EMPLOYEES

vs

INDEPENDENT

CONTRACTORS

An L&E Global Publication
2014
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Employees vs Independent Contractors

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EMPLOYEES
VS
INDEPENDENT CONTRACTORS

Understanding the Distinction between Contractors and Employees and the Re-characterization of a Contractor into an Employee
Founded in 2011, **L&E Global** is an integrated alliance of premier employment law boutique firms in Europe, North America and the Asia-Pacific region. Each member firm concentrates its practice on employment law, employee benefits, labour relations, workplace privacy, and immigration, and each firm is recognized by clients and legal organizations as a leader in these fields.

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There are important distinctions between a self-employed worker/contractor and an employee. These distinctions are all the more significant since failing to understand these differences could be costly to an employer. Generally speaking, the most important element to the distinction between a contractor and an employee under the laws of most countries is subordination.

Subordination is defined as ‘the consequence of authority on the part of the employer in respect of the employee’. In other words, the employer is defined as the person that ‘postulates authority’ by issuing instructions, which the employee must follow, as well as the right to supervise or maintain control over the employee’s performance.

Although there is no legal definition of ‘subordination’ it matters less how the parties define their relationship in their agreement; what is most important is the reality of the situation; i.e. whether or not subordination actually exists based on the actions of the parties.

If an individual is responsible for organising their own workload and occupational activities than subordination does not exist, as the individual is free to carry out his employment obligations without being subject to the ‘authority’ of another.

On the other hand, if someone is claiming to be an ‘employee’ they must prove that they are under the authority of another and that their actions are subordinate to that authority, i.e. the employer directs their actions and the employee is not free to independently dictate their work organisation.

Typically, employers and employees are free to determine the nature of their collaboration, provided that the performance of the contract corresponds to the said nature. Some factors helpful in determining whether or not a link of subordination exists include:

- The parties’ intention as expressed in their agreement
- The freedom to organize the working time
- The freedom of work organization
- The ability to exercise supervisory control as a superior

If the performance of the agreement reveals factual elements incompatible with the qualification chosen by the parties, a re-qualification of the relationship (from self-employed to employee or conversely) could occur. The said general criteria are to be used in determining whether such factual elements exist in a particular case.

Re-characterization

Re-characterization refers to changing the status of a contractor into an employee. In many jurisdictions, there are no specific laws that lead to an automatic re-characterization of a contractor into an employee. However, when the factual execution of the employment relationship does not fit the qualification given by the parties, that relationship can be re-characterized by Court decision. If a clear link of subordination exists between the parties, the contractor may be re-characterized as an employee.
The risks of re-characterization are born solely by the employer and generally imply the payment of:

- Arrears in taxes and social security contributions (plus penalties) over the sums paid to the contractor
- Arrears in salary emoluments
- Payment of termination indemnities, where relevant

Severance pay will be mandatory if deemed employment is recognized under the circumstances described above and re-characterized, or if it is provided by virtue of a contract between an employer and the contractor.

In addition to the re-characterization issue, if an employer should engage contractors, an employer should be aware of e.g. the official notification requirement for foreign contractors and issues of compliance with health and safety regulations. Moreover, in certain circumstances, an employer could be jointly and severally liable for arrears in, among others, taxes and contributions in the event of illegal employment by subcontractors used by the contractor.

**TIPS**

There are several guidelines which, in most jurisdictions, help to avoid uncertainty in an independent contractor’s agreement which could, as a result, prevent re-characterization. The most important is to properly document the relationship:

- Have the relationship accurately documented with a clear statement of contractor’s tasks and obligations.
- Do not use company employment application or forms when making initial engagement.
- Refer to contractor “as such”. Avoid words such as “employee”.
- Register all temporary work labor; enhance process of visibility of temporary labor and provide necessary guidelines.
- Add language to withhold payment or terminate immediately for cause in case they breach their obligation of paying their employees and being financially sound.

Another way to prevent re-characterization is to limit the assignment. The agreement should not make inferences to, or guarantee, the length of assignment or future employment. It is also important to avoid freelance status after employee-status at the company extending or renewing temporary assignments, as these may be barred or limited under local law.

In regards to the day-to-day treatment of the independent contractor, it is important to avoid a situation of subordination by giving specific orders and instructions to contractors. It is also necessary to avoid integrating the independent contractor into the organization.

**TAXES**

Another area of distinction involves the responsibility to pay taxes and social contributions. Generally, in an employee-employer situation, the employer is required to pay social security contributions and income taxes on wages. However, in a self-employed worker/contractor situation, the individual alone is responsible for ensuring that these contributions are satisfied. In the past few years, many countries have sought to harmonize the social security position of self-employed workers to align their benefits with those received by ‘employees’. However, this process is ongoing as to date a legal definition applicable to a self-employed worker’s social security position has not yet been delineated.

To conclude, it is extremely important for companies to be aware of the distinction between employees and self-employed contractors in order to ensure that the employment relationship is clearly defined and the accompanying obligations are followed accordingly.

For more information on the law in a particular L&E Global member country please contact:

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Q1: LAWS AND GUIDING PRINCIPLES

AUSTRALIA
Two main ones:
1) The FW Act
2) Multi-factor test

AUSTRIA
Two main ones:
1) Factor test is the most important principle when speaking about re-characterization
2) Austrian employment law

BELGIUM
Four main ones:
1) Belgian Civil Code
2) Act of 27 December 2006
3) Employment contracts
4) Factor test

CANADA
Two main ones:
1) Employment contract
2) Wiebe Door factors

FRANCE
Factors developed by jurisprudence

GERMANY
Two main ones:
1) Factors developed by jurisprudence
2) German Social Code

ITALY
In the absence of specific regulatory provisions the applicable principles can be found in case law.

MEXICO
Two main ones:
1) The Mexican Federal Labor Law
2) Subordination is the key element

NEW ZEALAND
Two main ones:
1) New Zealand’s Employment Relations Act 2000
2) Common law test (Control, Integration and Fundamental Test)

NORWAY
Three main ones:
1) The 2005 Working Environment Act
2) The 1988 Holiday Act

POLAND
The Polish Labor Code

ROMANIA
Two main ones:
1) Romanian Labour Code
2) Romanian Tax Code

SPAIN
Two main ones:
1) Spanish law
2) General principles of law such as the individual autonomy of the parties

UNITED STATES
Two main ones:
1) Factor test built by jurisprudence
2) Statutory and common-law approaches
Q2: What are the legal consequences of a re-characterization?

**Australia**
Worker would be entitled to the benefits under applicable modern awards (minimum wage, unfair dismissal, etc)

**Austria**
The former contractor would become entitled to all of the related protections and entitlements

**Belgium**
Two:
1) The employer could be held liable for not having withheld personal income taxes for a period of 3 or 5 years
2) The corresponding social security scheme will be applied - the whole relationship will be qualified as an employment contract from the beginning (which leads to possible arrears)

**Canada**
Application of employees’ statutory rights and benefits (workplace security, unlawfull dismissal, etc.)

**France**
The worker will be considered as an employee ab origine (from the beginning) and will benefit from employee benefits

**Germany**
Worker will gain the status of employee and its level of protection (unfair dismissal, etc.)

**Italy**
The relationship is converted ab origine (from the beginning) into an open-ended employment relationship

**Mexico**
Workers have to terminate the existing contract and enter into a new and different contract.

**The Netherlands**
Three:
1) Worker will now benefit from advantages for employees
2) Employer will have to withhold income tax and national insurance contributions from the employee’s salary
3) Employer will have to pay tax and national insurance contributions

**New Zealand**
The independent contractor agreement can be terminated and the worker can be re-engaged as an employee

**Norway**
Two:
1) Worker is entitled to permanent employment with the employer
2) Benefits from employees’ advantages (holidays, sick leave, etc.)

**Poland**
Ascertainment of the existence of an employment relationship by courts

**Romania**
Benefit from employees’ rights and advantages - if declared by a court ruling

**Spain**
Two:
1) Contract becomes an indefinite contract of employment
2) The contract termination can be classified as null or unfair

**United States**
Three:
1) Payment of arrears of contributions
2) Risk of lawsuits
3) May increase the number of employees and render an employer subject to other laws that were previously inapplicable, because the employer did not meet the threshold
Q3: What judicial remedies are available to persons seeking “Employee” Status?

**Australia**
A claim (for back pay) could be made.

**Austria**
Three:
1) Petition the Chamber of Labor for legal representation
2) Employee may bring their case directly to their organizations’ employee works council and their employer
3) If the employee works council cannot resolve the re-characterization of employment claim with the employer, then the petitioning employee may bring their claim to the competent labor court of first instance.

**Belgium**
A claim before the Labour Court.

**Canada**
Three:
1) Workers can be entitled to damages in court
2) For Insurance and Pensions, a ruling will determine whether a worker is self-employed or an employee, and thus, whether that worker’s employment is pensionable or insurable
3) Employees may choose to file an employment standards claim

**France**
A claim before the competent Labor Court

**Germany**
Possibility to address the competent labor court by lodging a declaratory action

**Italy**
"Ordinary" proceedings before the employment tribunal where the worker is required to prove he/she was subject to the directives and disciplinary power of the employer and show other indicators of an employment relationship

**Mexico**
Lawsuit filed by professional service providers against a company that hired his/her services.

**The Netherlands**
Declaratory decision from the courts about the qualification of the employment contract.

**New Zealand**
Two:
1) A person is eligible to apply to the authority for a declaration that they are an employee. The authority then applies the test provided in section 6 in deciding whether or not to provide the declaration sought
2) A worker can raise a personal grievance

**Norway**
Two:
1) Possibility of negotiations
2) Possibility of lawsuit in the courts claiming the employee status

**Poland**
Three:
1) Possibility to submit claims for ascertainment of the existence of an employment relationship
2) A claim may also be filed by a non-governmental organization within its statutory activities, if the employee agrees
3) A labour inspector may institute an action against the employer if a civil law contract is found to have been concluded on the terms of a contract of employment.

**Romania**
Ruling by the courts for each individual case.

**Spain**
Claim for recognition of law to the courts (with burden of proof)

**United States**
Two:
1) The worker can request a determination of worker status for purposes of federal employment taxes and income tax withholdings from the IRS
2) Workers may also file civil lawsuits.
Q4: What legal or administrative penalties or damages is the employer exposed to in the event of re-characterization?

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<th>Australia</th>
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<tbody>
<tr>
<td>1) Penalties of up to $33,000 (with possibilities of arrangement if the employer did not know about the indepedency)</td>
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<tr>
<td>2) Employer may be exposed to significant liabilities in respect to remuneration deductions, including penalties imposed by the Australian Tax Office</td>
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<tr>
<td>3) Possible damage to the Employer’s reputation</td>
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<tr>
<th>Canada</th>
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<tbody>
<tr>
<td>1) Liability for the income tax that should have been deducted</td>
<td></td>
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<tr>
<td>2) Obligation to pay both the employer’s share and the employee’s share of any premiums owing, plus penalties and interest</td>
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<th>France</th>
<th>Four:</th>
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<tbody>
<tr>
<td>1) Payment of overtime hours if any</td>
<td></td>
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<tr>
<td>2) Payment of social security contributions</td>
<td></td>
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<tr>
<td>3) Termination of the services agreement will be deemed as unfair termination entailing payment of the legal severance package</td>
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<tr>
<td>4) Criminal offence of “shadow employment” may be constituted</td>
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<tr>
<th>Germany</th>
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<tr>
<td>1) Payment of the outstanding social security contributions, plus a late payment fine (generally one percent of the amount due per month)</td>
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<tr>
<td>2) The employer’s managing director/legal representative in charge may be held liable under criminal law for wrongful non-payment of the employee’s social security contributions</td>
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| Italy | Administrative sanctions for delayed payment of social security contributions |

| Mexico | If a company has a service provider who in fact is a worker and not a provider, it is a violation of the employment and social security norms. In case of a lawsuit, the person shall be sentenced to comply with these guidelines |

<table>
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<th>Netherlands</th>
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<td>1) Payment of arrears (i.e. outstanding holiday payments, salary entitlements during sickness and/or pension entitlements)</td>
<td></td>
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<tr>
<td>2) Payment of unpaid contribution</td>
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<tr>
<td>3) Possible fines by the Tax Authorities</td>
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<th>Belgium</th>
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<td>1) Employer will have to pay the contributions that should have been paid to the NOSS</td>
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<tr>
<td>2) The employer could be held liable for not having withheld personal income taxes</td>
<td></td>
</tr>
<tr>
<td>3) The employer is exposed to financial sanctions provided by the Criminal Social Code</td>
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<th>New Zealand</th>
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<tr>
<td>1) The employer may be liable for the income tax that should have been deducted and also for social contributions that should have been paid</td>
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<tr>
<td>2) Concerning the contributions for the social insurance, additional costs might arise because of the delayed payment;</td>
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<tr>
<td>3) The employer may be exposed to damages in the form of an employee’s lost income and compensation for hurt and humiliation in the event that the person’s dismissal was found to be unjustified</td>
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<thead>
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<th>Norway</th>
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<tr>
<td>1) Compensation for any economic loss or holiday pay for the last three years</td>
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<tr>
<td>2) extra tax payments and punitive tax payments for both employee and employer</td>
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<th>Poland</th>
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<tr>
<td>1) Penal regulations</td>
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<tr>
<td>2) Fine of PLN 1,000 (ca EUR 250) to PLN 30,000 (ca EUR 7,500)</td>
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| Romania | Progressive sanction: contravention or criminal offense punishable under the Romanian Labour Code and general rules of criminal law, depending on the number of workers involved |

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<td>1) Un-prescribed contributions</td>
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<td>2) Will also have to pay the Social Security penalties</td>
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<td>1) Payment of back income tax withholdings and Social Security and Medicare tax contributions</td>
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</tr>
<tr>
<td>2) Payment of each hour worked</td>
<td></td>
</tr>
<tr>
<td>3) Tax penalties for failing to offer or provide sufficient coverage or make necessary premium payments</td>
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</tr>
<tr>
<td>4) Civil penalties for misclassification and restitution requirements</td>
<td></td>
</tr>
<tr>
<td>5) Audits and investigations and additional obligations, combined with penalties and interest for noncompliance</td>
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</table>
I. Legal Framework Differentiating Employees From Independent Contractors

II. Re-Characterization of Independent Contractors as Employees

III. How to Structure an Independent Contractor Relationship

IV. Trends and Specific Cases
Recent cases within the Australian courts and tribunals have over the last few years awarded large penalties and compensation against those who have been found to be mischaracterising employment and independent contract relationships. These cases highlight to employers, managers, directors and labour hire companies the need to understand and utilise properly defined employment and independent contractor arrangements. The Fair Work Ombudsman’s clear stance against sham contracts and mischaracterised employment relationships acts as a warning to those who are either recklessly or purposefully misrepresenting their employees’ or contractors’ contracting arrangements.

With an increasingly strong stance by the Fair Work Ombudsman, Courts and Tribunals against those who are failing to properly implement and maintain the appropriate employment and independent contract arrangements, it has become very important to identify the distinction between contractors and employees. At the same time, tough business conditions and increasing costs of labour regulation have made certain contracting relationships more attractive to businesses seeking to maintain competitiveness and labour flexibility in the Australian market.

This article provides a thorough outline of the law, rules, appropriate structures and trends affecting employment and independent contract arrangements. Part one of the article discusses the legal framework regulating contract and employment arrangements in Australia, whilst part two discusses the associated legal risks and exposures. Part three identifies and discusses the appropriate structures and methods of structuring independent contracting arrangements. Finally, part four of the article deals with recent trends and cases and the implications of these cases for employers, companies, employees and company directors.

I. LEGAL FRAMEWORK DIFFERENTIATING EMPLOYEES FROM INDEPENDENT CONTRACTORS

a. Factors that determine who is an employee and who is an independent contractor

The common law in Australia recognises a distinction between the working relationship of an employer and an employee, and the working relationship of a principal and an independent contractor. The former is recognised as a “contract of service”, whereas the latter is recognised as a “contract for services”.

Whether a worker is an employee or an independent contractor has significant legal consequences, which we have summarised below. The practical outcome of these consequences, however, is that before engaging any worker as an independent contractor, employers should assess the substantive nature of the working relationship to determine if the worker is truly an employee or an independent contractor.

Accurately assessing the distinction between employee and independent contractor is crucial for four primary reasons:

• Firstly, the two forms of relationship are mutually exclusive; and as stated, each gives rise to fundamentally different rights and obligations in contractual, tortious and fiduciary contexts.1
• Secondly, statutory rights and obligations that are conferred upon employees are seldom enjoyed by independent contractors. Similarly, the tax liabilities of both employers and workers are influenced significantly by the latter’s classification.2

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1Irving, above n 1 at 38.
2Ibid.
It is evident that distinguishing between employee and independent contractor is a vital component of Australian employment law. Accordingly, there is a significant body of settled principles that aid courts in differentiating between the two classifications.

There has been limited movement in statute or common law in attempting to define 'employment' or the 'employment relationship' with specific reference to the contractor-employee dichotomy. Rather, the status of a worker is determined by reference to developed common law principles.

This is significant, as it prevents parties from construing a relationship bearing the aspects of employer-employee as employer-contractor purely to reap the benefits that such a characterisation entails. Courts stated:

“The parties cannot create something which has every feature of a rooster, but call it a duck and insist that everybody else recognises it as a duck”

When asked to determine whether a particular worker is an “employee” or an “independent contractor”, Australian Courts have focused on the substance of the relationship, rather than the label given to that relationship by the parties. The High Court of Australia confirmed that there are a number of relevant indicia to determine whether a worker is an employee or a contractor. These indicia included:

- the mode of remuneration, the provision and maintenance of equipment, the obligations to work, the hours of work and provision for holidays, the deduction of income tax and the delegation of work by the putative employee...

Importantly, the High Court also emphasised that while these criteria are relevant, it is the totality of the relationship between the parties that must be considered in each case (Stevens per Mason J at 28-29).

The prevailing approach the courts have adopted to determine whether a worker is truly a contractor or employee is known as the “multi-factor test”.

The multi-factor test requires a judge to weigh the specific characteristics of the relationship in question, and then to form an “overall impression” of all those characteristics to determine whether the relationship is better described as an employment or contractual one. It will be immediately obvious that the nature of the test is necessarily subjective, and in many cases different adjudicators come up with different answers (that is – there is a lot of “grey areas” when it comes to the multi-factor test).

The following circumstances tend to indicate that a worker is a contractor:

- the contract is for a given result, rather than the mere provision of labour on an ongoing basis; the worker maintains a high level of discretion and flexibility as to how the work is to be performed, even if the contract contains precise terms as to the material to be used and the methods of performance;
- the worker bears the risk of the commercial loss or profit from the job, and the responsibility and liability for any poor workmanship sustained in the performance of the task;
- the worker sets their own hours of work;
- the worker provides their own equipment and assets;
- the contract does not include provisions for the worker to take paid leave;
- payment is based upon performance of the contract;
- the worker supplies an invoice for payment and/or quotes an Australian Business Number;
- the worker is responsible for their own expenses;
- the worker is expected to insure against the risk of being injured at work, and/or the risk of causing loss to others in the course of performing the work;
- the worker advertises their services to the public at large and accepts work from other parties;
- the worker has a power to delegate or sub-contract performance of the work to others.

The following circumstances tend to indicate that a Worker is an employee:

- the organisation for whom the work is performed has the right to direct the manner of performance of the work, so far as there is scope for such direction;
- the commercial risk is borne by the organisation, as is the responsibility for any loss occasioned by poor workmanship or negligence by the employee;
- the organisation prescribes the times and locations for the performance of the work;
- the remuneration is in the form of a salary or wages;
- PAYG tax is deducted by the organisation when paying the worker;
- the organisation provides the equipment and materials for the work;
- any use of the worker’s own equipment or materials is compensated by the reimbursement or by an allowance;
- the organisation has discretion in relation to task allocation and termination of the engagement;
- the worker cannot perform similar work for other organisations;
- the worker is identified to the public as being part of the organisation;
- the worker has no inherent right to delegate their work to another, though there may be power to delegate some duties to other workers; and
- the worker receives benefits such as annual, sick or long service leave.

