

working as a contractor

Contracting refers to an arrangement under which you render services to a company or organisation without becoming an employee. Contracts will generally be for a fixed period, usually weeks or months, although it is not uncommon for 'back to back' contracts to be offered.

why do companies and other organisations hire contractors instead of employees?

Some of the reasons companies and other organisations may hire contractors rather than employ someone on a permanent basis include:

- ~ The need for temporary resources for specific projects. Contractors may be hired to work on a specific project.
- ~ Restrictions on employee numbers. Some companies and organisations may have restrictions on full/part time employee numbers, however, they may be able to offer contracting roles.
- ~ Outsourcing. Many companies and organisations may out source particular functions eg, IT.
- ~ Flexibility. Contracting offers companies and other organisations flexibility to hire staff on a needs basis.

why do individuals take contracting roles instead of becoming an employee?

Some of the reasons individuals may take contracting roles instead of becoming an employee include:

- ~ Lack of choice. In some situations, individuals may only be offered a contracting role.
- ~ Flexibility. Contracting may offer greater flexibility than employment, eg, the ability to set working hours.
- ~ Financial. In some situations, contracting may offer greater remuneration than employment.

practical issues

There are a number of practical issues to consider when taking on contracting roles, including:

- ~ Structure
- ~ Cash flow
- ~ Job security
- ~ Asset protection
- ~ Insurance

structure

There are three main ways contacting arrangements are structured:

- ~ Individual

The simplest way to contract is to directly enter into a contract with a company or organisation.

- ~ Through an agency.

Another common way to contract is to offer your services through an agency. An advantage of this arrangement is that the agency may play an active role in seeking work for you and in negotiating your hourly rate. This comes at a cost, as the agency will charge a commission, which may reduce the hourly rate you receive.

- ~ Through an entity such as a company or trust.

Offering your services through an entity such as a company or trust involves additional cost over contracting as an individual. In some situations, having a company is a necessity as some companies and other organisations will only offer contracts through a company, ie they will not offer contracts to individuals. In addition, there may be some advantages in using a company or trust which may offset the additional cost. They may include:

- ~ Ability to take advantage of salary packaging options such as fringe benefits and salary sacrifice superannuation.
- ~ Income splitting opportunities, although these may be limited by the Personal Services Income (PSI) rules, which are discussed in more detail below.
- ~ Asset protection.

cash flow

One of the biggest issues, which you need to address in moving from employment to contract work, is cash flow.

- ~ Your budget needs to be able to accommodate periods when you do not receive contracting work
- ~ You may be paid in arrears and there may be a time lag between the time services are rendered and when you receive payment.

Part of your budgeting process should include a cash buffer or the ability to conveniently access borrowed funds to allow for peaks and troughs in your cash flow.

asset protection against litigation

When you are an employee, your employer is liable for your actions. As a contractor you could find yourself liable for work you perform under your contract. Accordingly, you need to consider asset protection strategies such as use of a company or trust, transfer of ownership of assets and professional indemnity insurance.

insurance

You need to review your insurance cover to ensure it is adequate. In particular, you should review the following:

- ~ Professional indemnity, as outlined above.
- ~ Workcover. Do you need to take out separate cover or are you covered by the policy held by the organisation you are contracting to?
- ~ Income protection. What definition of disability is used by the policy? As your income from consulting may be irregular, what definition of income is used by the policy?

sick, annual, long service leave

As a contractor you are unlikely to be eligible for sick, annual and long service leave. Thus you need to ensure that the amount charged for your services incorporates an allowance for these.

- ~ Taxation

- ~ Pay as you go (PAYG)
- ~ PAYG Withholding

If you contract directly with the company or organisation or contract through an agency and the contract is primarily for your labour, the company, organisation or agency may deduct PAYG tax from payments in the same way as would happen with salary and wage income.

Alternatively, if you are employed by your own company, your company will be required to deduct PAYG tax from the salary it pays to you.

PAYG instalments

If the payments you receive for contracting are not subject to PAYG withholding, you may be liable to pay quarterly PAYG tax instalments. You will be required to lodge either an Instalment Activity Statement (IAS) or Business Activity Statement (BAS) with the Australian Taxation Office (ATO), which is due when you remit the quarterly PAYG tax instalments.

goods and services tax (GST)

You may be required to register for and charge GST where you operate a contracting business or where you offer your services through a separate entity such as a company or trust. In this situation, you are required to register for GST if annual turnover exceeds \$75,000. You are required to charge GST on your invoices accordingly, you need to take this into account when negotiating contracts. You are also able to claim an input tax credit for GST on items purchased for use in your contracting business.

