

EMPLOYEE OR INDEPENDENT CONTRACTOR?

Background

This interpretation guideline will help taxpayers to determine correctly their employment status for tax purposes. It describes the common law tests developed by the courts for determining whether a person is an employee or an independent contractor.

This interpretation guideline replaces the policy statement entitled “Employee or independent contractor?” in Tax Information Bulletin Volume Four, No. 7 (March 1993) at pages 2-4 which outlined the tests for determining whether a person is an employee or an independent contractor. That policy statement was published before the Court of Appeal overruling the Employment Court decision in *Cunningham v TNT Worldwide Express (NZ) Ltd* [1992] 3 ERNZ 1030. On the whole the previous statement contained the correct factors to consider, but it did not fully reflect the approach to this question currently taken by the courts. This interpretation guideline is consistent with, and should be read in conjunction with, the policy statement in TIB Volume Five, No. 1 (July 1993) at page 5 which discusses the implications of the Court of Appeal decision in *TNT Worldwide Express (NZ) Ltd v Cunningham* (1993) 15 NZTC 10,234 in relation to the employment status of courier drivers.

Relevance of employment status

A taxpayer's tax obligations differ according to his or her employment status, so it is important to know if he or she is an employee or not. The employment status of a person has the following consequences for tax purposes:

- Payments to employees from their employer are salary or wages, which must have PAYE deducted at source.
- Employees cannot register for or charge GST for services they supply as employees.
- Independent contractors:
 - may deduct certain expenses incurred in deriving assessable income;
 - must account to Inland Revenue for tax and ACC earner and employee premiums for themselves and any employees; and
 - must meet all the requirements of the Goods and Services Tax Act 1985 if the services they supply are in the course of a taxable activity, and they are registered (or liable to register) for GST.

It is not possible for taxpayers to alter their employment status (or the resulting tax implications) merely by calling themselves independent contractors when they are essentially still employees.

Types of employment arrangement

A person's employment status depends on whether his or her employment contract is a "contract of service" or a "contract for services". In *New Zealand Educational Institute v Director-General of Education* [1981] 1 NZLR 538, Somers J in giving the judgment of the Court of Appeal said at page 539:

On many occasions over the years the Courts have had to decide whether the relationship between two persons was that of employer and employee or, as it used to be called, master and servant. The inquiry normally involved the distinction between a contract of service in which the relation was that of employer and employee and a contract for services in which the relation was that between employer and independent contractor. A decision in any particular case required an examination of the contract between the two – it might be expressed in words or it might be implicit from the circumstances.

Employees have a "contract of service" with their employer. Contracts of service evolved from the earlier concept of a master-servant relationship. Such a relationship required an employee to be continuously available for service and to accept a high degree of control by the employer.

A "contract for services" applies to the relationship between an independent contractor and a principal. It emphasises the nature of the services to be provided by a person rather than his or her availability to work as directed.

Either form of contract may include an unwritten agreement. A written contract is not necessary in determining the existence of any particular type of employment relationship. However, if there is a detailed written contract, it will form the basis for analysing the nature of the relationship the parties intended to have. Employment contracts often change as the relationship evolves (e.g. a person takes on more duties). Changes in regulations and work practices may also cause the employment status of some workers to change. The courts will consider how the parties actually work together when they determine the type of employment relationship the parties have.

Employment status and revenue law

Tax law relies on the terms "contract of service" and "contract for services", but does not define them. Therefore, their meanings depend on the contract law developed by the courts and any statutes that apply to a particular kind of work.

A person will have the same employment status for tax purposes as he or she has under the general law. Sometimes it is not easy to tell if a taxpayer is an employee or an independent contractor. Inland Revenue will use the current common law tests to determine a worker's status.

TNT Worldwide Express v Cunningham

A leading New Zealand case on the question of whether the relationship between two parties is one of employee and employer, or independent contractor and principal is the Court of Appeal decision in *TNT Worldwide Express*. In that case the Court gives guidance as to the appropriate focus of inquiry in deciding this question.

In *TNT Worldwide Express* the respondent was engaged by the appellant company, TNT, as an owner-driver to conduct a courier service for the company. The owner-driver:

- provided his own vehicle and was responsible for its maintenance and upkeep,
- was responsible for all his own tax and ACC payments,
- claimed deductions as if he were self-employed, and
- had a contract with TNT that said he was an independent contractor.

The company terminated the respondent's contract, and the respondent sought to invoke the personal grievance procedure under the Employment Contracts Act 1991.