With the multi-factor test, it is important to understand that there is no set number or combination of factors that will determine whether a worker is an employee or contractor. It is a matter for “overall impression”.

Ultimately, the courts will assess the totality of the workplace relationship to determine whether the worker is, on balance, an independent contractor or an employee. This involves the examination of a range of indicia, in order to determine the overall character of a particular relationship. Below is a more detailed look at the relevant indicia.

Control

The level and degree of control exercised by one party over the other is the most significant factor affecting the characterisation of a relationship. “Control” refers to things such as supervision and direction given as to how work is to be performed, and includes the authority to control work (as opposed to actual control). Generally, the

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1Ace Insurance Ltd v Trifunovski (2011) FCA 1204 at [25]-[28].
2Australian Air Express Pty Ltd v Longford (2006) 147 IR 340.
4Stevens v Brodribb Sawmilling Company Pty Ltd (1986) 160 CLR 16.
greater the level and degree of control exercised by one party over the other, the more likely the relationship is to be characterised as an employment relationship.

However, it is important to bear in mind examples in which, despite workers enjoying significant autonomy and choice regarding their hours and operational elements of their job, the fact that the organisation took ultimate responsibility for quality throughout the stages of the production process demonstrated a sufficient degree of control to establish an employment relationship.\(^7\)

**Mode of remuneration**

There is a notable and indicatory difference between the modes of remuneration for an employee as opposed to that of a contractor. Employees are typically paid on a periodic basis based on hours worked. Independent contractors are usually paid a pre-negotiated amount upon submission of an invoice at the completion of a service. Further, receipt of a fee as opposed to a regular wage or salary is indicative of an independent contractor relationship.

Wages that are not based on skill, difficulty of task or allotment of time for completion of the job suggest an ordinary employment relationship. Where the worker bears risk for unsatisfactory completion of the job, this suggests a contractor relationship.\(^8\) Payment following submission of an invoice by the worker will also carry weight – unless this has been dictated by the employer.\(^9\)

Although the courts do not always consider the mode of remuneration alone as a reliable indicator of the workplace relationship due to contemporary methods of payment, the court has already considered remuneration based on hours of work set out in timesheet entries as one of the (several) factors that indicated an employment relationship.\(^10\)

**Provision of tools and equipment**

Where the person has to purchase and maintain their own tools and equipment, this will more often than not point to a contractor relationship.\(^11\) However, in light of this, modest provision of tools and equipment will also carry weight – unless this has been dictated by the employer.\(^12\)

Where a worker is required to don the livery of their employer during their work hours, the fact that the organisation took ultimate responsibility for quality at all stages of the production process demonstrated a sufficient degree of control to establish an employment relationship.\(^7\)

**Risk and liability**

An independent contractor is likely to make a substantial investment in assets, using their own tools and equipment (for example, their own phone and computer). By contrast, an employee would be more likely to use tools and equipment provided to them by their employer.

**Business expenses**

An independent contractor is likely to pay their own overhead and business expenses, whereas an employee will often be reimbursed by their employer for any costs incurred in the performance of their work.

**Exclusive Engagement**

The right to the exclusive services of a person is characteristic of an employment relationship. A true independent contractor would be free to perform work for other people. However, jurisprudence noted that the mere freedom to work for others may be illusory\(^16\) – and as such, the court must take into account “the level of economic dependence of one party upon another, and the manner in which that economic dependence may be exploited” in applying this test.

**Separate place of work and advertises services**

This category is somewhat linked to the above ‘performance of work for others’ test. Put simply, an inference that workers carry on business on their own account is more easily made if they have a location for their own business that is in actuality separate from the impugned employer’s.\(^17\)

Furthermore, where the worker actively advertises their own business without reference to a connection with their employer, this factor will be in favour of their status as an independent contractor.\(^18\)

We appreciate that permitting contractors to work for others during the term of their engagement with the Principal may be commercially wise. Nevertheless, explicit references to the exclusive services of contractors to the Principal, lends weight to an argument for employment. Most Principals allow the contractors to perform work for others, provided that it does not influence their delivery of services to the Principal.

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\(^1\) Marcon Investments Pty Ltd v Amar [2004] AIRC 504 at [35].


\(^7\) Stevens v Bradngh (1986) 160 CLR 16 at 24 per Mason J.

\(^11\) Anika Holdings Pty Ltd v Giljevic (2006) ACTCA 6 at [43].

\(^12\) Hendis v Vabo.

\(^13\) Australian Air Express v Langford (2005) NSWCA 96 at [44].

\(^14\) B D Investments Pty Ltd v Workers Rehabilitation and Compensation Corporation [1994] SASC 4673.

\(^15\) B D Investments Pty Ltd v Amar [2004] AIRC 9 at [82].

\(^16\) Abdalla v Viewdaze (1986) 160 CLR 16 at 37 per Wilson and Dawson JJ.

\(^17\) Stevens v Bradngh (1986) 160 CLR 16 at 24 per Mason J.

\(^18\) Re Porter; Re Transport Workers Union of Australia at [14] and [26].

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\(^22\) Yaraka Holdings Pty Ltd v Giljevic [2005] NSWCA 96 at [44].
Right of delegation

A requirement that a person carry out work themselves is often typical of an employment relationship. Independent contractors frequently have power to delegate work to others, either with or without the consent of the party contracting their services, by either recruiting his or her own employees, or subcontracting the work to others.

The importance of powers of delegation will be touched upon again below. However, the Court of Appeal21 held that in deciding whether a person is an employee, it is the totality of the relationship that is important and as such the right to delegate or provide a substitute carried significant weight but was not completely decisive.22

Contractor agreements should contain the express right for the contractor to delegate his work to any other person or entities under the contractor's supervision. Any contractor agreement should ensure that the contractor is solely responsible for ensuring that any agent, employee, contractor or person engaged by the contractor to perform the work complies with all relevant laws.

Employment obligations and entitlements (taxation, superannuation and leave)

While the courts have, in the past, considered the treatment of employee entitlements and obligations such as tax deductions, superannuation contributions and leave entitlements as an indication of the workplace relationship, these matters are not determinative.

Typically, an employer withholds applicable tax deductions and superannuation contributions from an employee's remuneration, whereas an independent contractor should be paid a gross (untaxed) amount and is responsible for administering their own taxation and superannuation planning. Further, an employee is entitled to leave (such as annual leave, personal leave and parental leave), whereas an independent contractor is not.

At best, the treatment of these obligations and entitlements will assist a court in determining the intention of the parties. These obligations shall be considered in more detail further in this article.

Nature of the work

In assessing the employment relationship, the level of skill involved in the work may be a factor taken into account by the courts. Independent contractors are typically associated with a provision of skilled labour. Further, unskilled work often implies the need for more control over the worker and therefore, denotes an employment relationship.

Professionals and tradespeople are the two most significant groups that will be considered by a court to be self-employed. A requirement to hold a licence if the person is not considered an employee is only a minor consideration if attempting to deem him or her as a contractor.23

Business goodwill

A genuine independent contractor will often have the aim to generate its own business goodwill through the services it provides. However, if a worker is expected and/or required by their contracting business to be viewed by the public as a representative of that business (such as through the use of uniforms, business cards and general representations to the public), the worker’s ability to generate business goodwill will be significantly restricted.

The courts will often assess a worker’s ability to generate business goodwill independent to their contracting business, in determining whether they are an independent contractor or employee.

Express label given to the relationship

As set out above, the courts’ general approach is that they will not necessarily consider themselves bound by the express labels used by the parties but look to the relationship in practice.

However, where the nature of the relationship is ambiguous, consideration will be given to an express label. In this regard, how the parties characterise the relationship and express that in documentation may be considered by the Courts in determining the intentions of the parties and as part of all the overall factors to be considered.

Incorporation

An independent contractor relationship is more likely to be found in circumstances where the contract for service is with a company rather than an individual, as the courts have recognised that employers do not typically engage companies as employees.

There is no set number of the above factors that must be met in order to distinguish between an employee and an independent contractor. Rather, the question is one of overall impression. The relevant adjudicator must balance the indicia on a discretionary basis. This can result in uncertainty for employers seeking to utilise a specific classification for their workers.

As has been stated, the primary exception to the above is where the worker is permitted under the employment contract to delegate or subcontract the relevant work without permission or qualification from the employer.24 In these circumstances, the worker will almost always be classified as a contractor.25 However, where that power requires qualification or conditions set by the employer to be met, this rule will not apply with the same strength.26

Moreover, the recent decision of the Full Bench of the Federal Court of Australia27 in regards to the indicia to consider in distinguishing between a contract of service (employee) and a contract for services (contractor):28

“The other indicia of the nature of the relationship have been variously stated and have been added to from time to time. Those suggesting a contract of service other than a contract for services include the right to have a particular person do the work, the right to suspend or dismiss the person engaged, the right to the exclusive services of the person engaged and the right to dictate the place of work, hours of work and the like. Those which indicate a contract for

21Australian Air Express Pty Ltd v Langford [2005] NSWCA 96; Abdalla v Viewdaze [2005] NSWCA 96 at [65].
22Ibid.
23Ibid.
24Ace Insurance v Trifunovski (2013) 295 ALR 407 upheld the following passage from Stevens v Brodribb Sawmilling Pty Ltd (1986) 160 CLR 16. “Other indicia of the nature of the relationship have been variously stated and have been added to from time to time. Those suggesting a contract of service other than a contract for services include the right to have a particular person do the work, the right to suspend or dismiss the person engaged, the right to the exclusive services of the person engaged and the right to dictate the place of work, hours of work and the like. Those which indicate a contract for
25Queensland Stations Proprietary Ltd v Federal Commissioner of Taxation (1945) 70 CLR 539.
26Ibid.
28In Ace Insurance v Trifunovski (2013) 295 ALR 407 upheld the following passage from Stevens v Brodribb Sawmilling Pty Ltd (1986) 160 CLR 16. “Other indicia of the nature of the relationship have been variously stated and have been added to from time to time. Those suggesting a contract of service other than a contract for services include the right to have a particular person do the work, the right to suspend or dismiss the person engaged, the right to the exclusive services of the person engaged and the right to dictate the place of work, hours of work and the like. Those which indicate a contract for
services include work involving a profession, trade or a distinct calling on the part of the person engaged, the provision by him of his own place of work or his own equipment, the creation by him of goodwill or saleable assets in the course of his work, the payment by him from his remuneration of business expenses of any significant proportion and the payment to him of remuneration without deduction for income tax. None of these leads to any necessary inference, however, and the actual terms and terminology of the contract will always be of considerable importance.”

Examples in Recent Cases of the Indicia in Action

The following examples are important cases where a court has utilised the multi-factor test to discern the nature of an employment relationship:

**Employees**

Hollis v Vabu (2001) – a bicycle courier who was referred to as an independent contractor in his employment contract; and was paid according to the number of successful deliveries – however had to wear a company uniform, was told when his hours were and what to charge, and had his equipment supplied by the employer

Roy Morgan Research v Commissioner of Taxation (2010) – market research interviewers who had the power to accept or reject assignments to perform work, however were bound by detailed rules with regards to the conduction of interviews

Baker v Markellois (2012) – relief fishing boat captain earned a percentage of profits from the haul, but was prohibited from delegating work without consent of the owner

**Contractors**

Australian Air Express v Longford (2005) – delivery driver required to own and supply an expensive truck, and was permitted to substitute another driver with the employer’s approval

Sweeney v Boylan Nominees (2006) – fridge maintenance worker who was obligated to provide his own tools, invoice each job personally and maintain his own insurance

Commissioner of State Revenue v Mortgage Force Australia (2009) – ‘consultants’ contracted by financier to process applications for service; and enjoyed significant discretion with regards to the when and how they completed their work; as well as had the capacity to appoint sub-agents in their place with consent of the Principal.

b. Differences in tax treatment

Taxation systems fundamentally differ between employees and contractors. The distinctions can be primarily confined to tax regulation with regards to remuneration of workers; and personal services income provisions for contractors outlined in divisions 83-87 of the Income Tax Assessment Act 1997 (Cth). These will be discussed independently of each other.

Withholding tax from remuneration

In the context of an employer-employee relationship, an employer is obligated under Schedule 1 of the Taxation Administration Act 1953 (Cth) to deduct taxes from wages paid to an employee and consign that sum to the Australian Taxation Office (“ATO”). An employee will be taxed at the maximum rate possible unless they provide their employer with a valid tax file number.27

Conversely, independent contractors must generally meet their own tax obligations. Where an independent contractor submits an Australian Business Number (“ABN”) to the employer, or personally charges GST on their fees, the employer need not withhold any taxable amount from the payment. Given the ease with which a contractor may obtain an ABN,28 this option can be quite an attractive one.

However, an independent contractor and a business may enter into a voluntary agreement to withhold tax from remuneration payments.29

**Personal Services Income provisions**

The package of reforms brought in by the Howard government in 2000 to address inappropriate use of self-employed status to derive tax advantages must also be borne in mind – as a self-employed individual can often claim a much wider range of deductions with regards to their expenses.30

The position is now subject to the provisions of the Income Tax Assessment Act 1997. These place an onus upon individuals seeking to earn income from self-employment to prove that they are genuinely running a ‘personal services business’. Moreover, this requirement will become increasingly pertinent in scenarios where a self-employed individual earns 80% or more of their income from a single source.

The test established by the Income Tax Assessment Act is not dissimilar to the common law test articulated above, however an individual found to be an independent contractor by a court will not necessarily enjoy the same status in light of this legislation.31

The tests include:

- Whether they advertise services to the public
- Whether they engage others to help perform the work
- Whether they have their own business premises
- Whether they are paid to produce a particular ‘result’
- Whether they are obliged to rectify defects in their work

However, an employee deemed as such under the PSI provisions does not become an employee for any other legal purpose.

c. Differences in benefit entitlement

**National Employment Standard**

Under the National Employment Standard and the Fair Work Act 2009 (“FW Act”), employees are entitled to the following benefits:32

- Paid annual leave of four weeks;

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27 Ibid at 56.
28 Ibid.
30 Ibid, above n 2 p. 52.
• Maximum working hours of 38 hours per week, plus reasonable additional hours;
• The ability to request for flexible working arrangements;
• Parental leave;
• Paid personal leave, including carer’s and compassionate leave;
• Long service leave;
• Community service leave;
• Public holidays; and
• A minimum notice period for termination and a minimum amount of redundancy pay; and
• Minimum rates of pay.

In contrast, independent contractors are not entitled to these benefits.

Superannuation

Under superannuation law in Australia, employers have an obligation to pay the superannuation guarantee for their employees at a minimum rate of 9.25% of their base earnings if the employee:

• is 18 years old or over; and
• is paid $450 or more (before tax) in salary or wages in a month.

An employer is also required to pay superannuation for any employee if:

• The employee is paid $450 or more (before tax) in salary or wages in a month, and
• The employee works for more than 30 hours in a week.

In regards to contractors, a Principal may be obliged to pay superannuation at the minimum rate for a contractor in some circumstances. In particular, if a Principal pays a contractor under a contract that is wholly or principally for labour, the Principal has to pay superannuation contributions for the contractor. This is because the contractor is deemed to be an employee for superannuation guarantee purposes. This is even if the contractor quotes an ABN.

Generally, a contract is principally for labour if more than half of the value of the contract is for the person’s labour, which may include:

• physical labour
• mental effort, or
• artistic effort.

Workers’ Compensation

Workers’ compensation is covered by State and Territory laws and entitles employees to claim benefits for job-related injuries.

Some independent contractors are covered for workers’ compensation in some states and in specific circumstances.

An example is contractors under labour hire services arrangements, who are covered by the NSW workers’ compensation scheme pursuant to the Workplace Injury Management and Workers Compensation Act 1998 (NSW), which deems them workers for the purpose of claiming workers’ compensation.

However, not all contractors are entitled to claim workers compensation and it will depend on the relevant state legislation. All employees however are covered by workers’ compensation legislation and entitled to its benefits.

Benefits under Work, Health and Safety Legislation

Under the model Work, Health and Safety Act, which applies in all Australian jurisdictions, person conducting a business or undertaking must ensure, so far as is reasonably practicable, the health and safety of:

• workers engaged, or caused to be engaged by the person, and
• workers whose activities in carrying out work are influenced or directed by the person,
• while the workers are at work in the business or undertaking.

‘Worker’ is defined under section 7 of the Work, Health and Safety Act to include both employees and independent contractors.

Accordingly, independent contractors and employees have equal entitlement to a safe and healthy workplace, and both can consequently sue for associated breaches.

d. Differences in protection from termination

Termination under common law

Under the common law, an employer has the right to dismiss an employee at any time provided that the requisite period of notice is given. This is subject to State and Federal laws, as well as to any terms governing termination in the employment contract.

In contrast, the relationship between an independent contractor and a Principal is governed by contract. Accordingly, the Principal may only terminate the contract without penalty where the worker has not fulfilled the conditions of the contract, by agreement or where the contract provides for termination. A breach of contract, resulting in damages, will arise where there is an unlawful termination of the service contract.

Notice period

Section 117 of the FW Act specifies the minimum period of notice that must be given to an employee or employer on termination of the employment relationship. This period can fluctuate from 1 to 4 weeks depending on the employee’s period of continuous service with the employer at the end of the day the notice is given. A contravention of the minimum period of notice may give rise to a cause of action.

Conversely, no minimum period of notice is statutorily provided for the termination of a contract between an independent contractor and a Principal. As such, protection will only arise if it is provided for in the service contract.
Unfair Dismissal

However, an employer’s common law right to dismiss an employee is qualified by the FW Act, which stipulates that the dismissal of an employee must not be harsh, unjust or unreasonable. Contravention of this provision will result in a remedy being awarded to the employee.

In contrast, independent contractors cannot access the unfair dismissal regime under the FW Act due to the fact that they are not employees as defined by the FW Act. Accordingly, they are not protected from unfair dismissal in the same way as employees.

Adverse Action

Both employees and independent contractors have rights and remedies pursuant to the General Protection provision of the FW Act. Those provisions allow both employees and independent contractors to bring a claim if the employer or principal, in the case of independent contractors, has taken “adverse action” against them because they have exercised a “workplace right”. This is discussed further below.

e. Local limitations on use of independent contractors

The Independent Contractors Act 2006 promotes freedom to enter into genuine independent contracting relationships.

The Act also seeks to minimise limits on the use of independent contractors in genuine contracting relationships.

In particular, the principal objects of the Act are:

- to protect the freedom of independent contractors to enter into service contracts;
- to recognise independent contracting as a legitimate form of work arrangement that is primarily commercial; and
- to prevent interference with the terms of genuine independent contracting arrangements.

Accordingly, there are few limits on the bona fide use of independent contractors. However, the use of independent contractors will be limited where it is a ‘sham arrangement’. This is discussed below.

Likewise, the law allows a certain level of scrutiny and redress in circumstances where the independent contract is in fact an unfair contract, and makes provision for remedies for unfair contracts.

Moreover, deeming provisions in legislation, such as in superannuation legislation as discussed above, may impose additional obligations on principals who hire independent contractors.

42Fair Work Act 2009 (Cth), sections 365, 385.

f. Other ramifications of classification

Adverse Action

As mentioned earlier, both independent contractors and employees have access to a remedy for adverse action.

In particular, the FW Act provides independent contractors with a right to seek a remedy not only on termination, but also during the course of the contractual relationship.

Similarly, employees can make an application for a remedy during the course of the employment relationship.

Discrimination Laws

Likewise, whether an individual is classified as an employee or as an independent contractor will not affect their entitlement to seek a remedy under the various state and federal discrimination laws.

