

## Fact sheet: Employee versus independent contractor

### Employee Versus Independent Contractor

The question of whether a worker is an employee (working under a contract of service) or an independent contractor (working under a contract for services) is very important for all kinds of reasons.

An **employee** has all the legal protections attached to that status: the right to be paid at least minimum wage, the right to statutory holiday and leave entitlements and the right to have their employer pay KiwiSaver contributions, to name just a few.

A **contractor** should enjoy greater freedom as to how and when they work, but there will be more direct responsibilities for workplace health and safety requirements, and the payment of tax (income and GST) and accident compensation levies.

While the intention of the parties is important, the fact they call their relationship that of “employer and employee”, or “principal and contractor”, is not conclusive proof of that relationship. The Employment Relations Act 2000, which governs employment relationships, makes this very clear. The overarching question is “What is the real nature of the relationship between the parties?”.

The status of a person for tax purposes follows employment status. So, if a person works for hire or reward under a contract of service, their employer must, for example, deduct PAYE on their salary or wages.

The nature of work has changed drastically over the years, the “gig economy” resulting in comparatively few employees working under close management in an office for a standard 40-hour week over Monday to Friday. However, there are 3 major tests developed over many decades that the Employment Court and the Employment Authority still find useful when they are deciding whether a worker is an employee. These should be used as indicators to anyone setting up a working relationship with any individual.

### The tests

- **Control test:** has the employer the right to control the way the work is performed?
- **Integration (or organisation) test:** is the worker independent or instead an integral part of the business organisation of the person who engaged them?
- **Fundamental (or economic reality) test:** is the worker genuinely in business on their own account?

Many questions can be asked to determine if these tests are met. A recent judgment of the Employment Court (*Leota v Parcel Express Ltd* [2020] NZEmpC 61 ¶120-220) set out some of the most common questions, together with the *likely* direction a “yes” answer might suggest:

<i>Indicator</i>	<i>Employee</i>	<i>Independent Contractor</i>
Does the hirer have the right to exercise detailed control over the way work is performed, so far as there is scope for such control?	✓	
Is the worker integrated into the hirer’s organisation?	✓	
Is the worker required to wear a uniform and/or display material that associates them with the hirer’s business?	✓	
Must the worker supply and maintain any tools or equipment?		✓
Is the worker paid according to task completion, rather than receiving wages based on time worked?		✓
Does the worker bear any risk of loss, or conversely have any chance of making a profit from the job?		✓

Is the worker free to work for others at the same time?		✓
Can the worker subcontract the work or delegate performance to others?		✓
Is taxation deducted by the hirer from the worker's pay?	✓	
Does any business goodwill accrue to the hirer?	✓	
Does the worker receive paid holidays or sick leave?	✓	
Does the agreement describe the worker as an independent contractor?		✓

## Keep in mind

If Inland Revenue investigates a person claiming to be an independent contractor, the onus of proof and the possibility of penalties is as much on the hirer as it is on the contractor.

Inland Revenue is vigilant against attempts to avoid the PAYE system, conscious of the favourable tax treatment that self-employed taxpayers receive due to tax deductions for business expenses, not to mention the cash flow advantages.

Contracting through a company will not necessarily prevent Inland Revenue from overturning a decision to treat a worker as an independent contractor. If they consider the arrangement is a sham, the contractor will be treated as being in the PAYE system. The likely consequences include a PAYE bill on the grossed-up salary, penalties and even possible prosecution.

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