The Employment Court held that an owner-driver courier for TNT was an employee and not self-employed. In reaching that conclusion, considerable emphasis was placed on the rigorous control which the company exercised over its owner-drivers. The Employment Court found that the company's actions showed that it treated the owner-driver as its employee. In particular, the Court found it significant that the company:

- imposed an obligation on the owner-driver to provide a licence, wear a uniform, and have the company's logo painted on the vehicle,
- exercised strong control over the volume, type, quality, and location of his work,
- supervised him closely,
- restricted him from carrying freight for anyone else,
- had all ownership rights over the business and goodwill, and
- could regulate his income (by controlling where and how much he worked).

The Court of Appeal's decision reversed that finding, holding that the written contract entered into by the parties created a genuine independent contractor relationship. The Court accepted that an owner-driver courier was an independent contractor rather than an employee where his or her contract with TNT:

- required him to provide his own vehicle, uniform, approved radio telephone, goods service licence under the Transport Act 1962, and insurance,
- paid him mainly on a per trip basis,
- made him responsible for employing any relief driver,
- referred to the courier as an independent contractor, and
- gave TNT very extensive control over his operations.

The Court acknowledged the extensive control exercised by TNT over the owner-driver, but concluded that the owner-driver accepted only that degree of control and supervision necessary for the efficient and profitable conduct of the business he was running on his own account as an independent contractor. Casey J cited (at page 697) the following statement of MacKenna J in *Ready Mixed Concrete (South East) Ltd v Minister of Pensions and National Insurance* [1968] 1 All ER 433 at page 447:

A man does not cease to run a business on his own account because he agrees to run it efficiently or to accept another's superintendence.

The Court of Appeal said that when the contract is wholly in writing and it is not a sham, then the nature of the relationship intended by the parties is determined from the terms of that contract in the light of all the surrounding circumstances at the time it was made. Cooke P (as he then was) noted at page 10,235 that “it is necessary to consider all the terms of the agreement”, and made the following observations at page 10,238:

When the terms of a contract are fully set out in writing which is not a sham (and there is no suggestion of a sham in this case) the answer to the question of the nature of the contract must depend on an analysis of the rights and obligations so defined.

...

In the end, when the contract is wholly in writing, it is the true interpretation and effect of the written terms on which the case must turn.

Tests of the employment relationship

In cases where the nature of the relationship is unclear the courts have developed various tests to determine the type of contract that exists. Cases may not be clear-cut and the tests may overlap. Therefore, the results of the various tests must be carefully weighed to find the predominant factors that will determine the relationship. In *TNT Worldwide Express*, the Court of Appeal cited (at page 10,248) a statement from page 382 of the judgment of the Privy Council in *Lee Ting Sang v Chung Chi-Keung* [1990] 2 AC 374:

What then is the standard to apply? This has proved to be a most elusive question and despite a plethora of authorities the courts have not been able to devise a single test that will conclusively point to the distinction in all cases.

The Privy Council in *Lee Ting Sang* quoted with approval from the judgment of the English Cooke J in *Market Investigations Ltd v Minister of Social Security* [1968] 3 All ER 732, at page 185:

No exhaustive list has been compiled and perhaps no exhaustive list can be compiled of considerations which are relevant in determining the question, nor can strict rules be laid down as to the relative weight which the various considerations should carry in particular cases.

Although there are no single tests or exhaustive lists that are appropriate, there are 5 broad factors or tests which are useful in determining this question. These are not alternative tests but are simply relevant factors to be considered. A discussion of the tests follows.

1. *The control test*

The control test looks at the degree of control the employer or principal exerts over the work an employee or contractor is to do and the manner in which it is to be done. The greater the extent to which the principal or employer specifies work content, hours and methods, and can supervise, regulate and/or dismiss a person, the more likely it is that the person will be an employee.

This test used to be considered as the deciding factor, but this is no longer the case. The Court of Appeal in *TNT Worldwide Express* emphasised that control is only one of several factors relevant to the interpretation of the contract. The Court endorsed

the statement of Cooke J in *Market Investigations* (at page 185) that while control will always have to be considered, it can no longer be regarded as the sole factor in determining the relationship between the parties. The Court of Appeal in *TNT Worldwide Express* considered that this factor had been given too much weight by the Employment Court.

2. *The independence test*

This is the inverse of the control test. A high level of independence on the part of an employee or contractor is inconsistent with a high level of control by an employer or principal.

The following factors may indicate that a person has a high level of independence:

- work for other people or clients
- work from his or her own premises
- supply his or her own (specialised) tools or equipment
- have direct responsibility for the profits and risks of the business
- hire or fire whoever he or she wishes to help do the job
- advertise and invoice for the work
- supply the equipment, premises, and materials used
- pay or account for taxes and government and professional levies.