Negligence

An employer owes a duty of care to his/her employees. Therefore, an employer may be liable for compensation to the employee where there has been a breach of this duty.

In regards to the position of independent contractors, the Court of Appeal has held that though a principal owes a duty of care to independent contractors, this duty is not co-extensive with the duty owed by the employer to his/her employees. Similarly, a principal does not owe a duty to control the working systems implemented by the contractor where it is reasonable to assume that the contractors are competent to control their system of work without supervision by the Principal.

Vicarious liability

An employer is vicariously liable for the actions of his/her employees performed in the course of employment.

However, an employer is not vicariously liable for any actions committed by an independent contractor in the course of performing work for the employer.

Unfair Contracts

The Independent Contractors Act 2006 provides independent contractors with a remedy for unfair contracts.

Under the Independent Contractors Act 2006, an unfair contract is one where a person performs work on terms that are ‘unfair’ or ‘harsh’. It is possible to apply to the court to review a contract under the Act.

The Independent Contractors Act 2006 applies to those who have a service contract with a constitutional corporation, or the Commonwealth, or a resident of the Australian Capital Territory or the Northern Territory, or where the contract was formed or performed in either of those territories.

46Unilever Australia Limited v Pahi & Anor; Swire Cold Storage Pty Limited v Pahi & Anor [2010] NSWCA 149.
48Ibid.
II. Re-Characterization of Independent Contractors as Employees

The risks and consequences of engaging workers as independent contractors in circumstances where the true substance of the working relationship is an employment relationship are as follows:

- the workers would be entitled to, and therefore may be currently deprived of, certain statutory benefits that are only afforded to employees – such as the benefits under the FW Act and applicable modern awards;
- the employer may be liable for penalties of up to $33,000 per contravention of the sham arrangements provisions set out in the FW Act; and
- damages could be done to the employer’s reputation if it is a party to a contractual relationship, the sole purpose of which is to avoid liability associated with employment.

a. Employee benefits

The main source of legal exposure arising out of a situation where a business engages the workers as independent contractors in circumstances where the Workers are truly employees is in respect to forfeited employee entitlements (potentially leading to significant claims for back-pay) and liability in respect to non-compliance with statutory obligations. We detail each of these potential liabilities below.

Modern Awards

If the workers are found to be employees, they would be entitled to the benefits under applicable modern awards, such as a minimum notice of termination, minimum wages, overtime and allowances.

Some modern awards also cover employers which supply labour on an on-hire basis in respect to its on-hire employees.

National Employment Standards

Employees have the benefit of the minimum workplace entitlements set out in the National Employment Standards contained in the FW Act. These include redundancy pay, long service leave, annual leave, personal/carer’s leave, and parental leave.

The worker would be entitled to a claim for back-pay of these entitlements, and also to take such leave in the future.

Taxation and Superannuation

If the workers are found to be employees, and as a result, the employer has not complied with its obligations under applicable tax and superannuation legislation, the employer may be exposed to significant liabilities in respect to these remuneration deductions, including penalties imposed by the Australian Tax Office.

Unfair dismissal and general protections

Workers may be able to access the unfair dismissal provisions of the FW Act on the basis that they were actually an employee.

Under the FW Act, a worker is not permitted to access the unfair dismissal jurisdiction unless he or she has worked the “minimum employment period” specified in the legislation. The minimum employment period is a period of 6 months. If a worker is found to be an employee, and his or her total earnings are less than the prescribed remuneration cap (currently $129,300), the Worker may seek reinstatement or compensation of up to six months’ remuneration.

Similarly, a claim could be made under the general protection provisions in the FW Act which prevents employers from taking what is called “adverse action” against an employee in certain circumstances.

As noted above, the general protection provisions of the FW Act are also specifically available to independent contractors.

b. Penalties Under the Sham Arrangement Provisions of the FW Act

The sham arrangements provisions contained in the FW Act impose penalties on employers who misclassify employees as independent contractors. Employers must not:

- misrepresent an employment relationship as an independent contracting relationship – that is, by representing to a person who is actually an employee that they are an independent contractor; or
- dismiss or threaten to dismiss an employee in order to engage the employee as an independent contractor to perform the same, or substantially the same, work.

If an employer makes representations to workers that they are independent contractors in circumstances where they are employees, the company could be liable for a penalty of up to $33,000 and $6,600 for any individual involved in the contravention (such as a director or relevant manager) per occasion.

The FW Act does provide a defence to the sham arrangements provisions in circumstances where the employer did not know about the independent contractor relationship and was not reckless to the fact that the workers were employees rather than independent contractors. However, the burden of proof in relation to this defence rests with the employer.

Strictly speaking, the Fair Work Ombudsman is also empowered to prosecute such a charge of its own volition (that is, without the Workers’ involvement). Realistically however, it is unlikely the Ombudsman would ever find out about the contractor arrangements, and if it did, it is unlikely it would proceed, based on time and effort, with prosecution (the Ombudsman has limited resources with which to investigate and prosecute matters, and it generally focuses its attention on matters involving lower paid individuals). Nevertheless, the possibility of discovery and prosecution by the Ombudsman cannot be eliminated.

III. How to Structure an Independent Contractor Relationship

a. Labour Hire proposal

One of the ways to ensure that the workers are not employees, at least as a matter of common law, is to engage their services through another entity. This is commonly referred to as labour hire agreements.

If a labour hire agreement is established carefully, there are two contracts on foot:

- An agreement between the worker and the labour hire company, whereby the worker is paid for her/his work; and
- A commercial contract between the labour hire company and the principal (The host).
So long as there is no contract between them, on the orthodox view, the worker cannot be regarded as an employee of the Host. In the absence of any apparent intent to create such a contract, the courts will not imply that it exists. The Host will, on the other hand, still have obligations under the occupational health and safety legislation to provide a safe workplace.

b. Host as the employer (Odco System)

There have occasionally been cases where, despite the appearance of a labour hire agreement, it has been found that the worker is directly employed by the Host. Some examples of these cases are provided below. However, where a host enters into a bona fide labour-hire arrangement that is not contrived to disguise what is in fact an employment relationship, the possibility of a court finding the host to be an employer of a worker so hired for the purpose of termination is remote.

For example, in Damevski v Guidice (2003) 202 ALR 494 ("Damevski"), a cleaner worked for a firm as an employee. He was then told that he would no longer be employed directly, but would instead be hired through an agency. He signed a document prepared by the firm that indicated his acceptance of an offer of engagement by the agency. However, the firm assured him that "nothing will change". This helped persuade the court that, viewed objectively, he still had a contract with his original employer and hence could pursue a claim against it for unfair dismissal. This was so even though he was now paid by the agency.

Similarly, the host was held to be the employer by the NSW Industrial Relations Commission in Oanh Nguyen and Thiess Services Pty Ltd (2003) 128 IR 241 ("Oanh"). There the Agency had "no real or effective involvement or control in any aspect of the worker’s remuneration, day-to-day employment and dismissal. The Agency operated more like a “service company which was used as a conduit by the Host to pay the applicant’s wages and to deal with on-costs such as workers compensation”

It is important to understand that Damevski and Oanh represent the exception, rather than the rule. The parties did not do enough in that case to sever the original contract between the Host and the worker, and replace it with a new contract with the Agency. In the ordinary case of labour hire, there should be no basis for inferring a contract between Host and worker, and hence no possibility of an employment relationship.

However, whether the worker is an employee of the Agency that hires them out is a separate question that is tested by reference to the multi-factor tests of whether the Worker is an employee, discussed in Part One.

c. Tortious Liability

On a separate note, a worker under a labour hire agreement ("Agency Worker") may cause damage either to the host or to a third party whilst working under the labour hire agreement. While an employer is vicariously liable for the tortious wrongdoings of an employee during the course of employment, there are additional complications for Host businesses.

The key principle is that if the host has assumed effective control over all facets of the agency worker’s work so that the agency worker becomes the temporary employee of the Host, then the Host, instead of the agency, can be liable for the tortious conduct of the agency worker if injury is caused to a third party.

In the Victorian case of Deutz Pty Ltd v Skilled Engineering [2001] VSC 194, a labour hire company hired out a forklift driver, who, whilst driving the forklift, negligently caused extensive damage to the Host’s property. The court was reluctant to conclude that there had been a temporary transfer of employment from the labour hire company to the Host based on the following principles:

- Only in exceptional circumstances will an Agency be able to shift vicarious liability to a temporary employer (i.e. host);
- Transfer will be less readily inferred when a worker is hired out with a machine or where a skilled worker is provided;
- Transfer may occur where the Agency Worker is operating the equipment under the absolute control of the Host;
- A transfer may occur in certain circumstances, including where the Host can direct not only what the worker can do, but how he is to do it.

The Court held that there had been no temporary transfer of employment to the Host, rather the agency retained control. The agency had recruited the worker, paid his wages, established safety protocols, provided safety training, provided clothing with the agency logo, supervised the worker and had the power of dismissal.

Therefore, if labour hire mechanisms are implemented, it is important that the Host severs the relationship of control between it and the Worker in order to reduce any exposure to a claim in tort.

d. Structuring the Independent Contractor Relationship

In order to ensure that the relationship established between a principal and a worker is one classified by the Court and other regulating bodies, as an independent contractor relationship; companies should follow the following practical guidelines.

Firstly, consider whether the work can properly be the subject of a contract for services as opposed to employment. It is unlikely that some types of work would ever be considered as independent contractor work, such as a receptionist, factory worker and clerical employee.

Ensure that the parties enter into a properly drafted independent contractor agreement, which sets out the rights and obligations of each party. The contract should make clear that the relationship is that of an independent contractor and principal and that the independent contractor has the right to delegate the work, work for others, and has control over how and the manner in which he or she works.

Recent cases² have emphasised the significance of properly defining and documenting an independent contractor relationship in order to have a clear and enforceable understanding of the rights and obligations between the parties.

It is important to prepare for the possibility that the nature or characterisation of a relationship may be questioned. In keeping this in mind it may be useful to keep a record of any information that supports a verbal contract or the interpretation of a written contract, this may include; email communications, notes from meetings, quotes from conversations, diary entries, lists of specifications and any form of reporting or tasks lists.

Ideally, the independent contractors should provide invoices for the services he/she performs rather than being paid on a regular and systematic basis. The independent contractor should be an incorporated entity with an Australian Business Number, which itself employs an employee to perform the services. In circumstances

²such as Ace Insurance v Trifunovski (2013) 295 ALR 407.
where the principal contracts with an independent contractor which is a company, it is far more difficult for a court to find that the individual actually doing the work is an employee of the principal.

It must be remembered that independent contractors are often differentiated from employees due to the results-driven focus of their work. A system of documenting and managing the measurement of these results should be in place.

The principal should ensure that its managers manage the relationship with the independent contractor in a manner that is consistent with its independent nature, rather than in the same manner and with the same expectations, the Principal may have of its own employees.

The principal should ensure that the independent contractor has the necessary insurances and is paying the required tax and duties.

IV. TRENDS AND SPECIFIC CASES

The Various employment and industrial authorities in Australia, including the Fair Work Ombudsman, the Fair Work Commission and the Courts are taking a strong approach to the monitoring, investigation and penalising of misrepresented employment relationships. Several recent cases highlight the increasing penalties associated with the mischaracterisation of employment relationships and the proactive approach by the Fair Work Ombudsman in ensuring employers and labour hire companies are properly managing their workers contract arrangements.

**Fair Work Ombudsman v Happy Cabby Pty Ltd & Anor [2013] FCCA 397**

**Issue: Sham Contracting and Record Penalties**

This decision highlights the increasing penalties associated with sham contract arrangements. In the case Driver FM imposed a penalty of $238,920 on the company, and fined the sole director $47,784.

The company, Happy Cabby Ltd operates an airport shuttle business; using independent contracts for what His Honour found were employee relationships. These sham contracts caused a total of $26,000.00 in underpayment to drivers within the business.

The business was found to be in breach of s 357 of the Fair Work Act 2009 (CTH) ("FW Act") for misrepresenting employment contracts as independent contractor arrangements and s 45 for failing to meet award entitlements. The breach was identified by the Fair Work Ombudsman [FWO] after the business was selected for auditing in April 2011.

**Fair Work Ombudsman v Quest South Perth Holdings Pty Ltd (No 2) [2013] FCA 582**

**Issue: Re-Characterisation from employees to independent contractors**

This case involved a question of sham contracts and the appropriate method of converting workers from employment contracts, to the Odco system of independent contracting. The case highlights the need for employers to properly manage the re-characterisation of employees to independent contracts with an open, informative and consensual process.

Quest South Perth Holdings Pty Ltd (QSP), used a contracting company, Contracting Solutions Pty Ltd, to change its employees over to the Odco system. This system required workers to enter into an independent contractor relationship with Contracting Solutions, and then be on-hired to QSP. Through this system, employees were re-characterised from employees to independent contractors.

The Court faced two issues; firstly, is the Odco System merely a form of sham contracting (s 357 Fair Work Act) and secondly, for a receptionist who had refused to convert and subsequently was threatened with dismissal, was there a breach of s 358.

On the first issue, the judge found that the majority of employees had undertaken a consensual process to convert to independent contracts, therefore for the majority there was no breach of s 358. Further, it was determined that the contracting arrangement was not a sham and did not breach s 357, as the status of independent contractor was successfully achieved for all the converted workers. His honour did state that there had been a misrepresentation of the contracting relationship to the previous employees, this misrepresentation on the effects of conversion however was not argued by the FWO and therefore could not be actioned as a breach.

On the second issue Justice McKerracher found that the QSP had contravened s 358 when the manager told the receptionist that she would not be paid unless she converted to an independent contractor relationship. This was found to be threatening with dismissal and therefore breached s 358.

This case emphasises the need for employers to ensure the effects of conversion for employees to independent contracts is made clear. It further highlights the court’s willingness to take a strong stance against employment relationships and the independence of employees in choosing their contracting arrangement.

**Fair Work Ombudsman v Metro Northern Enterprises Pty Ltd [2013] FCCA 216**

**Issue: Mischaracterising employees and reckless employment relationships**

This case falls under the recent trend of the FWO to take a hardline approach to sham contract arrangements and the mischaracterisation of employees. The case sends a strong message to those using independent contractor relationships to properly consider the reality of the relationships in practice.

In this case the business was using independent contracts for those engaged in advertising its kitchen products in malls and stores. The court found that these contracts, which specifically placed liability on the individuals, using contract terms such as “The Independent Agent must therefore bear all costs of running his/her own business, and keep his/her own business records, and arrange his/her own insurance and taxation procedures,” did not match the reality of the relationship.

In practice, the way the positions were advertised, the manner in which they were carried out on a daily basis, exposed an employee relationship as opposed to an independent. The business was therefore in breach of s 357 of the Fair Work Act.

The defendants however, argued under the defence in s 357(2) that they ‘did not know’ they had engaged their representatives under employment contracts. Her honour, Justice Barnes, found that this defence could not apply as the business had been “reckless” with their contracts and “Metro acted in a manner that was careless or incautious as to whether the contracts with the [representatives] were in fact contracts of employment.”

Her honour found that Metro was in breach of its award obligations to pay wages, overtime, annual leave and a vehicle allowance, as well as s 357, and asked the FWO and the company to agree on amounts owing.
**ACE Insurance Limited v Trifunovski [2013] FCAFC 3**  
**Issue:** Strict application of indicia for independent contractor relationships  

This case considered the changing nature of work and working relationships, and the affect this change has had on the way independent contracts and employment relationships are to be defined and interpreted.

In this case, the Court of Appeal upheld a 2011 decision that several Ace Insurance sales representatives were employees, despite having signed contracts that stated they were independent contractors.

The deciding factor in the case was that the employees were required to discharge their duties and obligations under their contract, through personal service to Ace Insurance. This personal service was a strong indicator that there was a contract of employment. Justice Buchanan considered that this personal service, combined with other features of the relationship, such as a close control of the organisation and allocation of work, training and supervision, suggested the relationship was properly defined as one of employment.

As a result of the decision, Ace Insurance was required to pay the annual and long service leave payments owing to the representatives, in the amount approximately $500,000.

This decision enforced the strict application of the common law test and established indicia for identifying an independent contractor relationship.

**Fair Work Ombudsman v Contracting Solutions Australia Pty Ltd [2013] FCA 7**  
**Issue:** Large penalties against directors, companies and labour hire companies for misuse of independent contractor arrangements for minors and mischaracterization of casual employees as independent contractors

This year, the Federal Court took a hardline approach against a labour hire company, a fast food outlet and their directors for the misrepresentation of the employment relationships to two minors, who were found to be engaged under sham contracting arrangements.

Blue Steel Corporation Pty Ltd Director, Daryl Lenkic, had sought the advice of Michael Wright, Director of Contracting Solutions Australia, in relation to the introduction of an Odco-style labour contracting model. The companies entered into agreement in early 2004. Under the agreement Contracting Solutions would provide retail food assistants to Blue Steel and would assume all responsibility for the statutory requirements for the personnel.

In 2005, a 15 year old student applied for a position at Blue Steel’s shop, after responding to an advertisement within the shop seeking casual workers. The student and her mother were directed by Blue Steel to meet with Mr Wright of Contracting Solutions following her successful trial as a retail food assistant. The student and her mother agreed to sign an “Agreement to Contract,” with Mr Wright and Contracting Solutions under which the student was told the agreement was a contract for service and that she would be working as an independent contractor, “self-employed.”

In 2008, Blue Steel used Labour Contracting Solutions Ltd and Mr Wright to engage another 15 year old student on very similar terms to the previous student. In both cases, neither student was given working direction or instructions by Contracting Solutions or Labour Contracting Solutions, but rather completed their work under the Blue Steel store manager and Mr Lenkic.

The Federal Court, under Justice Lander, found that the arrangements under which both students were employed were that of casual employment and not an Odco nor independent contractor relationship, which would be unsuitable for minors. The conduct had breached s 900 of the *Workplace Relations Act 1996* (Cth), which prohibited the making of false representations that an employment contract was an independent contractor arrangement.

Michael Wright, Blue Steel and Mr Lenkic admitted to involvement under section 728 of the WA Act, and of section 900. Justice Lander found that the parties had been ‘reckless’ in misclassifying the students, and had not purposely planned to misclassify the personnel. Despite the lack of purpose and plan behind the misclassification, Labour Contracting Solutions Ltd and Mr Wright were penalised 45% to 60% of the maximum penalty under the *Workplace Relations Act*, amounting to a maximum of $19,800 for the company and maximum $7,920 for Mr Wright. Blue Steel and Mr Lenkic faced a penalty of 20% of the maximum under the Act, totaling $13,200 for Blue Steel and $2,640 for Mr Lenkic.
I. Legal Framework Differentiating Employees From Independent Contractors

a. Factors that determine who is an employee and who is an independent contractor

Under the current Austrian labor law regime, the determination of whether an individual is a standard employee or an independent contractor hinges on their personal and economic dependence upon the employer. Austrian employment law provides many protections for the rights of employees. However, these protections are subject to numerous exceptions depending on the specific classification of the employee.

Austrian employment relationships still operate with an antiquated distinction between white collar and blue collar workers. This distinction provides different protections to separately classified employees. Blue collar workers refers to those employees who perform predominantly manual labor and white collar workers refers to those who perform non-manual labor. Due to the basic disparity in power relations between an employer and a blue collar worker, Austrian statues confer substantial protections to blue collar workers and lessened protections to their white collar colleagues. The distinction between full-time employees and an independent contractor (whether blue or white collar) is based on the level to which the employee operates under the professional purview of the employer. The typical employment arrangement entails an employee working directly under the employer’s control, on the employer’s premises, and using the employer’s resources to carry out their assigned tasks. Another cornerstone of the typical employment arrangement is the employee’s economic dependence upon the employer for their livelihood. Typical employment arrangements, like service contracts or freelance labor, do not have these same characteristics, and therefore fall under a different set of laws and regulations.