GST is generally paid to the Taxation Office quarterly.

business activity statement (BAS)

Where you operate a contracting business or where you offer your services through a separate entity such as a company or trust, you will be required to lodge a BAS, usually on a quarterly basis. A BAS covers all payments to the Taxation Office including GST, PAYG and FBT. It is usually lodged quarterly and is required in addition to annual tax and FBT returns.

personal services income (PSI)

The PSI rules may apply where you receive income wholly or principally for your labour or services or where you receive income from exercise of personal expertise. They are an anti-avoidance measure which is designed to prevent you from diverting income from personal services to related person or a company, which would result in less tax being paid than if you personally earned the income. The PSI rules may also restrict the tax deductions you are able to claim.

Factors, which indicate that the PSI rules may apply, are as follows:

- ~ most of your personal services income comes from a single source (normally 80% or more)
- ~ you operate from premises supplied by the company or organisation you contract to

Factors which suggest the PSI rules may not apply are as follows:

- ~ you meet the 'results test:'
- ~ you are contracted to produce a specific result eg deliver a specific component of software
- ~ you provide your own plant and equipment or tools of trade
- ~ you are liable to rectify defects in the work performed
- ~ you contract to two or more unrelated entities

~ you employ one or more non-related parties who perform at least 20% of your personal services work.

If the PSI rules apply:

- ~ you cannot pay a salary or make superannuation contributions for a family member unless they perform 'principal' work
- ~ you cannot split your personal services income with other related parties eg through the use of a company or trust
- ~ if you contract through a company, all the profit from personal services must be paid to you as salary

australian business number (ABN)

You will need to quote an ABN when invoicing for your services. If you don't the company or organisation you contract to will be required to withhold tax at the top marginal tax rate (46.5%) on payments made to you.

Note that you do not need to quote an ABN if the amounts paid for your services are subject to PAYG withholding. In this situation, you would need to quote your Tax File Number (TFN).

superannuation guarantee charge (SGC) contributions

Companies and other organisations are required to make SGC contributions where they hire contractors and the contract is wholly or principally for labour. The required contribution is 9% of the gross amount payable under the contract, with a maximum contribution of \$3,436.20 per quarter (in 2008/09, based on quarterly income of \$38,180 or \$152,720 p.a.). You should also receive SGC contributions where you contract through an agency. In most situations you will be able to choose the superannuation fund to which your SGC contributions are paid.

Where you offer your services through your own company or trust, that company or trust has an obligation to make SGC superannuation contributions on your behalf.

salary sacrifice

You may be able to negotiate additional salary sacrifice superannuation where you contract directly to a company or organisation, which is required to pay SGC superannuation contributions or where you contract through an agency. However, the company or organisation you contract to is not required to offer salary sacrifice.

Where you offer your services through your own company or trust, you can arrange for the company or trust to make salary sacrifice superannuation contributions on your behalf.

personal deductible superannuation contributions

If your assessable income from sources where you are an employee for SG purposes is less than 10% of your total assessable income (and reportable fringe benefits) you may be eligible to claim a deduction for personal superannuation contributions. You may claim a deduction for up to 100% of your personal contribution, however, personal deductible contributions count towards the concessional contributions cap, together with any employer superannuation contributions you may receive. In 2008/09 the concessional contributions caps are:

age at 30 June 2009	concessional contributions cap
Under 50	\$50,000
50 or over	\$100,000



ipac explains

Contributions in excess of the concessional contributions cap are subject to 'excess concessional contributions tax' of 31.5% in addition to the 15% contributions tax, a total of 46.5%. The excess also counts against your non-concessional contributions tax.

where to seek help

For additional assistance, contact your ipac adviser or your tax or legal adviser.

ipac securities limited ABN 30 008 587 595 AFS Licence No. 234656
Level 31, 225 George Street, Sydney NSW 2000 Telephone 02 9373 7000 Facsimile 02 9373 7111

The information provided is of a general nature only and does not take into account the particular needs, objectives or circumstances of any individual. Professional advice should be obtained before implementing any investment Strategy. We believe the information contained in this publication to be accurate and reliable. However, no warranty of accuracy is given and no responsibility arising in any other way for errors or omissions including responsibility to any person by reason of negligence (except as required by law) is accepted by ipac securities limited, its directors or employees nor any other member of the ipac group. The technical information provided is current as at March 2009 and subject to change.

This publication may not, in whole or in part, be lent, copied, photocopied, reproduced, translated or reduced to any electronic medium or machine readable form without express written permission from the publisher.