On the other hand, when some independent contractors perform work for a principal, they may agree not to work for a competitor or give away trade secrets. This alone will not make the worker an employee (it actually emphasises that the worker is usually entitled to work for others).

Also, the fact that a person is contracted to one party only does not, of itself, necessarily dictate a conclusion that their legal relationship is one of employment.

3. *The organisation or integration test*

In *Enterprise Cars Ltd v CIR* (1988) 10 NZTC 5,126, Sinclair J said that this test is really whether the person is part and parcel of the organisation and not whether the work itself is necessary for the running of the business.

According to this test, a job is likely to be done by an employee if it is:

- integral to the business organisation
- the type of work commonly done by “employees”
- continuous (not a “one-off” or accessory operation)
- for the benefit of the business rather than the worker.

4. *Intention of the parties*

This test looks at the intentions of each party to the agreement regarding the nature of the relationship. The description given to a relationship by the parties to the contract is a strong, but not conclusive indication of the type of relationship that exists. The

fact that a written contract states that a person is an employee or an independent contractor may indicate the intention of the parties, but is not determinative. Holland J in the High Court in *Challenge Realty Limited and Ors v CIR* [1990] 3 NZLR 42 stated at pages 55-56:

Obviously the Court's function in interpreting a contract is to determine the intentions of the parties. When, however, the question for determination is the legal relationship between the parties created by the contract, **the expressed intention of the parties will not be determinative of the question. It is nevertheless an important factor, and if after considering all factors the exact state of the relationship is a matter of some ambiguity, may be decisive.** In the present cases before me Harcourts is the only one with a written agreement. Nevertheless I would conclude that in all cases it was the intention of the parties to create an agency relationship rather than an employer/employee relationship. The question remains as to whether that result has been achieved. (emphasis added)

Thus, if the actual circumstances point to an employment relationship, then simply labelling it an independent contract will not alter the actuality.

In *TNT Worldwide Express*, a clause in the written contract which purported to override all other aspects of the agreement stated that the courier was an independent contractor. The Employment Court found that the actual conduct of the relationship showed that TNT imposed a high level of control and supervision of its staff that was inconsistent with any independence or initiative on their part. However, the Court of Appeal in reversing this decision concluded, after weighing all the circumstances, that the TNT standard form contract created a genuine independent contractor relationship.

If an employment contract treats a person as an employee, for example by paying him or her at regular intervals, at a set rate, and deducting PAYE, this may indicate that there is an employment relationship.

5. *The fundamental test*

In *Market Investigations*, the English Cooke J said that the fundamental test for distinguishing an employee and an independent contractor was as follows:

Is the person who has engaged himself to perform these services performing them as a person in business on his own account? If the answer to that question is "yes", then the contract is a contract for services. If the answer is "no", then the contract is a contract of service. ... factors which may be of importance are such matters as whether the man performing the services provides his own equipment, whether he hires his own helpers, what degree of financial risk he takes, what degree of responsibility for investment and management he has, and whether and how far he has an opportunity of profiting from sound management in the performance of his task.

This test was approved by the Privy Council in *Lee Ting Sang* and subsequently cited by four of the five judges in the Court of Appeal in *TNT Worldwide Express*.

The fundamental test is also sometimes described as the "business test" or the "economic reality test". In *Challenge*, the Court of Appeal stated at page 65:

If it is helpful to look for a test or application in this case, apart from that of control, which is a key feature of the Act, we favour that suggested by Adrian Merritt, Lecturer in Industrial Law, University of New South Wales in his article "'Control' v 'Economic Reality': Defining the Contract of Employment" in (1982) 10 Australian Business Law Review 105 at p.118:

The issue that must be settled in today's cases is whether the worker is genuinely in business on his own account or whether he is "part and parcel of" - or "integrated into" - the enterprise of the person or organisation for whom work is performed. The test is, therefore, one of "economic reality".

This test looks at factors such as:

- whether the type of business or the nature of the job justifies or requires using an independent contractor
- the behaviour of the parties before and after entering into the contract
- if there is a time limit for completing a specific project
- whether the worker can be dismissed
- who is responsible for correcting sub-standard work
- who is legally liable if the job goes wrong.

Usually, an independent contractor agrees to be responsible for his or her work. He or she cannot usually be "dismissed", although the contract can be terminated if it is broken.

Summary

It must be emphasised that the "tests" outlined above are merely factors to be considered, rather than distinct tests, and it is important in each case to consider this question by balancing all the circumstances of the relationship between the parties. Often there will be competing factors that indicate differing conclusions as to whether someone is an employee or an independent contractor. In these circumstances, each of the tests described above should be applied to the facts of the case, and the resulting factors carefully and objectively weighed to determine the true nature of the relationship.