The current body of Austrian labor law allows for different kinds of independent contractor arrangements that confer varying degrees of protections and benefit entitlements to contractors and employers. The two most prominent legal forms of non-standard employment arrangements are Service Agreements (Freier Dienstvertrag) and Agreement for Work and Services (Werkvertrag). Within the scope of the Service Agreement, an employer agrees to hire an employee to provide limited services for a definite period. However, the affected employee is not as fully integrated into the employer’s organizational chain or as dependent upon the employment for their continued livelihood as a typical employee. Furthermore, the contracted employees generally use their own resources to carry out the contracted tasks and do not generally guarantee the success or sufficient quality of the agreed services. This service agreement usually covers either students or pensioners who work part time, providing only a limited number of hours per week.

There are differences in legal substance between the Freier Dienstvertrag, the Werkvertrag, on the one hand and the Dienstvertrag on the other hand. Employment may be defined as Dienstvertrag if the employment relationship entails a majority of the following factors:

- an ongoing employment relationship,
- the employee’s relative independence from the employer for continued livelihood,
- a lack of binding organizational directives such as an employee handbook,
- the contractor is free of restrictions upon personal behavior,
- the employee’s ability to regulate some facets of their own work product,
- the employer only need provide the essential operating resources, while the employee contributes their own tools to complete the contracted task,
- the contractor has no obligation to perform the work or service personally, and may sub-contract the assigned project.
b. Differences in tax treatment

Generally, Austria has a progressive income tax structure that applies tax rates that range from zero to fifty percent depending on the competent regional authority’s end-of-year taxable income assessment. Employers deduct their employees’ income tax at the source and redirect it to the competent government authority. This monthly deduction is counted against the employee’s annual income tax liability which is eventually balanced at the yearly tax assessment, taking into account the employee’s full income declaration. The Austrian Income Tax Act (Einkommensteuergesetz) lists specific types of income that fall under its purview. These mentioned types of income include income from agriculture, self-employed work, trade craft, standard employment, capital gains, and from real estate.

Within this tax structure, if an employee is classified as an independent contractor, then they will be treated as if they are self-employed persons. With this classification, they are subject to standard income tax, but remain exempt from earnings tax. As stated earlier, they must settle their income tax payment in accordance with their annual taxable income (less deduction). The minimum income threshold that activates Austrian income tax in this setting is €11,000.

c. Differences in benefit entitlement

Austria implements a strong social security system that requires employers to direct both of their employee’s social security payments and the employers’ portion to the Regional Health Insurance Fund. Within Austria’s social security system, employees make contributions based on their income. Employee contributions generally amount to approximately 18% of their calculated gross income. Minutely different rates apply to blue and white collar workers. These contributions are capped at €4,230 per month for normal remuneration, and €8,460 per year for special payments. Furthermore, low income employees are exempt from making contributions to the system, the threshold for this exemption being €376.26 per month, or €28.89 per day. In addition to employee contributions, employers make similar contributions to the social security system - paying approximately 22% of their employee’s gross income.

Independent contractors who have a monthly income lower than the minimum threshold that would trigger mandatory social security contributions still require a certain degree of insurance. If an employer agrees to enter into a service contract with this independent contractor, they must enroll the contractor in an accident insurance institution before the commencement of employment. Additionally, the independent contractor whose income falls below the minimum threshold may enroll themselves for supplementary health and pension insurance.

If the independent contractors’ monthly salary exceeds the minimum threshold listed above, they are required to register as independent contractors with the Regional Health Insurance Fund. Once they complete this registration, they are covered by standard Austrian social security protections – including accident, health, and pension insurance. Furthermore, Austria has recently enacted litigation that requires independent contractors who have a monthly salary above the minimum threshold to sign up for unemployment and bankruptcy insurance on a voluntary basis, which in turn entitles them to unemployment entitlements if the well runs day and they cannot maintain consistent contracted employment.

Independent contractors’ social security benefit entitlements mainly differ from standard employees’ in that the employer’s insurance obligation to draw the employee’s monthly contributions as well as make their own contributions to the social security fund cease once the contracted employment relationship ends. The end of the employment contract, and therefore the employer’s obligation, legally ends once the independent contractor no longer has a claim for remuneration.

d. Differences in protection from termination

According to the Austrian General Civil Code (Allgemeines Burgerliches Gesetzbuch) independent contractors do not enjoy the same level of protection as normal employees. However, in the realm of protection from termination, the same provisions that apply to standard employees apply to independent contractors. Therefore, the same procedures of notice or exceptions to the requirement of notice that bind employers in standard employment arrangements, similarly bind employers when seeking to terminate independent contractors. Independent contractors cannot challenge the termination for being socially unfair. Furthermore, independent contractors cannot take legal action against any notice given on unlawful grounds. In order to establish the independent contractor’s employment with a given employer they need not have a written contract, although it is preferable to have one. If the employer does not create an employment contract, then they are at the very least required to hand out a service note to any contractor insured under Austria’s General Social Insurance. This note should include a general summary of the services contracted.

However, independent contractor’s rights fall short of those guaranteed to standard employee’s rights regarding post-termination remuneration. Since independent contractors are not protected by the provisions of the Salaried Employees Act, they are not qualified for entitlement of accumulated vacation days, and continued remuneration based on severance. Further, during the period of their employment, they are not protected under the other various rights conferred by the Salaried Employees Act, including the Working Hours Act, and the Act on Rest Periods.

e. Other ramifications of classification

Generally, Austrian courts and Austrian law heavily lean towards protecting employee rights, as the foundation of Austrian labor law is the presumption that the employer holds the upper hand in negotiations with its employees. One specific ramification of this tendency is especially apparent in the scenario of hiring foreign workers within Austria. Employers are free to have a choice of law when hiring foreign citizens legally residing and working within Austria. Therefore, the employer in this scenario may choose to apply the foreign law to this specific employment agreement. However, taking into consideration Austria’s tendency to protect employees, if the employer challenges that employment agreement as unfavorable, especially when compared to the minimum standards of relevant Austrian employment law, the courts may still find that Austrian law will overrule the disadvantageous foreign employment law terms and disregard any pre-existing contract that the parties signed.

II. Business Presence Issues

a. How the use of one or more independent contractors creates a permanent establishment in country and the ramifications

In case of cross-border action foreign enterprises may be subject to Austrian taxation. Generally, an enterprise which engages standard employees within the Austrian borders has to redirect income taxes as required by Austrian tax law. On the contrary, the enterprise does not have to pay taxes if it engages independent contractors such as brokers, general commission agents or other agents of an independent status. This complies with the fact that independent contractors are generally obliged to settle their income tax payments by themselves. Therefore, in this case, the foreign enterprise itself is not affected by
can be found in the re-characterization of a fixed term contract to an indefinite employment contract. Employers in Austria are permitted to create fixed term contracts with their employees that come to a natural conclusion at the end of the fixed term. However, if an employer engages an employee in consecutive fixed-term contracts and the employee can claim the many characteristics of an indefinite employment contract listed above, then, as long as the employer does not have a special social or economic reason for the consecutive fixed-term contracts, the employee may claim all of the benefits of an indefinite employment contract. In the same sense, if an employee who started out as an independent contractor starts to take on the characteristics of a standard employee, they may have a claim for a re-characterization of their employment. The legal consequence of a re-characterization of an employment relationship would be that the former contractor would become entitled to all of the related protections and entitlements, which are extensive, and much more expansive than those granted to an independent contractor.

All Austrian employees are automatically members of the Chamber of Labor. The Chamber of Labor as well as organization-specific works councils and industry-specific trade unions represent employees’ varied interests and are independent democratic institutions. Membership in the Chamber of Labor has the benefit of providing employees with legal representation, if necessary. Therefore, as an initial measure, an employee seeking a re-characterization of their employment agreement may petition the Chamber of Labor for legal representation. Subsequently, the employee may bring their case directly to their organizations’ employee works council and their employer. If the employee works council cannot resolve the re-characterization of employment claim with the employer, then the petitioning employee may bring their claim to the competent labor court of first instance. These labor courts have jurisdiction over disputes concerning employment related contracts, and may submit a conclusive judicial holding on whether or not the employee is entitled to the claimed re-characterization.

In case of re-characterization, the employer would be liable for the income tax and the social insurance contributions that should have been deducted. Concerning the contributions for the social insurance, additional costs may arise as a result of the delayed payment. Moreover, the former independent contractor may be entitled to higher wages following the respective collective agreement. In this case, the employer is obliged to pay the remaining amount. Finally, the former independent contractor becomes entitled to all of the related protections and entitlements, which are generally extensive, and much more expansive than those granted to an independent contractor.

### IV. How to Structure an Independent Contractor Relationship

#### a. How to Properly Document the Relationship

As stated above, an independent contractor relationship does not require a written contract. However, to clearly define an employment relationship from the outset, an employer is generally obliged to provide the contractor with a written statement of terms and conditions (Dienstzettel). This statement must include basic information regarding the employment arrangement, including, at a minimum, the following elements:

- the names of the two parties,
- basic salary or wages,
- the nature of the proposed work,
- date on which the arrangement commences,
- duration of the notice period,
- any classification within the labor system.

Within the scope of re-characterization of independent contractors, an independent contractor may claim that their employment agreement exceeds that of an independent contractor. The decisive basis for this assessment is the manner in which the employee’s services are effectively carried out on a day-to-day basis, notwithstanding the terms of the employment contract or even the intention of the two parties at the time of the creation of the employment agreement. The decisive factors that define a standard employee as opposed to an independent contractor are:

- Personal dependency
- Economic dependency
- Continuous obligation
- Obligation to work for a certain period of time
- Use of the employer’s equipment
- Incorporation into the employer’s organization
- Success of the assigned tasks directly benefits the employer
- The employer incurs the risk of production

While all of these factors are not required to be present, if the majority of these characteristics outweigh the characteristics of an independent contractor, then the competent authority will find that the employment arrangement was, in fact, a standard employment contract as opposed to an independent contract.

A parallel example of the dangers of a re-characterization of an employment agreement can be found in the re-characterization of a fixed term contract to an indefinite employment contract.
If the independent contractor is supposed to work abroad for more than one month, the statement of terms and conditions must additionally include information about:

- the expected duration of the foreign operations,
- the currency in which salary or wages are to be paid,
- the conditions of the return to Austria and
- potential additional payments.

This written statement of terms and conditions is often required by the employee to register for social insurance, if they are seeking to do so independent from their employer. The employer is obliged to issue the statement in written form immediately following the start of the independent contractor relationship, at the latest however, within one month. In case of changes concerning the information included in the statement, the employer is obliged to give immediate notice to the independent contractor in writing.

However, a statement of terms and conditions is legally superfluous, if the independent contractor relationship is not supposed to last for more than one month or if the above mentioned information is contained in a written contract.

b. Day-to-Day Management of the Relationship

As mentioned above, the classification as an independent contractor relationship or a standard contract of employment does not only depend on the arrangements of the written contract or the statement of terms and conditions. Rather, the classification is subject to the manner in which the employee’s services are effectively carried out on a day-to-day basis. Therefore, it is crucial that the employer remains cognizant of how the contractor is carrying out the indicia of their employment. In particular, the employer should be sensitive to whether the contractor’s scope of employment is bleeding into the employer’s basic organization structure. Recommended business practices dictate, at the very least, monthly written or oral evaluations or memoranda concerning the scope of the contracted party’s employment to maintain records that may be used to refute a claim for re-characterization of employment.

V. TRENDS AND SPECIFIC CASES

Due to the obligations connected with Austrian employment law, employers in Austria tend to use different possibilities for drafting contracts. Therefore, Service Agreements and Work Service Agreements are frequently used. Moreover, the amount of temporary workers (Leiharbeiter) and fixed-term employment contracts (befristete Arbeitsverträge) is increasing. However, to avoid a circumvention of the Austrian employee protection legislation, the jurisdiction is strict in applying the above mentioned criteria for the classification as a standard Contract of Employment. Additionally, there are special rules in the Austrian Temporary Employment Act (Arbeitnehmerüberlassungsgesetz) to protect temporary workers from discrimination compared with regular employees.

Jurisdiction concerning Service Agreements, Work and Service Agreements and Employment Agreements

As stated, the distinction between standard Contracts of Employment, Service Agreements and Work and Service Agreements depends on a case-by-case decision. The Austrian jurisdiction concerning the classification of doctors demonstrates this approach in an exemplary way.

Following the Austrian Jurisdiction, a doctor cannot generally be placed in one of the mentioned categories. Rather, the Jurisdiction distinguishes between the different arrangements of the respective contractual relationship. Therefore, a standard Employment Contract between a doctor and a hospital can only be assumed if the doctor is integrated in the organization of the hospital. The main factors are based on the above mentioned criteria, regular working hours and official duties.

According to the Jurisdiction, the classification as a standard employee is therefore not justified in case of an attending doctor with flexible time management. The same is generally valid for a prison doctor. In this case, the Austrian Supreme Court stated that because of his professional duty, a doctor has to fulfill his responsibilities to the prison independently and under his sole responsibility. In particular, the classification as standard employee does not result from the restricted independence of the doctor, which is due to the security and the specific circumstances given in a prison.

Furthermore, the contract between a doctor and his patient is generally qualified as Service Agreement. However, if the doctor owes the patient only one specific task, the contract might be classified as Work and Service Agreement. Therefore, Austrian Jurisdiction assumes a Work and Service Agreement if the doctor’s task only includes for example, the preparation and adjustment of prosthesis.

Jurisdiction concerning temporary work

Temporary work means that the employees of a temporary works agency are lent out to work for another person. In this case, the temporary work agency continues to function as the employer. The person hiring the temporary worker generally does not have to fulfill all duties of an employer. However, in exceptional cases, it might be possible that an employment agreement is concluded between the hirer and the temporary worker as well. Whether this is the case or not, depends on a case-by-case decision based on the above mentioned criteria for the classification as an employment contract. However, there are limits to protect the employees from a circumvention of Austrian employee protection legislation, the jurisdiction is very strict in applying these criteria.

In case there is no Employment Agreement between the hirer and the temporary worker, the Austrian Temporary Employment Act must be kept in mind. This implies, amongst other things, obligations for the hirer such as compliance with safety regulations and the employer’s duty of care.

Jurisdiction concerning fixed-term employment contracts

Another way employers try to reduce the risks associated with Austrian employee protection legislation is through the use of fixed-term employment contracts. The employment agreement ends with the expiry of the term agreed upon in this case. Therefore, the employee loses the protection against dismissal granted by Austrian legislation. To avoid a circumvention of these regulations, there are certain limitations to fixed-term employments. On the other hand, there are limitations concerning particularly long periods of fixed terms. On the other hand, the employer is obliged to protect employees under a fixed-term contract against discriminations compared with permanent employees. Finally, the fixed-term agreement has to be objectively justified. In particular, as mentioned above, it is impermissible to string together a large number of fixed-term employment contracts without an objective justification. In this case, the agreement on a fixed-term employment is void. Therefore, the employee may have a

1Judgment of the Austrian Supreme Court of 13 July 1976 (case reference 4 Ob 27/76).
2Judgment of the Austrian Supreme Court of 29 September 1981 (case reference 4 Ob 45/81).
3Judgment of the Austrian Supreme Court of 10 July 2008 (case reference 8 ObA 55/07g).
5Judgment of the Austrian Supreme Court of 12 March 1993 (case reference 5 Ob 514/91).
6Judgment of the Austrian Supreme Court of 7 February 2008 (case reference 9 ObA 2/08a).

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claim for a re-characterization of the contract. Again Austrian jurisdiction is very strict when it comes to the question of an objective justification. Therefore, special social or economic reasons are required to justify consecutive fixed-term contracts.

VI. Conclusion

As stated above, an independent contractor employment relationship does not require a written contract. However, to clearly define an employment relationship from the outset, an employer should issue the contractor a written statement of terms and conditions (Dienstzettel). This statement of terms must include basic information regarding the employment arrangement, including the names of the two parties, basic salary or wages, date that the arrangement commences, and any classification within the labor system. This written statement of terms is often required for the employee to register for social insurance, if they are seeking to do so independent from their employer.

In addition to this contract, an employer should remain cognizant of how the contractor is carrying out the indicia of their employment and remain sensitive to whether the contractor’s scope of employment is bleeding into the employer’s basic organization structure. Recommended business practices dictate, at the very least, monthly written or oral evaluations or memoranda concerning the scope of the contracted party’s employment to maintain records that may be used to refute a claim for re-characterization of employment.
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I. Legal Framework Differentiating Employees From Independent Contractors

a. Factors that determine who is an employee and who is an independent contractor

A worker who has an employment contract is considered as an employee. There are three essential elements making up an employment contract: work, remuneration and relationship of authority. The third element is the most characteristic. A “self-employed worker” is any individual (literally ‘natural person’) performing professional activities in Belgium within the scope of which he/she is not bound by an employment contract; this means that he/she does not work under the authority of an employer. Consequently, the criteria for distinguishing between a self-employed person and an employee are based on the existence or the absence of a link of subordination between the contracting parties: if one of these parties exercises an employer’s authority over the other, the employment relationship is deemed to be an employment contract.

The Employment Relations Act created a legal framework to ascertain the legal nature of the employment relationship. The key test remains whether or not there is a relationship of authority/subordination between the parties. The new element introduced by the Act is that the intention of the parties (and therefore the mutually agreed legal status) constitutes the essential factor to determine whether or not a subordinate relationship exists. This is in line with the established case law of the Belgian Supreme Court. Under this Act, re-qualification of the relationship (from self-employed to employee) and the resulting obligation to register with a different social security status, will only be possible in cases where certain factual elements are found to be incompatible with the qualification chosen by the parties.

The Act defines the four general criteria to be used in determining whether such factual elements exist in a particular case:

- The parties’ intention as expressed in the agreement: the qualification decided by the parties will be the starting point for the judge’s analysis of the nature of the contract; however, it is understood that the actual performance of the agreement must be in line with the nature of the employment relationship chosen by the parties.

- The worker’s freedom to organize his/her own working time: impossibility of freely organizing working time; obligation to strictly follow working days (performing a given number of hours, reporting any absence); execution of specific orders regarding specific tasks – all of these are elements that point to subordination.

- The worker’s freedom to organize his/her work: in the framework of self-employment, parties enjoy a wider degree of freedom regarding the organization and the practical execution of the work, even if it is accepted that general guidelines may be given to accommodate the requirements of the job itself (e.g. the opening and closing hours of a shop which, although placing an obligation on an independent contractor, do not necessarily indicate subordination). The absence of any obligation to justify the time schedule, freedom to work the number of hours of choice, complete freedom to choose the dates of annual vacations – all of these elements in principle indicate self-employment.

- The ability to exercise hierarchical control.

The Act also provides neutral criteria that are not relevant for determining the nature of the employment relationship. These criteria relate to a number of legal elements which are mere formalities and which concern the manner in which the contracting parties organize their relations with the social and tax administration. They contain no...
information regarding the way in which the parties perform the employment relationship. These criteria include the title of the contract, registration with a social security office, and registration with the Cross point bank for Enterprises, registration with the VAT administration, and the way in which the revenue is reported to the tax authorities.

The Act has also allowed the Government to list specific socio-economic criteria, for a determined sector, or profession or categories of professions. These specific criteria apply in addition to the criteria listed above. They may not deviate from either the general or the neutral criteria laid down in the law. The Act sets out a number of examples: the possibility of hiring or replacing employees, working in places or with materials which are personal property, guaranteed pay, personal and substantial investment in the enterprise with personal capital, power of decision over financial resources. The Act also provides a procedure for establishing these specific criteria.

By means of an Act, in 2012, the Government applied this ability to list specific criteria and as from January 1st 2013, there are now new measures against false self-employment. There is a refutable presumption (which can be reversed by all means of law) of the existence of an employment agreement. However, this new disposition is limited to four sectors:

- The construction industry;
- Security and monitoring/surveillance activities on behalf of third parties;
- Transport of goods and/or passenger transport on behalf of third parties, with exception for ambulance services and transport for disabled persons;
- Activities falling within the scope of the Joint Committee for the cleaning sector.

