SHAM EMPLOYMENT ARRANGEMENTS

INTRODUCTION

The question of whether a person engaged to perform work is an employee or a contractor is one of the most litigated issues in industrial law. That is mainly because there is no set formula to determine the question. Another reason is the modern trend for businesses to '*contract out*' as many functions as possible.

The issue most commonly arises in the industrial jurisdiction: for example, unfair dismissal and underpayment of wages claims.

The issue also arises frequently in the workers compensation jurisdiction where, as the title suggests, a person must be a worker to have an entitlement to compensation.

Then of course there are disputes relating to the tax treatment of persons purportedly engaged as contractors.

Sham contract arrangements are usually put in place to benefit the employer. The main benefits are:

- less tax;
- no WorkCover levies;
- no employment liabilities such as:
  - long service leave;
  - superannuation;
- flexibility.

That is not to say that there may not be at least a perceived benefit to be enjoyed by the worker in entering into a sham employment contract. They might negotiate an hourly rate well in excess of any Award or other applicable rate sufficient to cover lost superannuation and other benefits. They might also think that they are getting paid enough to afford personal income protection in lieu of statutory workers compensation entitlements. Given the recent cuts to workers compensation in this

State, essentially to make it a two year pension scheme (with income maintenance paid at 80% for the second year), income protection schemes generally offering two years' pay at 75% of salary are relatively commensurate.

Of course it can be all happy days when the sham arrangements is entered into. Lawyers and Courts do not hear about cases where parties happily engage in a sham arrangement for many years and then part ways amicably.

A worker who freely enters into a sham arrangement is not prevented from later asserting an employment relationship if things turn sour (for whatever reason) and they wish to retrospectively establish an entitlement to the benefits of employment.

Having said that, how the parties viewed the relationship when it was formed is one of the considerations that the Courts will take into account when considering this vexed question.

Turning then to the other considerations.

THE INDICIA OF EMPLOYMENT

The cases dealing with this issue invariably talk about the "*indicia"* of employment, more recently referred to by the Courts as the "*multi factorial test*" or "*totality test*".

There is no one single factor which will determine whether a person is an employee or a contractor. The relationship as a whole must be analysed.

The indicia often considered include:

- Who supplies the tools or equipment used to perform the tasks?
- Is the worker free to perform work for other employers?
- Can the worker send someone else to perform the work in their place?
- Who carries the risk of financial loss or put conversely, who has the opportunity to make a profit from the work?
- The method of payment.
- Whether the worker holds themselves out as an agent of the employer to third parties.
- How the parties view the relationship.

A number of these indicia relate to the level of control that the employer has over the worker, which has developed into what is referred to as the "*control test*". Common examples of where the employer exerts control over the employee are:

- Directing an employee where and when to perform their work: e.g., set starting and finishing times, set times for breaks.
- Requiring approval for periods of leave.
- Requiring a worker to be available to work exclusively for the employer.
- Forbidding the worker to send someone else to perform the contracted tasks.

While determining the question of whether a worker is directed to work at a particular time and at a particular place is usually straightforward, more argument arises when considering the question of "*how*" a worker is required to perform their work. Often, employers will argue that a person is a contractor because they are given complete autonomy with full discretion as to how they perform their tasks. It may be that they are even working alone at a remote location.

How a worker performs their work will not on its own determine the bigger question. Longstanding, trusted and experienced employees will often be given a degree of autonomy of their work, but if they are told to be at a particular place at a particular time day in day out they will most likely be an employee.

An early example of the High Court's consideration of this topic is *Zuijs v Wirth Brothers*, a 1955 case. There the worker was a trapeze artist in a circus. In arguing that Mr Zuijs was a contractor, the circus company pointed to the fact that he had complete artistic control of his routine. As you can imagine, however, Mr Zuijs was required to be available to perform at particular times and at particular locations. The High Court held that he was an employee.

The High Court has considered the question of weighing up the indicia of employment on a number of times since 1955, most recently in *Hollis v Vabu*, but not much has changed in terms of the Court's analysis.

No magic formula has been developed.

The process has been variously described by Judges in these terms:

"*There is no magic touchtone*"

"*The elephant test – an animal too difficult to define but easy to recognise when you see it*".

"*Like viewing a painting from a distance, requiring the adjudicator to 'stand back' from the details and make a considered qualitative appreciation of the whole*"

More recently, the test has been described by a Federal Court Judge less eloquently as "*the smell test*".

One useful development in the Courts' approach to the question is to consider which of the parties is operating a business. In a 2011 Federal Court case, Justice Bromberg considered this:

"*In an employment relationship there would typically be an entrepreneur, but that will be the employer, it would never be the employee. The employer will take the risk of profit or loss. The employee seeks the security of fixed and certain remuneration. Unlike the independent contractor, the employee has no business, and typically will have no interest or desire, in exposure to the risk of loss in return for the chance of profit*".

