



# INDEPENDENT CONTRACTORS

*the easy complete guide for employers*

## **COPYRIGHT**

© Aidmax Limited 2002, 2005, 2006, 2007

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted, in any form or by any means, without the written prior permission of Aidmax Limited (via its publishers - AdviceWise People Limited), or as expressly permitted by the law. The authors have asserted their rights.

## **DISCLAIMER**

This publication is a general guide only. No person should act on any statement contained in this guide, without first getting professional advice. For specific advice applicable to your circumstances, contact 0800 WANZHELP (0800 9269 4300).

# INDEPENDENT CONTRACTORS

---

## Introduction

Contracting and outsourcing are increasingly being seen as an attractive option for both businesses and individuals. Contracting allows more scope for business to adjust contributions to exactly what is required at any time, which results in the business being more efficient and cost effective. For individuals and contracting companies there is the advantage of generating a spread of income from more than one source.

However, many companies and individuals choosing contracting are not fully aware of the legal obligations that contracting requires. For the principal (the “employer”) in any arrangement there are particular hazards. Some principals hope that by engaging contractors they can eliminate some of their workplace risks associated with the contracting activity, or reduce the overheads associated with employees such as PAYE, FBT, holiday pay, ACC levies etc. However this is not always the outcome.

Businesses often engage contractors on an ad hoc basis without having a properly drafted written agreement. Even though generally these may be short term, low value arrangements the risks to the Principal can still be substantial. Accordingly, it is essential that a principal draft an agreement before entering into a contracting relationship. The written agreement should be tailored to take into account the particular risks associated with the contracting activity.

It is important therefore that before hiring a contractor that the following sections are clearly understood.

## Why Contract

A business can have a number of reasons to consider contractors. These could include:

- The need for flexibility in its workforce to cope with fluctuating demand for its products or services.
- A belief that costs may reduce if contractors are used rather than directly employing staff
- Difficulty in sourcing and retaining specialist staff (this is particularly so in the I.T. areas)
- A business plan that focuses the enterprise on its core direction and seeks to remove distracting ancillary servicing requirements from the business

Contracting out to a contractor (individuals or a company) tasks which have previously been carried out by staff can be fraught. There may be implications with staff made redundant as a result, union concerns and workplace unrest. We recommend you contact AdviceWise People Ltd to discuss these issues before making a decision as our experts can advise on the best process to be followed.

## The critical issue – Employee or Contractor?

The distinction between an employee and a contractor is very important. If a contractor is in fact determined by the Department of Labour, the Employment Authority or the Courts to really be an employee, the principal (the “employer”) will be responsible for correcting the situation. This could include:

- Employing the contractor as an employee
- Providing for previous leave and allowances

- Undertaking directly certain obligations (such as OSH etc.) that had been assumed to be the contractors responsibilities
- Being fined should the arrangement be seen to be a deliberate attempt to avoid legal duties

A business must be very clear before taking on independent contractors of:

- What determines who is an employee and who qualifies as an independent contractor
- The obligations imposed on a principal when engaging an independent contractor
- Potential problems that may arise throughout the relationship with a contractor

The following sections look at the issues in depth.

### **Defining the relationship**

Before an independent contractor is engaged it is vital that the principal clearly understands what constitutes an employee and what the differences are with an independent contractor.

The legal position is spelt out in the various Acts and also there are some common law principles.

### **Incorporated Contractors**

Most independent contractors, even if they are an individual person, operate as a limited liability company. And many of course are substantial local, national or indeed international entities.

In most cases a contract with a registered company that effectively comprises more than one person will be upheld by the Courts as defining a relationship between a principal and an independent contractor. However this cannot be taken as a certainty and there are cases where employees of the independent contractor were in fact deemed to actually be employees of the principal.

### **Individual contractors**

Determining whether arrangements with individuals directly employed as independent contractors meet the requirements of the law needs to be very carefully considered. An "individual" can include a person who contracts in their own name, works as a partnership, or uses a business name.

### **The tests**

There are a number of tests that can be applied to determine whether a person is an employee or independent contractor. A decision is reached on a combination of factors that indicate the true nature of the relationship. If the relationship fails any one of the tests it is not an independent contractor arrangement. The worker is deemed an employee.

The Control Test considers at the degree of control that the principal has over the contractor in deciding the manner in which the contractor performs the services. For example:

- Can the principal direct when the contractor is required to work, as well as the manner in which the work is to be done?
- What type of procedures must the contractor comply with?
- Will the principal or the contractor be supplying any equipment?

The Integration Test considers whether the person performing the services is a person in business on his or her own account. That is, is the work of the contractor an integral part of the principal's business, or is it merely an accessory to the business.

A further test looks at whether terms of an independent contractor agreement are consistent with an employment agreement.

The Multi-Factor Test involves consideration of a number of indications and incorporates the Control Test as only one.

**Test Checklist**

You can use the checklist below to indicate whether there is an employee or independent contractor relationship.

Using the checklist will not definitively determine the legal position as this is ultimately decided by a Court which will not necessarily consider all the same factors. A Court is more likely to give more weight to what actually occurred in the workplace and the potential for the arrangement rather than what was considered when the agreement was made.