The presumption applies when it appears, out of an analysis of the contractual relationship, that more than half of the following nine criteria are fulfilled:

- Absence of any financial or economic risk for the worker, such as absence of a personal and substantial investment with his/her own resources in the company, or absence of a personal and substantial part in the profits or losses of the company;
- Absence of liability and decision making power in respect of the financial resources of the company;
- Absence of power of decision in respect of the purchase policy of the company;
- Absence of power of decision in respect of the price policy, unless prices are fixed by the law;
- Absence of commitment in respect of the result of the agreed work;
- Guaranteed payment of a fixed compensation without regard to the result of the company or the volume of the performed work;
- Not being an employer of personally and freely hired staff, or absence of possibility to hire personnel to carry out the agreed work or to be replaced;
- Not acting as a company towards other individuals or working usually or mainly for the same contractual partner;
- Working in spaces of which one is not the owner or tenant, or working with materials provided, financed or secured by the contractual partner.

Recent Royal Decrees have been published in order to complete these legal criteria with regard to the security and the construction sectors (see below point V “Trends and specific cases”).

b. Differences in tax treatment

Income tax

For the contractor of the self-employed worker, payment of the agreed remuneration will be made directly to the worker, without any required tax withholdings (however, in most cases, the value added tax will be generated). This means that the independent contractor is personally responsible for the tax obligations. Within the framework of an employment contract, mandatory source deductions must be made by the employer.

The level of income taxation for employees and self-employed individuals is similar. The income tax rate is progressive (the more the worker earns, the higher the tax rate). However, an independent contractor can benefit from some tax advantages, for example, in the field of the writing of business expenses or by working through his own management company.

Social security contributions

The employer is responsible for the registration, declaration and payment of both the employee and employer’s social security contributions. The employee does not have to pay his social contributions by himself. The employer retains each month 13.07 % of the gross salary as personal social security contributions and pays a maximum of 35 % of the gross salary as employer’s contributions. In total, the social security contributions represent around 48 % of the gross salary of an employee (this stands for white-collars only, employer’s contributions on blue-collars are higher).

The self-employed person must register himself to a social insurance fund by the time he begins his activities. He will pay his own social contributions of approximately 21 %, every three months, to his social insurance fund. Contrary to employees, the social security contributions of a self-employed person are capped (i.e. beyond a certain amount of income).

c. Differences in benefit entitlement

Employment benefits

Legally, independent contractors are not entitled to specific benefits. They normally only receive the remuneration agreed between the parties.

Apart from the base fixed salary, an employee will be entitled to benefits provided by law, such as, for example: Holiday leave and pay; End of year premium; Public holidays; overtime pay.

Social security benefits

Employer and employee’s social security contributions are used to pay:

- allowances in the event of sickness
- unemployment benefits
- allowances in the event of incapacity for work through sickness or invalidity
- allowances in the event of accidents at work
- allowances in the event of industrial disease
- family allowances
- retirement and survival pensions

The self-employed worker’s contributions are fixed at a lower percentage than the joint contributions of employers and employees, and provide fewer rights. The independent contractor’s benefit entitlement covers four social security branches:

- family benefits, which includes childbirth or adoption allowance, monthly family benefits, and others benefits such as age-based supplementary payments and orphan allowance;
• retaining and survival benefits;
• sickness and incapacity insurance covering some health care needs and incapacity for work (the self-employed person is required to register with the insurance fund of his choice);
• social insurance in case of bankruptcy: this insurance will allow the self-employed person to maintain his rights regarding healthcare insurance and family benefits for four quarters, and allow him to obtain temporary compensation.

In addition, the self-employed person will also benefit from a maternity insurance. As a rule, a self-employed person is not entitled to receive unemployment benefits, contrary to employees. It should be noted that the legislation on social security for independent contractors also apply to their caregivers. The caregiver is a person who, in Belgium, assists or supplies an independent contractor during the exercise of his function, but who is not engaged to him with any type of contract. The spouse of the independent contractor, or the person having made a declaration of legal cohabitation (provided that they do not have a professional activity as employee or independent) will automatically be considered as a caregiver and therefore, benefit from all the rules. This presumption is rebuttable.

d. Differences in protection from termination

The general termination modes of contractual relationships are the same for employees and self-employed persons. This stands, for example, for termination by mutual agreement, force majeure or judicial resolution of the contract.

However, for employees, there are a set of legal rules restricting the possibility to unilaterally terminate their employment contract. Apart from the dismissal for serious cause, there are two methods of termination of an employment contract concluded for an indefinite period of time: either by giving notice or by paying severance compensation in lieu of notice. The duration of the notice period is in principle fixed by law and depends mainly on the seniority of the employee concerned.

It should also be noted that some employees benefit from a specific protection against dismissal based on their individual situation (e.g. maternity, trade union activities, complaint against sexual or moral harassment, etc.). Depending on the case, the protection involves procedure or motivation requirements and is sanctioned by a specific termination indemnity fixed by law.

As a rule, there is no requirement to ask a court for permission to dismiss, except in very exceptional circumstances (e.g. for employees involved in trade union activities and representing the personnel in the Works Council, the Committee for Prevention and Protection at Work and/or the Trade Union delegation). Even under these exceptional circumstances in which prior approval would be required, not asking for approval will never result in the nullity of the dismissal itself. The sanctions that are imposed are only of a pecuniary nature.

With regard to the termination, it is clear that there is a higher degree of flexibility when working with a self-employed person, in comparison with the protective and mandatory legal rules applicable to the employees. As a rule, a self-employed person does not benefit from any legal protection from termination, unless otherwise agreed between contracting parties. In absence of such protection rules, parties will have to take into consideration case law when determining the termination rights (notice period, compensation).

e. Local limitations on use of independent contractors

There are no specific local limitations on the use of independent contractors. However, the independent contractor will be assumed to work as an employee within the framework of the Act of 3 July 1978 relating to employment contracts, which provides that “benefits of additional services performed under a contract of services are presumed to be done under an employment contract, without that the evidence of the contrary can be made, and this when the service provider and the recipient of these are bound by an employment contract for the performance of similar activities” (free translation). In other words, a worker can in principle not work as an employee and as a self-employed person for the same company.

f. Other ramifications of classification

Employees who have been struck by the closing-down of their company can benefit from the intervention of the “Indemnity Fund for the Closing-down of Firms” (IFCF).

The IFCF is mainly financed by employer’s contributions and reimbursements by receivers and liquidators of the amounts that were advanced to the employees. In addition, the IFCF receives limited funding by the Belgian government.

In practice, the IFCF pays the amounts payable to the employees and recovers them afterwards from the receiver(s) and liquidators.

The IFCF intervenes in case of bankruptcy, take-over after bankruptcy, conventional transfer, liquidation and closing-down. Following certain legal criteria, it pays different kinds of indemnities to the employees: closing-down indemnities, contractual indemnities, transition indemnities, company bonuses and additional remunerations due to certain protected employees.

g. Leased or seconded employees

Under Belgian law, the lease out of employees is governed by the Act on temporary work. This Act prohibits in principle the activity which consists in a natural or legal person leasing its employees to third parties who use these employees and exercise over them, any part whatsoever, of the authority belonging to the employer. The violation of this prohibition can lead to civil, criminal and administrative sanctions.

This Act provides, however, for some exceptions. In certain cases, an exceptional leasing of employees is indeed permitted, subject to the respect of general conditions and the warning to, or prior authorisation of, the Labor Inspectorate. Those general conditions are:
• Exceptional character: The leasing of employees must be of an exceptional character, which means that it must be both limited in time and not be repetitive.
• Permanent employees: The leased employees must be permanent employees, i.e. persons who are already in the employ of the employer who leases them and who work regularly for him.
• Level of remuneration: The remuneration and fringe benefits of the leased employees cannot be inferior to those from which employees carrying out the same functions within the user company benefit.

If the above-mentioned general conditions are fulfilled, it is possible to obtain authorization by the Labor Inspectorate. To this end, a specific procedure must be followed and a written document must be signed by the employer, the user and the worker before the start of the leasing.
It is also possible to have recourse to the leasing of employees by means of simple prior information to the Labor Inspectorate in two hypotheses:

- Within the framework of collaboration between companies of the same economic or financial entity (groups, holding);
- For the execution on a temporary basis of specialised tasks requiring a specific professional qualification.

In these hypotheses, the signature of a written document by all parties prior to the leasing is also required.

The legal leasing of employees not only implies that the contract between the employee and his/her employer continues to be legally valid and in force, but also that the user becomes jointly liable with the employer for the payment of social security contributions, remuneration, indemnities and benefits which derive from the employment contract.

An alternative to the leasing of employees could be to have recourse to a service agreement between the companies concerned.

In such a framework, a user company gives limited instructions to employees of a service provider working within the user company based on a service agreement executed between the user company and the employer/service provider. The purpose of the said agreement is not the lease out of employees, but the execution of a determined work.

However, the following conditions must be simultaneously met:

- The service agreement must be in writing and clearly and in detail list the exact types of instructions that can be given to the service provider’s employees by the user company (the types of instructions will depend on the work to be performed and on the functions concerned and must cover all aspects thereof which could result in an extensive service agreement; e.g. attendance to meetings; preparation of documents on a determined topic; respect of deadlines; etc.);
- These instructions may not undermine the legal employer’s authority over the employees;
- The factual situation must correspond to the wording of the service agreement.

If any of these conditions are not met, there will be a prohibited lease of personnel.

h. Regulations of the different categories of contracts

Belgian labor law is very protective and many aspects of the employer/employee relationship are regulated by federal legislation and collective bargaining agreements. With regard to employment contracts as such, the main rules are stipulated in the Act of 3 July 1978 relating to employment contracts, which contains the major provisions in that matter. This Act regulates the conclusion, the execution and the termination of the contract, be it a contract for an indefinite or a definite period. It also regulates specific situations such as, for example, the salesman agreement, the domestic agreement and the homework agreement. Moreover, this Act contains provisions about the duration and the suspension of the contract, the obligation of both parties, the termination of the contract, the non-competition clause, etc. Another important legal source is the Act on Work, which mainly deals with working time issues. What is not specifically regulated by Labor laws is subject to general Civil law.

Agreements concluded with self-employed persons are generally much less regulated. There is no specific global Act about the self-employment relationship. The general civil, commercial and corporate laws will apply. However, certain types of contracts concluded with a self-employed person are legally regulated (e.g. the Commercial agency agreement), but it is rather uncommon.

II. BUSINESS PRESENCE ISSUES

a. How the use of one or more independent contractors creates a permanent establishment in country and the ramifications

With regard to permanent establishment, Belgian regulations are generally consistent with those of the Organization for Economic Co-operation and Development ("OECD") in its Model Tax Convention. The Belgian authorities issued a “Standard agreement for the avoidance of double taxation with respect to taxes on income and on capital and for the prevention of fiscal evasion”, based on the OECD Model. This matter is also regulated by the Belgian Income Tax Code 1992.

According to the said Code, “permanent establishment” means a fixed place of business through which the business of an enterprise is wholly or partly carried on. This includes especially: a place of management; a branch; an office; a factory; a workshop, and a mine, an oil or gas well, a quarry or any other place of extraction of natural resources. A foreign company would be deemed to have a Belgian establishment if, for the same or related projects, it carries out services in Belgium through one or more individuals (that are present in Belgium) for, in total, more than 30 days during any 12-month period.

However, “permanent establishment” shall be deemed not to include:

- The use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise;
- The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery or of processing by another enterprise;
- The maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise;
- The maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character;
- The maintenance of a fixed place of business solely for any combination of certain activities provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.

An enterprise shall not be deemed to have a permanent establishment merely because it carries on business through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business.

Under Belgian Double Tax Convention law, a dependent agent will only give rise to a permanent establishment if he has, and habitually exercises, authority to conclude contracts on behalf of its foreign principal. Independent agents acting in the ordinary course of their business do not give rise to a Belgian establishment.

b. How the employment of one or more individuals creates a permanent establishment in country and the ramifications

The same principles under point a. above will apply. The employment of one or more individuals may create a permanent establishment where there is either a fixed place of business, or where business is conducted via a dependent agent. The ramifications include that the foreign company will have to pay taxes in Belgium on its business profits attributable to the permanent establishment.
III. RE-CHELARACTERIZATION OF INDEPENDENT CONTRACTORS AS EMPLOYEES

a. Laws and Guiding Principles

Such a re-characterization can only be established by a Court. Re-characterization of the relationship (from self-employed to employee) and the resulting obligation to register with a different tax and social security system, will only be possible in cases where certain factual elements are found to be incompatible with the qualification chosen by parties. Indeed, since 2003, and following several decisions of the Court of Cassation (Belgian Supreme Court), it is admitted that the judge will have to determine first how the parties have qualified their relationship, so that the will of the parties and the qualification of the contract are the pre-eminent criteria, and this qualification can only be re-characterized if there are elements incompatible with the chosen qualification.

b. The Legal Consequences of a Re-Characterization

Principle – In case of a re-characterization, there are several legal consequences; both for the self-employed person and the other party as regards to tax, social security, and labor relations.

Tax law - The Company (i.e. the employer) could be held liable for not having withheld personal income taxes. Tax increases and fines can be imposed. However, contrary to the social security contributions, the company will not become solely liable for the taxes. If the authorities demand the payment of the taxes from the company, the latter will have recourse against the employee for the amounts paid (provided the employee is still solvent).

The Tax Office could claim such amounts for a period of 3 years (or 5 years in case of fraud) preceding the re-characterization. The amounts due before this date are barred. It must be noted that the Office could claim a tax on secret commissions, equal to 309% of the amounts that were not mentioned on the fiscal statement – which was naturally not delivered by the employer.

Social security – Basic approach – The corresponding social security scheme will be applied, taking into account the applicable prescription period. This means that, as a rule:

- The Company could be held fully liable for the entire amount of social security contributions that should have been paid, i.e. 13.07% employee contributions and approximately 35% employer contributions of the fees paid, to be increased with interest (7%), penalties and an increase of 10%. There is no possibility of recovering the amounts so paid from the employee concerned (any contractual stipulation to the contrary would be null and void).
- Moreover, criminal sanctions (fines) could also be imposed for not declaring the employment to the National Office for Social Security (NOSS).

The NOSS could claim such amounts for a period of 3 years (or 7 years in case of fraud).

Social security – Derogations – However, since January 1st 2013, the re-characterization has fewer consequences for the employer in the field of social security and this in two cases:

- when the employee voluntary registers to the NOSS (in a specific notice);
- when the parties obtained a social ruling from the Administrative Commission on Employment Relations (see below point V “Trends and specific cases”)

In these two cases (only), some reductions are possible with regard to the claimed amounts, the regularization in time and the calculation basis. Criminal sanctions are also excluded.

Labor law – The whole relationship will be qualified as an employment contract from the beginning. As a consequence, the worker will have the right to claim arrears of certain benefits, such as holiday pay, end of year premium, salary increases provided by law, salary for overtime work, etc. The worker could also claim a legal severance indemnity in case of termination.

c. Judicial Remedies Available to Persons Seeking ‘Employee’ Status

Most of the time, it is when the independent relationship comes to an end and the individual concerned starts legal proceedings, that a Labor Court will examine the qualification given by the parties to the contract as well as the concrete terms of the relationship. When there are sufficient elements that are not compatible with the chosen qualification of the contract, it will be re-characterized as an employment contract and the individual concerned will be granted several amounts specific to the execution and the termination of the employment contract (e.g. arrears of salary, termination indemnities).

d. Legal or administrative penalties or damages for the employers in the event of re-characterization

In addition to the tax, social security and labor law consequences as described above (see point a), the employer is, in case of re-characterization, exposed to financial sanctions provided by the Criminal Social Code, for example, due to the lack of:

- Declaration to the National Office for Social Security;
- Payroll documents;
- Work accident insurance;
- Work Rules;
- Holiday pay.

IV. HOW TO STRUCTURE AN INDEPENDENT CONTRACTOR RELATIONSHIP

a. How to Properly Document the Relationship

It is recommended to draft a written agreement. This agreement should take into consideration the general criteria provided by the Act, as described above. In other words, it should be clearly stipulated, for example, that the worker is free to organize his/her work and his/her working time. The relationship should be structured in such a way as to include as many independent factors as possible, while avoiding elements specific to a subordinate relationship. The written agreement will play a significant role in establishing the nature of the relationship.

In addition, it is recommended to include specific clauses such as termination provisions.

b. Day-to-Day Management of the Relationship

The management of the day-to-day relationship must be consistent with its contractual qualification. Therefore, exercising close control on the work performed and giving detailed instructions must be avoided. Only general directives should be transmitted from the principal to the individual. The principal should give the worker as much independence as possible.
For example, in a decision of 6 December 2010, the Court of Cassation has ruled that monitoring the quality of work is allowed. However, such control cannot go beyond a standard control of the quality of the delivered work and must stay in line with the independent qualification of the relationship. This implies that only the result can be controlled.

V. Trends and Specific Cases

In 2013, a set of topics relating to “false self-employment” were brought forward. Some are detailed below.

Ability to obtain a social ruling: in order to reduce the risk of re-characterization and to avoid the related sanctions, the parties, or the self-employed person - him/herself, seeking legal certainty with respect to the relationship, can request a social ruling from the Administrative Commission on Employment Relations, now in place.

This ability can be used prior to beginning the relationship or during the first year. The ruling is valid for a period of three years. The final decision-making power to re-characterize an independent relationship into an employment agreement rests with the Labor Courts. However, the consequences of such re-characterization will be less severe, at least concerning social security matters, if the employer has obtained a social ruling.

Issues with the interpretation of the new criteria: several Belgian authors have already mentioned that some of the nine new specific criteria introduced by the Act of August 25, 2012 could be difficult to apply in practice. For example, the criteria “Not acting as a company towards other individuals or working, generally and habitually, for one contracting party” could be interpreted as an alternative criterion, but also as a cumulative criterion. In addition, several criteria refer to the notion of “company”, but if the self-employed person works through an intermediary company (i.e. his/her own management company), it is not clear whether the criteria refer to the self-employed person’s company, or to the main company (i.e. the principal).

Specific rules for the security and the construction industry: as mentioned above, in the security industry and the construction industry, Royal Decrees have been published recently in order to complete the existing legal criteria. It is not excluded that the same will occur for other sectors of activity in the future.

VI. Conclusion

Since the Act of December 27, 2006, a clear legal framework exists in Belgium to ascertain the legal nature of the employment relationship. This Act provides determined criteria in order to qualify the contractual relationship: general criteria, neutral criteria (that are not relevant for determining the nature of the relationship), and also specific criteria applying to certain sectors of industry.
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VI. Conclusion
I. Legal Framework Differentiating Employees From Independent Contractors

a. Factors that determine who is an employee and who is an independent contractor

Determining whether an individual is an employee or an independent contractor in Canadian law is more of an art than a science. In simple terms, actions speak louder than words. A well-drafted and properly executed contract will not be determinative in evaluating the status of the relationship.

In making status determinations, Canadian courts and administrative tribunals will consider the subjective intention of the parties, which may include a written contract, along with the objective reality of the working relationship. The weight that Canadian courts and tribunals place on a written contract varies.

Recently, the Federal Court of Appeal restated the legal test applicable to determining whether an individual is an employee or an independent contractor. As outlined in that decision, the current test to be applied in Canada when making a status determination is this two-step inquiry:

• First, the court should determine the subjective intention of the parties by written agreement or conduct; and
• Second, the court should ascertain the objective reality by evaluating whether the facts are consistent with the parties' stated intentions.

