without permission from ATL. They are also required to comply with a code of conduct that covers punctuality, dress, confidentiality etc.

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Panel members also need to report back to ATL within 24 hours of the completion of the assignment. ATL argued that the code of conduct was consistent with the ethics for all interpreters and translators as part of their professional membership and that the administrative requirements are merely for efficiency. It was argued that these same arrangements would apply to a totally independent interpreter engaged for a one-off assignment.

- Complaints were not dealt with by the panel member but by ATL. The Tax Commissioner argued that complaints affected ATL's goodwill not the contractors. The Commissioner also noted that the panel member did not have the capacity to develop goodwill with the client or generate business. Panel members had to refer any assignments requested by clients back to ATL.
- The payments and invoices were managed by ATL. In the event of a complaint or poor conduct, panel members may be subject to some sort of warning or sanction. Where payment was withheld, it was generally because the client had withheld payment. In effect, the panel member did not bear the risk of the assignment.
- Panel members carry ATL business cards, or identification cards, with their name, confirmation that they are an ATL panel member, and their NAATI accreditation number. ATL pointed out that the identification cards are simply a way of confirming to the client that the interpreter is an ATL panel member and properly accredited. The Tax Commissioner saw that the panel members were represented as being part of ATL not independent to it. Commercially, this issue would pose a problem for many businesses if they followed the Commissioner's logic as it would mean diluting the prominence of their own brand by exposing their client base to and developing the contractor's personal profile.
- ATL also noted that panel members were free to accept and generate business in their own right including from competitors. This fact however was disregarded by the tribunal.
- ATL also noted that it does not place controls over how the panel member completes an assignment. However, the tribunal saw that employees also did not face these controls and the company's capacity to review all of the assignments was limited.

Weighing up the case, the tribunal saw that ATL's panel members were not 'only part and parcel of the business, they were the business. ATL has no capacity to deliver their services across the range of languages and geographic locations without them. Following this decision it would be hard to see how any business that relied predominantly on independent contractors to fulfil its services could establish the independence of those contractors.

But it was two other factors that tipped the scales in favour of the Tax Commissioner:

- **Control** – while panel members can decline an assignment, once they have accepted they are under fairly tight control by ATL. The view of the tribunal was that a contractor would generally not be expected to report back to the contracting organisation within 24 hours.

ATL argued that this is merely an administrative necessity of how their services are sold.

- **Lack of freedom** – panel members did not have the capacity to delegate an assignment. They could not complete the assignment as they saw fit.

The tribunal also considered the issue of whether the contractors were employed to produce a result. The 'results test' is a key test in other areas of tax law to determine if someone is a contractor or an employee. ATL contested that panel members are paid for an assignment. Contentiously, the tribunal agreed with the Commissioner's view that panel members are not contracted to produce a result but paid for their time because if a client cancels at the last moment, ATL still charges the client and the panel member will still be paid - therefore, the panel member is not paid to produce a result in these circumstances because there is no result.

The tribunal's decision is interesting as cancellation fees are a standard policy of many businesses to compensate for time being wasted or the opportunity cost of the cancellation. In this case, the fact that a panel member is paid even if an assignment is not completed is merely an extension of the penalty applied by ATL.

This case deals with independent contractors who are individuals. The use of an interposed company structure is often seen as a way of overcoming this problem (where the company represents an individual only and is the vehicle to provide their personal services) but there still may be a risk.

If you employ contractors, take a close look at the arrangements in place and whether you have a superannuation guarantee exposure.