To use the checklist below, it is not necessary that every indication for an independent contractor have a "tick". Also, a person may be an independent contractor, even though some of checklist items indicate that they have the characteristics of an employee. In an Employment Court decision in August 2002 Judge Colgan found that although a contractor /principal relationship "had some hallmarks of an employment relationship.....I am satisfied that it was not substantially such a relationship".

We recommend you use the checklist only as a guide and call AdviceWise People if you have any queries or uncertainties.

Conditions		Employee	Independent Contractor
1.	Does the agreement state the relationship is one of an independent contractor?	No	Yes
2.	Is it the express intention of the parties that there will be an employer / employee relationship?	Yes	No
3.	Is the person engaged fully integrated into the principal's business?	Yes	No
4.	Is it the right of the principal to control how, when, where, and by whom, the work is performed?	Yes	No



5.	Can the person engaged decide to perform the work during the hours, and at the locations, which are suitable and convenient to them?	No	Yes
6.	Does the agreement require the work to be performed personally by the person engaged?	Yes	No
7.	Does the person engaged have the power to delegate or sub-contract the work?	No	Yes
8.	Can the person employ others to carry out the work under the contract?	No	Yes
9.	Is the person engaged free to accept work from other principals?	No	Yes
10.	Does the person engaged offer their services to the public generally?	No	Yes
11.	Does the person engaged personally profit from working more efficiently or productively?	No	Yes
12.	Is the person engaged responsible for losses occasioned by poor workmanship or negligence?	No	Yes
13.	Is there a right to the exclusive services of the person engaged?	Yes	No
14.	Is there a continuing engagement for an indefinite period?	Yes	No
15.	Is there a necessity to enter a into new agreement each time a new task is required	No	Yes
16.	Is there a contract for a specified result?	No	Yes
17.	Is the person's remuneration by fixed salary or hourly wage?	Yes	No
18.	Is the person's remuneration based on a quotation?	No	Yes
19.	Is the person engaged paid according to invoices?	No	Yes
20.	Is the person engaged paid upon the completion of the task?	No	Yes (usually)
21.	Is the person engaged required to provide their own equipment and / or materials	No	Yes
22.	Does the person engaged provide the office space, power, telephone, etc?	No	Yes

23.	Is holiday pay, long service leave or sick leave paid?	Yes	No
24.	Is the person engaged subject to the principal's internal processes and procedures	Yes	No
25.	Does the principal have the right to suspend or dismiss the person engaged by the contractor to perform the services?	Yes	No (usually)
26.	Does the arrangement provide that the principal is to be responsible for providing ACC?	Yes	No
27.	Is the person a registered for ACC purposes?	No	Yes
28.	If the principal terminates the agreement, is it required to pay redundancy pay, or any other monies on termination of the agreement?	Yes	No
29.	Is a significant proportion of the remuneration for materials used or expenses incurred by the person engaged?	No	Yes (sometimes)
30.	Does the work involve a profession or trade on the part of the person engaged?	No (usually)	Yes (sometimes)
31.	Will the person be held out as being a part of the principal's business, or to be representing the principal (eg, business cards, etc)	Yes	No
32.	Can the work be performed by the person engaged be done by the principal's other staff?	Yes	No

### **Risks for Principals**

The engagement of contractors to provide labour or outcomes gives rise to a range of legal obligations and potential risks and liabilities for the principal. Some of the significant areas of legal risk are:

#### **Insurance**

Ensure that your insurance protection and that of your contractor are compatible. In addition, it is recommended that the principal have in place processes by which it can confirm that its contractors have in place the appropriate type and level of insurance, and that the contractor complies with all known policy conditions.

#### **Termination**

Independent contractors can sue for breach of contract in a civil action under contract law if they believe the contract was breached.

At termination (or in some cases even during the term of a contract) it is increasingly common for an individual independent contractor to seek advice from the Department of Labour or an employment professional in an attempt to establish in the Mediation Service, Employment Authority or Courts that they were in fact an employee (not an independent contractor) and needed to be treated as such. The principal would then be considered an employer and be responsible for matters such as holiday pay, notice and fair process of dismissal.

## **The Law**

While the Employment Relations Act does not apply to independent contractor arrangements (except section 6 - defining an employee) there are several areas of law a principal has to comply with when engaging contractors. These include the Human Rights Act, Bill of Rights Act and contract law.

Under the Health & Safety in Employment Act the principal has the same duty of care for contractors working on its premises or using its equipment as it has for its own employees.

## **Intellectual Property**

The principal must take care with the protection of proprietary intellectual property (such as designs, exclusive processes and ideas) and should ensure that ownership by the principal is identified in any agreement. The ownership of intellectual property developed by the independent contractor while being paid by the principal should also be made clear in the agreement.

## **Indemnities**

The principal should gain an indemnity from the independent contractor against any liability which the principal may have to third parties in relation to the contractor's actions and/or which require the contractor to hold harmless the principal against any losses which it may suffer.

## **Taxation**

Taxation matters related to contractors can be quite complex. This includes whether withholding tax needs to be deducted from payments and at what level. Refer to the IRD website [www.ird.govt.nz](http://www.ird.govt.nz) or call your accountant to find out what the appropriate tax treatment is for each particular case.