In considering this second step, decision makers will often consider the following four factors enunciated in the case of "Wiebe Door", which have become known as the "Wiebe Door" factors:

• Control
• Ownership of Tools
• Chance of Profit
• Risk of Loss

The courts have repeatedly held that no particular factor is dominant. Instead, these four factors constitute a non-exhaustive list, and there is no set formula as to their application. The relative weight of each factor will depend on the particular facts and circumstances of the case. In this respect, the courts will consider all factors and evaluate the totality of the relationship on a case-by-case basis. In applying the Wiebe Door factors, the courts will consider some of the following questions for each factor:

Control

Is the worker under the direction and control of another regarding the time, place, and manner in which the work is performed? Is the worker hired, given instruction, supervised, controlled, or subject to discipline? Does the worker set his or her own hours and complete work independently? Can the worker hire subcontractors to complete the work? Situations where a worker has more flexibility over how and when the work is performed tend to suggest an independent contractor relationship.

1 1392644 Ontario Inc. (Connor Homes) v Canada (National Revenue), 2013 FCA 85 ("Connor Homes").
2 These factors were enunciated in Wiebe Door Services Ltd v The Minister of National Revenue (1986), 87 DTC 5025 (Fed CA) ("Wiebe Door") and 671122 Ontario Ltd v Sagaz Industries Canada Inc., [2001] 2 SCR 983 ("Sagaz").
3 See for instance Wiebe Door and Sagaz.
4 See Sagaz, supra at para 48.
Ownership of Tools
Does the worker use tools, space, supplies or equipment provided by the company or does the worker utilize his or her own resources to complete the work? Situations where the worker supplies highly specialized and/or expensive equipment may suggest a non-employment relationship, whereas situations where the company provides most resources may suggest an employment relationship.

Chance of Profit
Can the worker increase his or her earnings by using entrepreneurial skills? Is the worker paid an hourly rate, which limits his or her chance of profit, or is he or she paid piecemeal, meaning greater efficiency may increase profits? Situations where a worker’s skills, efficiency, or entrepreneurial work can increase the worker’s earnings tend to suggest an independent contractor relationship.

Risk of Loss
Is the worker at risk of losing money if the cost of doing a job is more than the price charged for it? Is the worker at risk of not being paid if the work is not done correctly? Situations where workers are at a greater risk for loss when performing services may favour a finding of a non-employment relationship.

In considering all of the above, it is clear the courts will consider status issues on a case-by-case basis evaluating all relevant facts. A contract will not ensure a particular status if the practical reality is not consistent with that status.

To make matters more complicated, a determination in one forum may not always be binding in another forum. For instance, a finding in the Tax Court of Canada (“Tax Court”) that an individual is an independent contractor may not result in the same finding under employment standards legislation. Indeed, despite the importance of correctly characterizing an employment relationship, there is no universal definition of “employee” in Canadian legislation. The Supreme Court of Canada has stated that when courts and tribunals are examining whether or not a particular individual is an “employee”, the particular policy objectives of the statute at issue must be taken into account.5

b. Differences in tax treatment
There are many tax advantages for both companies and individuals to classifying workers as independent contractors rather than employees.

For companies, payment will be made directly to the independent contractor, without any required source deductions. Also, companies will not be required to make deductions or employer contributions to various government programs, namely Employment Insurance (“EI”) or Canada Pension Plan (“CPP”) premiums.

For the independent contractor, the lack of deductions means more money in the independent his pocket. The totality of income tax and premium deductions can be significant, so the independent contractor benefits greatly from reducing and deferring the income tax payable, and by never having to make EI or CPP contributions unless he or she qualifies for, and opts into, a program to do so.

Independent contractor status also provides the independent contractor with other tax advantages. Independent contractors can write off various business expenses, which may include home-related expenses such as internet, phone, utilities, and even a portion of mortgage/housing rental fees, along with business equipment, business use vehicles, gas, meals, and sometimes entertainment. This means the independent contractor has the potential to net far higher earnings than an employee earning a similar gross amount. The possibility of savings for the company does not come without risk. A company can face significant liabilities if the Canada Revenue Agency (“CRA”) determines that an individual who has been treated as an independent contractor is actually an employee. Such liabilities may be particularly concerning for a business that classifies a significant portion of workers as independent contractors (for instance, as may be seen in a taxi or tow-truck company). A reassessment in those cases could compromise the future of the business. As such, companies that contract with a number of independent contractors should not only ensure that a well-drafted independent contractor agreement is in place, but also that the practical reality of the relationship is consistent with an independent contractor status. Otherwise, today’s moderate tax advantage could turn into a far more significant tax liability, as the company could not only be responsible for its own premiums and deductions, but also the worker’s portion that it failed to remit.

In this respect, there are advantages to classifying a working relationship as employer-employee. Deductions are made by the employer, without potential liabilities relating to income tax, EI and CPP. An employer-employee classification also provides increased protection for the worker, including the ability to apply for EI benefits should he or she become unemployed.

c. Differences in benefit entitlement
In general terms, independent contractor status provides workers with financial/tax benefits (as described above) at the cost of all other employment-related benefits. For instance, given that independent contractors are not required to pay government premiums for EI or CPP, they likewise will not qualify for receipt of these benefits. In this respect, an independent contractor will not receive government income protection (EI) for a period where they do not have work. Also, they will not receive government pension payments by way of CPP benefits, unless they elect to contribute.

Further, independent contractors are not entitled to the basic protections of employment standards legislation. This includes the benefit of vacation pay and statutory holiday pay. Employees protected by employment standards legislation may take various paid leaves of absence, which may include: pregnancy leave, parental leave, sick leave, family medical leave, and so forth. Independent contractors have no right to such leaves.

In terms of medical benefit coverage, Canada’s employment standards legislation generally does not require that companies provide medical insurance benefits for employees; however, medical benefits are often provided to employees as part of a negotiated remuneration plan. It is unlikely that an independent contractor would receive medical benefit coverage, which may include provisions for long-term disability, extended health, dental, and other insurance coverage. Notably, Canadians have universal health care coverage and are not required to pay directly for most non-elective medical procedures and assessments.

Canadian jurisdictions have workplace safety and insurance regimes to provide benefit coverage in the event of a work-related accident. Such coverage may include loss of earnings payments, medical treatment coverage, and even retraining for a new career. In general terms, employees will qualify for such coverage, whereas independent contractors may not.

There may be special status for independent contractors in various workplace safety and insurance regimes. For instance in Ontario, individuals can apply for optional insurance for “independent operators”. Not only does this benefit the contractor, but it also provides significant legal protection for the company, as workers entitled to benefits under the...
Workplace Safety and Insurance Act for matters arising out of work-related injuries are precluded from pursuing civil actions (i.e. personal injury lawsuits) for work-related injuries. In contrast, an independent operator without optional coverage may be able to sue the company for damages in respect of a work-related injury.

d. Differences in protection from termination

Both independent contractor and employment relationships can be terminated; it is usually a question of how much notice is required to terminate the relationship.

Independent contractors are generally not entitled to significant notice of termination under employment standards legislation or common law, unless their contract contains a provision that stipulates some form of notice.

Generally, employees are entitled to greater notice of termination. First, applicable employment standards legislation sets a minimum requirement for notice and sometimes severance pay. Second, employees may be entitled to common law reasonable notice of termination, unless a contract of employment otherwise limits notice. Reasonable notice at common law is a remedy the courts can provide for employees terminated without notice or insufficient notice, which is more often than not far greater than the minimum legislative requirements. An employee is entitled to at least the minimum legislative standards in respect of notice and severance, if applicable, except in the case of significant misconduct (often termed as “just cause”).

Some Canadian courts have recognized an intermediate category of contractor, between an employee and an independent contractor. This intermediate category is often referred to as a dependent contractor because it is economically dependent on the contracting company. A dependent contractor will generally be entitled to notice of the termination of his or her contract, but not to as much notice as an employee may be under similar circumstances.6

Notably, most of the law considering status disputes has evolved out of the Tax Court; however, other courts and administrative tribunals have consistently considered the Wiebe Door factors and have otherwise generally applied an analogues approach.

Often such cases only come forward at the end of a relationship where a former worker, classified as an independent contractor, becomes dissatisfied with the notice of termination received when the relationship ceases. Unfortunately, even though that individual may have reaped the tax benefits of independent contractor status for years, he or she may be considered an employee or dependent contractor under the above tests, and thus, be entitled to reasonable notice of termination.

e. Local limitations on use of independent contractors

The main limitation on the use of independent contractors in Canada is the risk that they will be reclassified as employees.

Another limitation relates to work performed under a collective agreement. Where a union holds bargaining rights over particular work, companies may not be at liberty to hire independent contractors to complete such work. A company cannot circumvent a union’s bargaining rights by giving independent contractors bargaining unit work, unless the collective agreement allows for such by express or implied terms.

f. Other ramifications of classification

Labour Relations Ramifications

Pursuant to provincial labour legislation, such as the Ontario Labour Relations Act, where an individual is considered an “employee”, that individual may be included as part of an existing bargaining unit, or may be eligible to be included in an application for certification of a union. Under the Labour Relations Act, only an employee, which is defined to include a “dependent contractor”, is eligible to unionize and collectively bargain.

Insolvency Ramifications

If a company becomes insolvent, whether a worker is an independent contractor or an employee can affect the priority for amounts to be paid to the worker. Pursuant to the federal Bankruptcy and Insolvency Act, as well as various other statutes, employees take priority over other creditors up to certain amounts. In contrast, independent contractors do not have the same priority.

g. Leased or seconded employees

Use of a staffing agency may provide more flexibility to meet businesses’ staffing needs. The use of an agency may limit many liabilities, including wrongful dismissal claims. Further, the contracting company will not be required to pay premiums for EI, CPP or other employment-related benefits in respect of agency employees; however, presumably the cost of such would be built into the fee charged by the agency.

In the event a company contracts or seconds employees from an agency or another company, the company should ensure that the arms-length relationship is preserved by the practical realities of the engagement. For instance, if the company controls all aspects of the work, it may be found to be the “true employer” of the agency employees, which could result in findings of liability for various employment-related matters.

Further, even contracting workers from an agency may not limit liabilities in certain legal venues. For instance, the contracting company may, in some circumstances, have all or at least partial liability in respect of a workplace accident. Further, a contractor could file a human rights application against the contracting firm. As such, while using an agency does provide some protection, these protections are not boundless. Given the practical realities of working relationships, a contractual relationship may be most useful for fixed-term work projects or temporary work.

h. Regulations of the different categories of contracts

Employment agreements in Canada are regulated only in the sense that a court or government body (such as the CRA) can review or analyze a relationship in the course of litigation, at the request of one of the parties, or in some cases, by undertaking an independent audit. Otherwise, parties are generally free to enter into whatever sort of relationship they wish, provided they comply with the statutory requirements that arise depending on how the relationship is classified. The relationship of parties who enter into an agreement is generally regulated by that agreement, and will not be subject to a judicial or administrative decision, unless a dispute arises that result in litigation.

The remaining issues above are not applicable in Canada, except as discussed elsewhere in this paper.

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6McKee v Reid’s Heritage Homes Ltd., 2009 ONCA 916
II. BUSINESS PRESENCE ISSUES

a. How the use of one or more independent contractors creates a permanent establishment in country and the ramifications

A non-resident corporation that carries on business in Canada generally will be subject to Canadian tax filing requirements and will be required to pay taxes on business profits attributable to that establishment. Nonetheless, Canada is a party to the Convention between Canada and the United States of America with Respect to Taxes on Income and on Capital (the “Convention”). Article VII of the Convention provides that business profits will only be taxable in Canada if the non-resident carries on business through a “permanent establishment”. Article V establishes two types of permanent establishments: a “fixed place of business” or a “dependent agent”. A dependent agent must have authority and habitually exercise that authority to conclude contracts in the name of the U.S. corporation. Paragraph 7 of Article V stipulates that a permanent establishment will not be created where business is carried out in Canada through a broker, general commission agent, or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business.

The key factors in the dependent agent permanent establishment analysis are set out in American Income Life Insurance Co. v Canada, 2008 TCC 206 (“American Income”):

- Did the agent have the authority to conclude contracts in Canada?
- Was the agent of independent status, both legally and economically?
- Was the agent acting in the ordinary course of his or her business?

With respect to permanent establishment, the CRA’s views are generally consistent with those of the Organization for Economic Co-operation and Development (“OECD”) in its Model Tax Convention on Income and on Capital and its Commentary. The OECD has clarified that a dependent agent must habitually exercise its authority to conclude contracts, and that those contracts must relate to the operations that constitute the “business proper” of the non-resident.

In light of the foregoing, a truly economically independent contractor in business for himself or herself is unlikely to create a permanent establishment for the purposes of Canada’s Income Tax Act. The independent contractor versus employee tests outlined above will be relevant to determining whether an agent was performing services as a person in business on his or her own account. If the agent was not in business for himself or herself, then that agent must have significant contracting authority in order to create a permanent establishment.

b. How the employment of one or more individuals creates a permanent establishment in country and the ramifications

The employment of one or more individuals in Canada may create a permanent establishment where there is either a fixed place of business, or where business is conducted via a dependent agent. The ramifications of the creation of a permanent establishment include that the non-resident corporation will be required to pay taxes in Canada on its business profits attributable to the permanent establishment. An employee in Canada may create a permanent establishment where that employee has significant power to bind the non-resident corporation in contract. Such authority must extend to concluding contracts which relate to the operations which constitute the “business proper” of the non-resident and that authority must be exercised habitually.

Whether an employee’s contractual authority will be sufficient to create a permanent establishment will depend upon the particular facts and circumstances involved in each case.

III. RE-CHARACTERIZATION OF INDEPENDENT CONTRACTORS AS EMPLOYEES

a. Laws and Guiding Principles

It is crucial that parties clearly define whether or not they have an employer-employee or an independent contractor relationship. Nevertheless, simply labelling a worker an “employee” or an “independent contractor” is not sufficient to establish such a relationship. The intention of the parties is only one of many factors that will determine how the relationship is ultimately viewed. Rather, the total relationship between the parties will be examined.

In undertaking such an examination, courts will review the Wiebe Door factors underlying an employment relationship. Courts will, in addition, review the degree of economic independence in the employment relationship (that is, whether a party is carrying on business for himself/herself or on behalf of a superior). The duration of a relationship between a worker and a company is also an important factor. If an independent contractor has been providing services to a company for many years, is providing little (or no) services to other companies, and has become dependent upon the company for income, such may indicate that the relationship is that of a dependent contractor or employee, rather than an independent contractor.

Such tests are open to a great deal of interpretation, and the aforementioned factors are not exhaustive. However, they are important considerations that will be looked at in examining the status of an employment relationship.

b. The Legal Consequences of a Re-Characterization

The issue of whether an individual is an employee or an independent contractor is significant because an individual’s status as an employee will trigger the application of statutory rights and benefits under a number of pieces of legislation.

In Ontario, for instance, specific obligations to employees may arise under the following statutes: the Income Tax Act, the Employment Insurance Act, the Canada Pension Plan, the Employment Standards Act, the Workplace Safety and Insurance Act, the Pay Equity Act and the Labour Relations Act.

c. Judicial Remedies Available to Persons Seeking ‘Employee’ Status

The remedies available to those seeking employee status depend on the forum in which the status is sought.

Pursuant to the Employment Insurance Act and the Canada Pension Plan, workers may apply to the CRA for a determination of their status. A ruling will determine whether a worker is “self-employed” (i.e. an independent contractor) or an “employee”, and thus, whether that worker’s employment is pensionable or insurable under the Canada Pension Plan and/or Employment Insurance Act. If an individual is found to be an employee by the CRA or the Tax Court, he or she may be eligible for EI or CPP benefits.

Further, an individual who has been found to be an employee may be entitled to damages for wrongful dismissal (i.e. common law notice) in the courts.

7 Income Tax Act, RSC 1985, c 1 (5th Supp), s 2(3)(b).
8 See for instance Wiebe Door and Sagaz, as well as Connor Homes.
In other cases, newly reclassified employees may choose to file an employment standards claim to seek remedies under employment standards legislation, such as notice and severance pay, vacation pay, public holiday pay and/or overtime pay.

d. Legal or administrative penalties or damages for the employers in the event of re-characterization

Mischaracterization of the relationship between an employer and a worker can result in liability for the employer under a number of statutes.

Tax Implications

Employers are obligated to deduct income at source from all employees for tax remittance purposes. Such deductions are not required for independent contractors. Where an independent contractor is subsequently deemed to be an employee, the employer may be liable for the income tax that should have been deducted. When this occurs, the CRA generally will first turn to the individual for the outstanding amounts; however, the employer will remain liable if the individual is unable to pay, or cannot be located. The CRA can assess a penalty of 10 percent of the amount of CPP, EI, and income tax an employer fails to deduct, and can apply up to a 20 percent penalty to a second or later failure to deduct in the same calendar year; if such failure was made knowingly or by gross negligence.

Pensions and Insurance Implications

CPP payments and EI benefits are both administered by the CRA. The same factors used in determining whether an individual is an “employee” for income tax purposes are also considered in determining whether an individual is an employee or an independent contractor for the purposes of the application of both the Employment Insurance Act and Canada Pension Plan. For both CPP and EI, employers are required to make an employer’s contribution, and to deduct the employee’s contribution to remit to CRA.

With respect to CPP, employers are not expected to make contributions for independent contractors. An employer who fails to deduct required CPP contributions from an employee has to pay both the employer’s share and the employee’s share of any premiums owing, plus penalties and interest. Therefore, where an individual who has been operating as an independent contractor is deemed to be an employee, there are significant financial repercussions for the employer.

With respect to EI, independent contractors do not receive benefits, and no contributions are required. However, it is not unusual for independent contractors to dispute their status as independent contractors after their contract is terminated. If it is determined that they were, in fact, employees, they will be eligible for EI benefits. In such an instance, an employer may be liable for the payment of both the employee’s and the employer’s contribution for a period that includes the current year, up to the three previous years, including interest and penalties.

The current prescribed interest rate (as of October 1, 2013) for unremit income tax, CPP, and EI contributions is 6 percent, compounded daily. Interest applies to the penalties described above as well.

Workplace Safety and Insurance Act Implications

Pursuant to provincial workers’ compensation legislation, such as Ontario’s Workplace Safety and Insurance Act (the “WSIA”), certain individuals are entitled to benefits if they are injured while at work. The issue of whether or not a specific individual is covered under the WSIA (and is thus eligible for benefits) frequently will depend upon whether that worker is considered an “independent operator” or a “worker”. Workers, who are those individuals working under contracts of service, generally are entitled to benefits if injured at work. In contrast, so-called “independent operators”, or those working under contracts for service, may not be entitled to benefits under the WSIA, unless they voluntarily apply to the Workplace Safety and Insurance Board (the “WSIB”) for optional insurance coverage.

Workers may file a complaint with the WSIB against employers who do not fulfill their obligation to pay benefit contributions. In addition, the WSIB may audit employers to ensure that premiums are being paid on behalf of all workers. The WSIB has broad powers of enforcement. If an employer fails to pay the premiums in respect of a worker, the employer may be ordered to pay the amount of premiums payable for one year, and as a penalty, may be ordered to pay that amount again. Employers may also be liable to a worker for any losses suffered by that worker as a result of non-compliance. As such, if an individual is injured and it is determined that they are, in fact, a worker and not an independent operator, then there may be serious implications for the employer.

Wrongful Dismissal Claims

Generally, independent contractors cannot claim wrongful dismissal; however, if a court finds that an individual was actually an employee or dependent contractor, that individual may be entitled to reasonable notice of termination at common law.

As previously mentioned, issues with status of employees in wrongful dismissal claims commonly arise following the termination of a worker that has been functioning as an independent contractor for the length of their tenure with the Company. When that independent contractor realizes, for instance, that he or she is not receiving a severance package, the independent contractor may claim he or she was actually an employee and thus should have received reasonable notice at common law.

The length of the reasonable notice period owing to an employee will depend upon a number of factors, including the age of the employee, their length of service, the position they had when they were terminated, and the availability of alternate employment. As stated above, dependent contractors will generally be entitled to less notice than employees.