When looked at this way, it becomes easier to determine whether a person is a worker or a contractor.

Three of the indicia which are central to the question of whether a person is a budding entrepreneur or an employee are:

- Whether the worker can send somebody else to perform the contracted works (i.e., their own employee or a business partner).
- Whether they are free to work for other parties during the term of the contract.
- How they hold themselves out to third parties when performing the contracted works.

The Court will also need to have a look at the books to determine whether the person is operating a business for profit or is merely receiving wages for work performed.

PRACTICAL CONSIDERATIONS

While this issue is most commonly examined after the fact, clients will often seek advice about possible sham arrangements at the '*front end*'. This can arise in two situations. Firstly, where an employer is starting a business and wishes to engage someone as a sub-contractor. The other scenario is where a business has been engaging staff as employees but wishes to convert their employment to a principal/contractor arrangement.

In the latter case, it is often not proposed that there be any change in the relationship other than the employer wishing to cut costs by avoiding its obligations as an employer. They merely wish to 'dress up' what is clearly an employment relationship as a principal/contractor one.

The devices most commonly used in such a case are:

1. A self-serving contract which describes the parties as principal and contractor and includes a clause like:

   "*Nothing in this agreement is intended to create an employment relationship and the parties will remain as principal and contractor*".

   Such a clause is sure to attract scrutiny.

2. The second device is for the employer to insist that the employee provides a tax invoice for payment and, if necessary, register for GST.

If both of these devices are employed, but everything else about the relationship points to employment, the Court will no doubt find that an employment relationship exists.

There is more scope to establish a genuine/contractor relationship in the case of a new business looking to engage workers on such terms, but only if the requirements of the job allow it. For example, The parties will not be able to agree that the worker can perform work for other principals (and effectively run their own business) if the employer requires them to be at their work place from 9 to 5, Monday to Friday.

The only conceivable way for a true employment relationship to be disguised as a principal/contractor relationship is for an incorporated principal to insist that the worker themselves incorporate.

Traditionally, a contract between one Pty Ltd and another Pty Ltd would not ever be viewed by the Courts as a contract of employment, even if the worker Pty Ltd was a one person operation incorporated only to facilitate a sham arrangement.

The Courts have in recent times been prepared to peak behind the so called "C*orporate Veil*" to examine what is really going on.

Examples include a UK case where the operator of a cafe car wash required the individual car washers to incorporate. There are also Australian cases where the Courts have found an employment relationship to exist between two companies.

The Courts' alertness to these shams has prompted employers to become more creative. In particular, employing companies have started establishing triangular contracting arrangements to put a third entity between them and the employee.

The High Court recently and convincingly considered such an arrangement in the matter of *Fair Work Ombudsman v Quest South Perth Holdings Pty Ltd*, a decision handed down in December 2015.

This is a useful case because it opens a discussion about the sham contracting provisions contained in the *Fair Work Act* 2009.

Those provisions make it unlawful for an employer to misrepresent to someone who is in fact an employee that they are engaged as an independent contractor.

In *Quest*, the High Court held that at Section 357(1) of the Act prohibits an employer from misrepresenting to an employee that the employee performs work as an independent contractor under a contract for services with a third party.

The facts in *Quest* were these:

- Quest operated a business of providing serviced apartments.
- Margaret Best and Carol Rodden were employed by Quest as housekeepers.
- Contracting Solutions Pty Ltd operated a labour hire business.

- Quest and Contracting Solutions entered into a triangular agreement under which Contracting Solutions purported to engage Ms Best and Ms Rodden as independent contractors.
- Contracting Solutions then purported to provide the services of Ms Best and Ms Rodden to Quest under a labour hire agreement.
- Quest represented to Ms Best and Ms Rodden that they were performing housekeeping work as independent contractors of Contracting Solutions, when in fact they continued to perform that work for Quest under implied contracts of employment.

The Fair Work Ombudsman commenced a civil prosecution of Quest which failed in the Federal Court both at first instance and on appeal.

The Full Federal Court found that Section 357 would only be contravened by an employer's representation to an employee which mischaracterised the contract of employment that existed between the employee and the employer, not any contract between the employee and a third party.

The High Court looked beyond the triangular agreement and overturned that decision.

The sham arrangement provisions in the *Fair Work Act* are civil remedy provisions. A breach of them can make an employer liable to pay pecuniary penalties. A single breach of the sham arrangement provisions attracts a penalty of up to $10,800.

There will of course still be employing entities prepared to take the risk on entering into a sham arrangement. They need to be advised that any attempt to disguise what is truly an employment relationship as something else will most likely fail.

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