Vicarious Liability of Employers

In general, an employer is vicariously liable for the acts and omissions of an employee where such acts and/or omissions are committed by that employee “in the course of employment”. In contrast, employers generally are not vicariously liable for the actions of an independent contractor. If an independent contractor is found to actually be an employee, the employer may then be liable for the acts and omissions of that individual.

IV. HOW TO STRUCTURE AN INDEPENDENT CONTRACTOR RELATIONSHIP

a. How to Properly Document the Relationship

An employer should first and foremost consider what relationship it wishes to establish with a worker. The employer should then draft a written agreement that reflects the Wiebe Door factors, and other tests commonly used. Employers who wish to enter into
an independent contractor relationship with a worker would be wise to structure their relationship in such a way as to include as many independent contractor factors and to exclude as many employee factors as possible. The terms of the relationship should be clearly set out in a written agreement that explicitly states what type of relationship the parties wish to enter into. In the case of an independent contractor, the agreement should be titled “Independent Contractor Agreement” or “Contract for Services” (as opposed to a “Contract of Services”). As previously mentioned, an agreement between the parties will not be determinative of the relationship, but it will play a role in establishing the nature of that relationship.

The agreement should also include legally enforceable termination provisions. It may be prudent to limit the independent contractor’s entitlement on termination to the minimums in the applicable employment standards legislation, to mitigate against the risk that an independent contractor may be found to be an employee.

b. Day-to-Day Management of the Relationship

Since the way in which services are provided can change over time, the employer should periodically review its relationship with an independent contractor to ensure that the situation continues to be properly characterized as an independent contractor relationship, rather than an employment relationship. Both the employer and the worker must act consistently with the relationship described in their written agreement. In the event a relationship is assessed, it will not be helpful if the agreement between the parties is titled “Independent Contractor Agreement”, but the parties are behaving as though the relationship is one of employer-employee. The bottom line is, if an employer wishes for a court or the CRA to treat a relationship as an independent contractor relationship, that employer should give the worker as much independence as reasonably possible, almost as though that worker were a separate business entity.

V. TRENDS AND SPECIFIC CASES

In recent years, the trend in Canada, much like the trend elsewhere, has moved towards an increased use of independent contractors and short-term contracts. In Canada, this has led to an increase in litigation at the Tax Court, as workers seek entitlement to benefits to which only employees are entitled. Consequently, the issue of whether a worker is an employee or an independent contractor has taken on increased significance.

Canadian jurisprudence defining employee versus independent contractor status is not entirely consistent. The courts have taken varying approaches with respect to the weight that should be given to written contracts in making status determinations. For instance, some decisions heavily favour a finding consistent with the written contract agreed on by the parties, whereas other decisions completely ignore the same.

Royal Winnipeg Ballet v. MNR (2006 FCA 87) (“Winnipeg Ballet”) suggested substantial weight should be given to the stated intention of the parties. In Winnipeg Ballet, the Federal Court of Appeal overturned a previous decision by the Tax Court which had found that three dancers were employees and not independent contractors.

The evidence clearly indicated that both parties believed the dancers to be independent contractors, and the parties acted consistently with their understanding that the dancers were independent contractors. The dancers charged GST for their services, and the employer did not withhold taxes. The agreement contained no express provision regarding their status. It set out, inter alia, minimum rates of pay, contributions to health care and disability insurance. Dancers were required to pay for certain costs independently, including costs of rehearsal outfits and makeup, while the employer was required to pay for other costs, such as the purchase of costumes.

The majority of the Federal Court of Appeal held that “in determining the legal nature of a contract, it is a search for the common intention of the parties that is the object of the exercise.”10 The Federal Court of Appeal found that the Tax Court erred in failing to consider the parties’ intention, and should have considered the Wiebe Door factors in light of the evidence that both parties had understood and acted as though the dancers were independent contractors. The Federal Court of Appeal did state that the understanding of the parties with respect to status is not necessarily determinative, if their stated intention is not reflected in the terms of the contract and the practical reality of their day-to-day relationship, then intention will be disregarded.

The Winnipeg Ballet decision has been applied with varying results in subsequent decisions. In considering this varying jurisprudence, the Federal Court of Appeal in Connor Homes recently clarified the test to be applied in determining the status of a worker, as outlined above. Specifically, the Court enunciated a two-step inquiry to be applied at paragraphs 39 to 41:

Under the first step, the subjective intent of each party to the relationship must be ascertained. This can be determined either by the written contractual relationship the parties have entered into or by the actual behaviour of each party, such as invoices for services rendered, registration for GST purposes and income tax filings as an independent contractor.

The second step is to ascertain whether an objective reality sustains the subjective intent of the parties. As noted by Sharlow J.A. in TBI Personnel Services Inc. v. Canada, 2011 FCA 256, 422 N.R. 366 at para. 9, “it is also necessary to consider the Wiebe Door factors to determine whether the facts are consistent with the parties’ expressed intention.” In other words, the subjective intent of the parties cannot trump the reality of the relationship as ascertained through objective facts. In this second step, the parties’ intent as well as the terms of the contract may also be taken into account since they color the relationship. As noted in Royal Winnipeg Ballet at para. 64, the relevant factors must be considered “in the light of” the parties’ intent. However, that being stated, the second step is an analysis of the pertinent facts for the purpose of determining whether the test set out in Wiebe Door and Sagoz has been in fact met, i.e. whether the legal effect of the relationship the parties have established is one of independent contractor or of employer-employee.

The central question at issue remains whether the person who has been engaged to perform the services is, in actual fact, performing them as a person in business on his own account.11

It remains to be seen what weight courts will continue to place on the stated intent of the parties, and how various other factors will be balanced.

The Ontario Court of Appeal considered the differences between employees, dependent contractors and independent contractors in McKee v Reid’s Heritage Homes Ltd., 2009 ONCA 916. The plaintiff carried on business through her company and even had her own employees. Her contract, although no longer binding, seemed to show the intention to

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10Royal Winnipeg Ballet v MNR, 2006 FCA 87 at para. 59.
11Connor Homes, supra, at para 39-41.
that she be considered a contractor. The plaintiff was paid by commission; however, she was economically dependent on the employer, as she had worked exclusively for that employer for a number of years.

The Ontario Court of Appeal considered a number of factors, including the following:

- whether the person works exclusively for the employer;
- whether the person is subject to the control of the employer;
- whether the person owns the tools of the trade;
- whether the person has undertaken risk or loss/chance of profits, as distinct from fixed compensation; and
- whose business is it?

The Court concluded that the plaintiff was an employee, rather than an independent contractor or dependent contractor. Accordingly, the plaintiff was entitled to reasonable notice of the termination of her contract.

This case demonstrates that if an individual is in an economically vulnerable position vis-a-vis an employer - for instance, if they are dependent on the employer for most of their work - there is a risk that a court will find that an employment relationship or a dependent contractor relationship exists.

This decision is also notable because it explains the intermediate category of dependent contractor. A dependent contractor is a contractor (and not an employee), but not an independent contractor. A dependent contractor is dependent on the employer for most or all of their business. Dependent contractors are entitled to notice of termination, although not to the same extent as employees.

VI. Conclusion

The foregoing summarizes some of the distinctions between employees and independent contractors in Canadian law.

In Canada, the line between who is an employee and who is an independent contractor is often blurred, which may have significant implications for the employer. If an independent contractor is found to be an employee, the employer faces significant liability under a number of statutes, as well as the common law. As a result, it is imperative that the relationship between the parties is correctly characterized in a clear and legally enforceable written agreement, along with a practical reality that is consistent with that agreement.

Generally, the various tests and factors that have been applied by Canadian courts and tribunals will examine the totality and true nature of the relationship. In simple terms, if it looks like an employee and acts like an employee, the Canadian courts will find it is in fact an employee.
FRANCE

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I. Legal Framework Differentiating Employees From Independent Contractors

a. Factors that determine who is an employee and who is an independent contractor

The notion of “employee” is not defined by French law. French case law defines it by defining the employment contract. Employment contract is defined as an agreement by which an individual works for another person (natural or legal), under the latter’s subordination, for which s/he receives remuneration.”

Therefore, three factors typify an employment contract: (1) discharge of tasks (2) remuneration and (3) relationship of subordination. As the first two factors are found in almost every agreement, a subordination relationship is the only factor which allows to differentiate employees from other service providers, including independent contractors.

The French labour Code defines independent contractor as follows: “is presumed to be an independent contractor, any individual whose working conditions are defined exclusively by himself or in a contract, in conjunction with his customer”. The French labour Code also provides that individuals who are registered as self-employed service providers are presumed not to be linked to their customer with an employment contract in the execution of their activities. However, this is a refutable presumption, as the same Article provides that the existence of an employment contract may however be established when the same registered individual provides services under conditions which place him in a permanent relationship of subordination with respect to his customer.

Therefore, the predominant factor which differentiates employees from independent contractors is the subordination relationship.

Pursuant to the French Supreme Court a “subordination relationship is characterized by performance of duties under the authority of an employer who has the power to give orders, monitor execution of assigned duties and punish his subordinates’ breaches of duties” (Cass. Soc. 13 November 1996, n° 94-13187). Therefore, independent contractors should be “independent” when it comes to carrying out their duties. They carry out their work assignment autonomously, without receiving permanent instructions and/or orders from the company. Therefore, the key factors taken into account by the courts consist of the frequency of the instructions, the monitoring of performance and possible sanctions.

Other criteria, some of which are listed below, allow the courts to ascertain the existence of a subordination relationship. In their assessment, the courts use a set of factors. A single factor is not sufficient or decisive.

- Working Hours: employees should comply with company working hours or time under penalty of disciplinary measures. On the contrary, independent contractors are not subject to company working hours, but have the latitude to arrange their working time as they wish.
- Duties & Remuneration: employees have a permanent task for which they receive a regular monthly salary. Whereas, when a company calls upon an independent contractor, it is for his specific skills and a work assignment that the company cannot accomplish with its own staff. As for the remuneration, independent contractors are usually paid lump sum remunerations upon task accomplishment.
- Place of Work & Work Equipment: employees usually work on company premises. The company should provide them with all necessary work equipment and materials. To the contrary, independent contractors should have their own work equipment. They could occasionally use company facilities but they mainly carry out their work by their own means. Independent contractors also have their own office, business card.
b. Differences in tax treatment and benefit entitlement

As for social security contributions, a company directly pays its own share and deducts the employee’s share from his salary. As for benefit entitlements, a company has the obligation to affiliate its employees with relevant pension and healthcare institutions and pay its dues. Employees are subject to the income tax on their salaries.

Independent contractors are also subject to the income tax on their profits and can deduct their professional expenses from their professional income. They also have a different social security scheme. Independent contractors can only subscribe to private pension and healthcare schemes and should pay their own contribution, which is more costly than if they were employees.

c. Differences in protection from termination

French employment law is protective of employees. There is no concept of "employment at will" under French law, which means that any termination should be justified with valid grounds. In other words, termination of the employment contract is only possible if there is "serious and real cause" for termination. Termination of employment could be for personal reasons (e.g. poor performance, prolonged absence and negative impact on the business activity, etc.) or for economic reasons (e.g. redundancy as a result of the company’s restructuring to preserve the company’s market share). The termination procedure is also heavily regulated with obligatory timelines to respect. Once terminated (except in case of termination for serious/gross misconduct), the employee is entitled to a legal “severance package” which consists of dismissal indemnity, notice period and paid holidays indemnity. If the termination is on economic grounds, depending on the size of the redundancy plan, the employee also benefits from accompanying measures. Any unjustified termination would be unfair, allowing the employee to sue the company and seek damages.

There are also specific protection periods for certain employees (e.g. pregnant employees, employees on occupational sick/accident leave, employees with a staff representative mandate). Termination of employment during the protection period is either impossible or allowed under specific circumstances, under penalty of being null and void.

As for independent contractors, unlike employees, they do not benefit from any specific protection against termination as it is not the employment law, but the commercial law which applies to the services agreement. French case law stresses that termination of services agreements should not be abusive and the contractual notice period should be respected. Most services agreements are concluded for a definite period of time and contain a termination clause which allows each party to terminate the services agreement, provided that a certain notice period is respected.

In a recent decision dated 22 January 2013, the French Supreme Court brings a certain level of protection to independent contractors. In this decision, the Court held that in case of non-compliance by the customer with the contractual notice period, the independent contractor is entitled to an indemnity amounting to the compensation he would have received until the term of the services contract. In this case, a services agreement for cleaning company premises was concluded for a period of one year, renewable tacitly. The services agreement provided that each party could terminate it by giving three months’ notice before the renewal date of the agreement (i.e. by June 30th at the latest). The customer gave notice of termination by a letter dated July 4th (with 4 days of delay). The Court held that since the contractual termination notice was not fully respected, the customer had to pay to the independent contractor the sum of 216,463 euros, equivalent to one year of services.

d. Local limitations on use of independent contractors

Recourse to an independent contractor should be justified by the latter’s specific know-how and skills, in order to carry out specific work that the company cannot accomplish with its own staff.

e. Leased or seconded employees

Companies could use different mechanisms to get a specific task done. However, in each case, the user company must remain vigilant not to put the employee in a subordination relationship so that a co-employment situation with the user company could not be claimed by the employee.

Temporary Work

Recourse to temporary employees ("intérimaires") is only possible to carry out a specific temporary task, called "mission" and in cases exclusively specified by law (e.g. to replace an absent employee, temporary increase in business activity, seasonal work, etc.). The temporary employee is employed by the temporary work agency which puts him at the user company’s disposal for a specific period of time. The main argument for this mechanism is that as the user company is not the direct employer, it does not have to deal with related employment issues with respect to the temporary employee. The temporary employee is paid directly by the temporary work agency which then invoices the user company for the rendered services.

Labour Leasing

The lending company puts its employee at another company’s disposal to perform a specific task or mission. The lending company and the user company must sign an agreement which stipulates the duration of the labour leasing, the identity and qualifications of the employee, the method of determining wages, payroll taxes and professional fees invoiced by the lending company to the user company. Labour leasing is only valid if it is not lucrative. It shall be accordingly distinguished from subcontracting, an operation which does not only consist of posting employees (see below). The lending company can only invoice the user company for wages, social security fees and professional expenses incurred by the employee. Lucrative labour leasing is illegal, entailing heavy criminal and civil liabilities for the company. During the leasing period, the employment contract between the employee and the lending company is neither terminated nor suspended. The employee continues to belong to the staff of the lending company and remains paid by the latter. At the end of the labour leasing period, the employee regains his initial position within the lending company or if said position is no longer available, a similar position.

Subcontracting

The company calls upon a subcontractor to perform a clearly defined task that it cannot perform with its own staff, due to either economic or technical reasons. The subcontractor remains the sole employer of its staff. The subcontractor supervises and remunerates
employees vs independent contractors - france

Employees vs Independent Contractors - France

III. RE-CHARACTERIZATION OF INDEPENDENT CONTRACTORS AS EMPLOYEES

Courts are not bound by the name given by the parties to the relationship. According to the French Supreme Court "the existence of an employment relationship does not depend on the parties’ intention or the name they have given to their agreement, but on the actual conditions under which the work is performed". This means that if the re-characterization factors are gathered, the court can re-characterize a services contract into an employment contract. The re-characterization of an independent contractor into an employee is not automatic and should be ordered by a court, which must first ascertain the existence of a subordination relationship between the independent contractor and his customer.

The burden of proof lies upon the independent contractor who should demonstrate the existence of a subordination relationship. The re-characterization, should it be ordered, involves:

- Payment of overtime hours if any, bonus schemes and other benefits applicable within the company,
- Payment of social security contributions. Indeed, payments made to the independent contractor will be considered as "salary" and as such will be subject to employee/employer social security contributions.

- Termination of the services agreement may be deemed as unfair termination involving payment of the legal severance package (i.e. notice period, dismissal indemnity, paid holidays) and damages. Criminal offence of "shadow employment" may be constituted. The criminal offence of shadow employment (i.e. failure to declare salaried employment) is punishable by up to 3 years of imprisonment and a fine of up to €45,000 for the company’s legal representative and a fine of up to €225,000 for the company as a legal entity. Moreover, a specific indemnity corresponding to at least six months’ wages would be awarded against the company in case of termination of the relationship with the independent contractor, now considered as an employee.

IV. HOW TO STRUCTURE AN INDEPENDENT CONTRACTOR RELATIONSHIP

As mentioned above, the existence of an employment relationship depends on the actual conditions under which the work is carried out, regardless of the name given to the relationship by the parties. As a result, in order to avoid any risk of re-characterization, it is imperative to make sure – on a daily basis – that the independent contractor retains his autonomy in carrying out his duties at all times. Below are a few guidelines on how to avoid such risk.

- Make sure that the independent contractor is registered with the Trade Registry as a self-employed independent contractor. For services agreements with a value of at least 3000 euros, the Company must verify that the independent contractor is in full compliance with his registration, social and tax requirements.
- Make sure that the independent contractor is not put under a subordination relationship. Therefore, he should not receive direct orders and instructions from the company. If the parties can establish tasks and objectives together, the independent contractor should remain as autonomous as possible when it comes to carrying out the work assignment.
- The independent contractor should not be given any company email, office, business card, or equipment. The latter could occasionally use company facilities, but it is necessary to make sure that he carries out his work mainly by his own means. He should have his own office outside the company. The company could allow him to occasionally use a company office, but he should not spend all his working time in the company office.
- Make sure that the independent contractor has his own portfolio of clients and that the company is not his sole client.
- The independent contractor should not be subject to company working hours. He should be able to arrange his working time as freely as possible.
- The Company should not issue any pay slips. Normally, independent contractor’s fees are not paid on a monthly basis, as it is the case for the employees. He is paid upon accomplishment of his work assignment.

V. TRENDS AND SPECIFIC CASES

Below are two recent decisions which demonstrate how the courts assess various factors to determine whether or not a subordination relationship is established.

Cass. soc, decision dated 24 April 2013 n° 399

In this case, services agreements concluded with reality TV show participants were re-characterized into employment agreements. The judges, after looking into various factors establishing the existence of a subordination relationship held that "there was between the Production team and the participants a subordination relationship
characterized by the existence of an “agenda” which outlined the schedule for each day, imposed filming periods, repetition of scenes and repeated interviews conducted in a way that led the interviewee to say what was expected by the Production. The subordination relationship was also manifested in the Production’s choice of clothing, imposed hours going up to 20 hours per day, obligation to live on the site and not to engage in personal activities, monetary penalties in case of departure during filming, and finally the obligation to follow activities organized by the Production which all put the participants in a dependency relationship with respect to the Production team (…)"

*Cass. soc., decision dated 10 April 2013 n° 11-27.384.*

In this case the judges upheld the Court of Appeals decision and refused the re-characterization claim brought by a lawyer. The Supreme Court held “given that MZ. had personal clients, was registered with the social security agency (URSSAF) as self-employed independent lawyer, his remuneration was paid either by his clients directly or as fees like other non-salaried lawyers, that specific materials were put at his disposal by the law firm to receive his own clients and finally on his headed paper he presented himself as a member of the law firm like other lawyers without mentioning his alleged salaried status (…) the Court of Appeal rightfully concluded from these factors that the subordination relationship was not established”.

**VI. Conclusion**

Use of independent contractors brings more flexibility to the company; however, special attention should be given to the day-to-day management of such business relationships in order to avoid any risk of re-characterization and the serious consequences for the company that follow the re-characterization.
GERMANY

I. LEGAL FRAMEWORK DIFFERENTIATING EMPLOYEES FROM INDEPENDENT CONTRACTORS 95

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I. Legal Framework Differentiating Employees From Independent Contractors

In Germany, the distinction between an employee and an independent contractor is not regulated by one specific regulation. There is a strict assessment under various criteria, which generate partly from German law regulations, but mostly from rulings of the German labor courts and the German administrative courts. Both courts use slightly different criteria for their assessment of whether a person is an employee or an independent contractor, which may lead to different rulings regarding their status. However, mostly, the assessment with both kinds of criteria will lead to the same results.

The question, whether a person is an employee or an independent contractor by status may come up in various situations, e.g. during a company audit either the contractor or the principal, during an investigation procedure by a prosecutor or by German authorities with respect to the payment of social security contributions, or – as will often be the case – in a dispute about the termination of a contract.

If employers err about the social status of their contractors, or deliberately try to avoid an employment relationship, several risks are involved. The employer will be held liable for paying social security contributions effectively for up to five years in arrears, and employer’s managers or directors may be subject to a criminal indictment for non-payment of these contributions. Furthermore, the pseudo-contractor may claim permanent employment with the employer. In return, the employer may reclaim part of the paid remuneration from the employee, as independent contractors usually receive a higher remuneration than a comparable employee.

Under German law, both the principal and the contractor, whose status is in doubt, may address the competent German authority and initiate a declaratory procedure about the contractor’s social status. This procedure has the advantage of a clear and reliable assessment, whether a person must be regarded as an employee or can be treated as an independent contractor. However, in debatable cases the authority will often rule in favour of the status of an employee, where the status of an independent contractor may be very well justifiable.

a. Factors that determine who is an employee and who is an independent contractor

In Germany, the decision whether a person is an employee or an independent contractor, depends on numerous criteria.

German law indicates in the Commercial Code (Handelsgesetzbuch – HGB) that an independent contractor has the distinction of being able to freely determine his/her performance as well as his/her working time. In contrast, an employee is someone who may not determine his/her work performance free from instructions by the principal/employer and is bound by specific working times.

However, as these criteria are rather vague, especially with regard to flexitime wage accounts and highly specified jobs, and no other statutory regulation exists, the German Federal Labor Court (Bundesarbeitsgericht) specifies the distinction between a “dependent” employee and an independent contractor by the grade of personal dependence.

Therefore, the main criterion for the Federal Labor Court is whether a contractor is personally dependent on the principal. This will be assessed based on the scope of instructions, which the principal may give: if the principal may decide on the content of the performance, the kind of performance, the time, duration and place of performance, and if the contractor is strictly bound by these instructions, then the contractor will most likely be regarded as an employee. Therefore, as a guideline it may be said:
The more the principal may determine the work performance of the contractor, the more likely the contractor is an employee. Labor courts will therefore decide on the legal status of a contractor by an overall assessment of various criteria such as:

- How sophisticated are the working tasks given to the contractor (i.e. how to perform the assigned tasks)?
- How is the working time determined?
- How is the workplace determined?
- To what extent does the contractor's work depend on the principals' business organization (e.g. use of equipment and resources, team work with other employees)?
- In a valuation reflection, which of the two parties gains more directly from the performed services?

As these criteria are still vague and in border cases hard to assess, the social security authorities have developed several criteria, which may be taken into account when determining the status of an employee. These criteria are:

- Does the contractor have to provide his services in person or may he engage an employee/subcontractor himself?
- Who bears the economic risk of no performance or poor performance?
- Is the contractor integrated into the business organization of the principal?
- Is the contractor named in duty rosters?
- Who provides the equipment for the work performance?
- Does the contractor have a regular workplace at the principal's location? Does he have an e-mail address or a telephone number? Is he registered in the principal's telephone book? Does he have branded business cards of the principal?
- Does the contractor attend internal team meetings? Does he attend training sessions? Does he attend internal events like Christmas parties?
- Is the contractor obliged to notify about holidays or other leave?
- Does the contractor receive a fixed monthly remuneration or is he paid only for the services he actually provided?
- Does he have to write invoices?
- Is he covered for sick leave or for holiday?
- Is there a fixed monthly payment?
- Does the contractor have his own trade license / registered business?
- Does the contractor announce / advertise his services in the market?
- Does he work for other principals or is he at least free to choose other principals?
- How much payment does he receive overall by only one principal (more than 5/6 of his overall income)?
- How much time does he work for one principal?

The decision whether a contractor is to be qualified as an employee or an independent contractor, depends on an overall consideration of these criteria. In their considerations, labor courts tend to focus more on the degree of personal dependency, whereas the social security authorities rely more on the economic independence of a contractor.

Finally, it should be noted that it is not relevant how the parties determine their contractual relationship. Especially, it is not relevant how the parties have designed their contractual relationship in the contractual documents, but how the contractual relationship is exercised in the day-to-day business. Thus, even if both parties involved are convinced that their contractual relationship is a service agreement, it may still be assessed as an employment relationship by German courts or authorities.

b. Differences in tax treatment

The differentiation between an employee and an independent contractor has several consequences for the parties involved. Especially with regard to social security law and tax treatment, there are significant differences between an employee and an independent contractor.

Social security law

In Germany, a comprehensive statutory social security system is established. The system includes health insurance, long term care insurance, unemployment insurance and a state pension scheme. The system is funded by social security contributions of generally all workers that have the status of an employee. Both employer and employee pay these contributions, which are calculated on the basis of the employee's monthly gross salary. The employee's contributions are withheld from the salary and paid by the employer along with its own contributions as an aggregate amount.

In 2013, the contribution rates are as follows:

<table>
<thead>
<tr>
<th></th>
<th>Employee</th>
<th>Employer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Health insurance</td>
<td>15.50 %</td>
<td>(8.2 % employee; 7.3 % employer)</td>
</tr>
<tr>
<td>Long term care insurance</td>
<td>2.05 %</td>
<td>(1.025 % employee; 1.025 % employer)</td>
</tr>
<tr>
<td>Unemployment insurance</td>
<td>3.0 %</td>
<td>(1.5 % employee; 1.5 % employer)</td>
</tr>
<tr>
<td>Pension scheme</td>
<td>18.9 %</td>
<td>(9.45 % employee; 9.45 % employer)</td>
</tr>
</tbody>
</table>

Exceptions are made for marginal employment, short term employment and student employees. Here, the social contributions may be paid as a lump sum and borne in their entirety by the employer or may not accrue at all.

As a general rule, independent contractors do not participate in the German statutory social security system. They need to arrange for their social security on their own accord, e.g. by means of private health insurance and private pension funds. Therefore, they usually receive a higher (gross) remuneration than comparable employees.

However, with regard to the statutory pension scheme and for specific professions, there are exceptions to this general rule. Independent contractors, who do not employ any employees themselves and are mainly engaged by one principal only, must participate in the German statutory pension scheme and make contributions to it. In contrast to employees, they must, however, bear the total contributions themselves.

Tax law

There are also differences between employees and independent contractors regarding tax treatment:

An employee’s remuneration is subject to wage tax, which is a withholding tax and is deducted by the employer from the employee’s monthly gross salary.

The services of an independent contractor are generally subject to VAT (Umsatzsteuer). Certain professions are excluded from the taxation, such as specific professional medical services. Furthermore, an independent contractor is exempt from such VAT taxation, as a petty trader, for annual revenue up to EUR 24,500. The independent contractor is responsible for transferring the incurred VAT and his personal income tax.

c. Differences in benefit entitlement

By virtue of statutory law, an employee is entitled to some particular benefits, each
Employees’ protection against dismissal is divided into general and special protection. These particular benefits include:

**Paid holiday leave**

Employees must be granted at least 20 days of paid holiday leave, based on a five-day week. However, it is more common in Germany to grant employees 25 to 28 days of paid holiday. In addition, employees are entitled to receive their regular remuneration on statutory holidays (approx. 10 – 13 days per year), while they are generally not obliged to work.

Independent contractors on the other hand are, in general, not granted any paid holiday leave. This is only natural as independent contractors by definition do not have a specific working time and are therefore free to take days off at their own discretion. However, they are typically not granted any compensation for such time off, as they only get paid for services effectively rendered.

**Paid sick leave**

In case of incapacity to work due to illness, employees remain entitled to receive their remuneration from the employer for a term of up to six weeks pursuant to the German Act on Continued Remuneration (Entgeltfortzahlungsgesetz – EFZG). This covers both fixed remuneration as well as any variable remuneration such as bonuses. Under certain conditions, the entitlement applies several times per year, e.g. if the employee was healthy to work for a period of at least six months in between two instances of illness.

The German Act on Continued Remuneration does not cover independent contractors. However, with regard to § 616 German Civil Code (Bürgerliches Gesetzbuch – BGB) an independent contractor may claim compensation in case of incapacity to render his services for personal reasons, e.g. illness. However, this provision covers only a short period of time, generally less than a week, and its application may be excluded by the parties. As a general practice in Germany, independent contractors are not granted any compensation for sick leave at all.

**Special allowances**

Many employers in Germany grant additional benefits to their employees that are not mandatory, e.g. holiday allowance, Christmas allowance or surcharges for overtime work or work rendered on Sundays or statutory holidays.

Independent contractors, on the other hand, typically do not receive any such special allowances. Their remuneration usually exceeds the average salary of a comparable employee and no additional benefits are granted.

d. Differences in protection from termination

The difference regarding the termination of an independent contractor and an employee is extensive. Whereas an employee in general may only be terminated for a valid reason, an independent contractor may be terminated without cause, observing a contractual notice period.

Employees’ protection against dismissal is divided into general and special protection. Specialist protection is provided to employees who generally face greater detriments in case of a dismissal, such as handicapped or pregnant employees. In such cases, the permission of relevant government authorities is required prior to issuing a termination. Also, employees who engage as employee representatives, such as a member of a works council or data privacy officers, enjoy special protection against dismissal.

As to the general protection, the freedom of the employer to dismiss an employee is substantially restricted by the German Act on Protection Against Unfair Dismissal (Kündigungsschutzgesetz – KSchG). The act applies if:

- a business establishment generally employs more than ten employees and;
- if the employee has worked in the same company or business establishment for six months without interruption.

Under the Act on Protection Against Unfair Dismissal, a termination of employment by the employer is only legally effective if it is reasonably justified. Generally, a termination is only justified if it is based on grounds related to the person (e.g. impairments, lengthy or frequent illnesses) or the conduct (breach of contract) of the employee, or where compelling operational reasons, which preclude the continued employment of the employee in the business, exist.

Termination of an employee is generally subject to a notice period. Its term is governed by statutory law and ranges from two weeks to seven months on a sliding scale, contingent upon the duration of the employment relationship. The parties may agree to a prolonged term of the otherwise applicable statutory notice period.

In contrast, the contractual relationship with an independent contractor may generally be terminated for virtually any reason or no reason, except if the termination violates the principle of good faith. Parties may agree on specific reasons that need to be on hand to effectively terminate the contractor.

Termination of an independent contractor is generally subject to a notice period. In the absence of a provision in the contract, the term of the applicable notice period is based on the applied reference period for the payment of the agreed remuneration and varies between one day and six weeks to the end of a quarter. However, it is common to agree on a notice period of one month to the end of a calendar month in the contract.

Both employment relationships and relationships with independent contractors may, in case of severe breach of contract, be terminated for cause with immediate effect by the affected party.

e. Local limitations on use of independent contractors

There are no limitations on the use of independent contractors in Germany.

f. Other ramifications of classification

Other ramifications of the distinction between employees and independent contractors mainly relate to their scope of protection during the contractual relationship.

For example, most of the safety regulations, e.g. regarding the prevention of accidents at work, are only applicable to employees. Also, employers must abide by working time regulations for their employees, which do not apply to independent contractors. Furthermore, employees enjoy limited liability regarding their work performance in case...
of normal negligence, while an independent contractor is generally fully liable in relation to his services.

Finally, the legitimate interests of employees are represented by a works council, who is not competent for the interests of independent contractors as they are not part of the workforce in its strict sense.

g. Leased or seconded employees

Under German law, it is possible to lease employees to another employer. In order to legally operate, the lessor (temporary employment agency) must hold an administrative permission, and the deployment of temporary agency workers must always comply with the requirements set forth in the German Act on Employee Leasing (Arbeitnehmerüberlassungsgesetz – AÜG) and other applicable law. Where a lessor does not hold said permission, any temporary agency worker deployed by him may claim full employment with the corresponding lessee.

As a general rule, the lessor is obligated to grant his employees (the temporary agency workers) the same fundamental conditions of employment that apply to comparable regular employees at the lessee’s. This fundamental principle of German and EU legislation can be deviated from if the lessor applies a collective bargaining agreement for his employees. In the vast majority of cases, such collective bargaining agreements apply.

The main advantage of employee leasing is flexibility: temporary agency workers are not considered regular employees of the lessee/principal. As such they are not subject to dismissal protection, and therefore the principal can react quickly to a reduction of the workload and without further redundancy costs in case of a restructuring process by cutting temporary agency workers. Vice versa, in case of an increased workload or in case specialized personnel are needed, employee leasing can be a useful option to raise workforce without significant hiring costs.

Of late, costs have become more an issue than an advantage, as employee leasing is subject to a statutory minimum wage and the tariff-level is on the rise. Highly qualified temporary agency workers are usually more expensive than one’s own regular employees anyway.

Strictly to be distinguished from employee leasing is the use of a contracting firm to fulfill certain services within the principal’s business operation, e.g. facility management, cleaning services, operation of catering or canteen services, etc. The contracting firm will usually employ its own employees to perform the agreed services. When engaging a contracting firm, the principal must refrain from acting as the actual employer of the contracting firm’s (i.e. external) employees. Otherwise, such use of a contracting firm may be considered as disguised employee leasing; if the contracting firm does not hold the mandatory permission for employee leasing, its employees may claim full employment with the principal. In order to assess whether a principal acts as the actual employer, the criteria to determine a contractor as an employee apply mutatis mutandis.

The distinction between employee leasing and use of a contracting firm is currently a very hot topic in Germany, and often principals are not aware of this issue. However, risks are major as imprudent principals may end up employing regular employees they never wanted on their payroll.

h. Regulations of the different categories of contracts

Under German law, both contracts with independent contractors and contracts with employees are in substance service agreements. Therefore, both types of contracts do have the same roots and resemble each other. Both are subject to German civil law, mainly set forth in the German Civil Code.

However, as employees are historically regarded as more vulnerable, there are many special legal regulations that protect employees’ rights and do not apply to independent contractors. Many of these protective regulations constitute a mandatory minimum and cannot be superseded by the parties to an employment contract. However, the terms and conditions of employment contracts, especially remuneration and benefits, are widely set and governed by collective bargaining agreements rather than by legal regulations. There are currently only a few industrial sectors where statutory minimum wages apply for employees.

As for independent contractors, there are scarcely binding rules regarding terms and conditions of their engagement.

II. Re-Characterization of Independent Contractors as Employees

a. Laws and Guiding Principles

As described above, the re-characterization as employee depends on several criteria which have been developed by German federal courts based on the few scattered law provisions on this issue.

With regard to employee protection rights, the German labor courts usually decide on the legal status of a contractual relationship within the scope of a legal dispute over the application of a specific regulation or benefit that applies to employees only.

The social security authorities decide on the status of a contractor with respect to the question whether the principal/employer has complied with its legal obligation to pay social security contributions for every employee. For this purpose, the authorities audit employers regularly and check for any unregistered employees, for whom social security contributions are due.

b. The Legal Consequences of a Re-Characterization

The legal consequences of a re-characterization are broad and entail comprehensive risks for the employer.

In case of a re-characterization, the pseudo-contractor may claim employment with the principal/employer, thus gaining the status of an employee including the applicable level of protection. Specifically, the re-characterized employee may claim dismissal protection under the German Act on Protection Against Unfair Dismissal. This means that a termination requires a specific reason in order to be valid, and that the applicable notice period has to be observed. The employer may no longer terminate the contractual relationship without a valid reason.

Furthermore, the employer is, pursuant to German Social Code, obligated to retroactively pay social security contributions for the re-characterized employment relationship. In this regard, the employer is liable for the aggregate amount of the social security contributions without being allowed to deduct the employee’s contribution from his/her salary in full. This obligation for payment of social security contribution arrears generally covers the entire duration of the re-characterized employment relationship and is thus only limited by the applicable statute of limitation. This means that the employer may have to pay social security contributions for almost up to five years in arrears.
The employer’s managing director/legal representative in charge may be held liable under criminal law for wrongful non-payment of the employee’s social security contributions pursuant to the German Criminal Code. The legal representative may be sentenced to up to five years of imprisonment or charged with a fine.

c. Judicial Remedies Available to Persons Seeking ‘Employee’ Status

Persons seeking the status of an employee may address the competent labor court by lodging a declaratory action. If the claimant prevails, the court will declare that an employment relationship is in place and/or has been concluded at some particular point of time in the past between the claimant/employee and the defendant/employer.

As the employee status is sine qua non for some particular benefits or protective regulations to apply, a court will have to imply decide on a claimant’s labor status if he/she sues the principal/employer for one of these particular benefits or protective measures. In practice, this commonly occurs following the termination of the contractual relationship by the principal/employer where the claimant would enjoy dismissal protection if qualified as an employee.

As previously mentioned above, principal and contractor may, either jointly or alone, also address the competent German authority and initiate a declaratory procedure about the contractor’s social status. The authority's decision may be challenged by either party in court.

d. Legal or administrative penalties or damages for the employers in the event of re-characterization

In the event of re-characterization, the employer must pay the outstanding social security contributions for up to almost five years in arrears, plus a late payment fine (generally one percent of the due amount per month).

Furthermore, penalties from a criminal conviction are possible and may include a sentence to imprisonment or a fine, whose amount depends on the income of the convicted employer/employer’s legal representative. Any such penalties are imposed on the legal representative of the employer. The likeliness of such conviction would necessarily be involved when misjudging the social status of an employee in order to justify a conviction.

If convicted, the employer/employer’s legal representative may also be personally liable for the outstanding employee’s social security contributions. This will particularly become relevant if the employing entity has filed for bankruptcy.

III. HOW TO STRUCTURE AN INDEPENDENT CONTRACTOR RELATIONSHIP

a. How to Properly Document the Relationship

Under German law, it is not necessary to conclude a service agreement in written form. For purposes of evidence, however, it is recommended to agree upon a service agreement in writing.

Furthermore, all documents suitable as proof for the status as independent contractor should be collected and maintained. This may include inter alia invoices, declarations/representations from the independent contractor, the contractor’s business card, references on the contractor’s marketing activities or employment with other principals, etc.

It is necessary to understand that the status of an independent contract cannot be determined or chosen only by mutual agreement between contractor and principal. Instead, it is generally decisive how the contractual relationship is exercised in the day-to-day business. However, the service agreement with an independent contractor should still be properly drafted: it should include typical provisions of an independent contractor’s contract and bar any provisions that are indicative of an employment relationship.

b. Day-to-Day Management of the Relationship

When managing the contractual relationship with an independent contractor, it is highly important to observe the criteria detailed below. This means especially, that the independent contractor should not receive:

- Instructions on when to work
  - Better: Give a time line, when the project must be finished.
- Instructions on how to work
  - Better: Give instructions on what characteristics the final work product shall have.
- Provide equipment
  - Better: Let the independent contractor work with his own equipment.
- Provide a regular work place, telephone line, e-mail address
  - Better: Let the independent contractor work at home or at a flexible work place in the office
- Fixed payment every month
  - Better: Payment per day/hour actually worked in a month, or a lump sum payment upon the achievement of milestones of the work product.

By such management of the contractual relationship, it is possible to demonstrate that the independent contractor is not integrated into the principal's business organization. The allegation of an employment relationship can thus be disproved.

IV. TRENDS AND SPECIFIC CASES

Currently, there is an ongoing debate about the possible misuse of the position as independent contractor. Critics argue that the law in force widely enables employers to prefer independent contractors over employees for the sake of flexibility and cost reduction. This, however, is considered unjust as independent contractors are not granted the same level of protection and standard of social security as employees, while they are in fact often comparable to employees in terms of personal and economical dependency, and in some industrial sectors do not even earn a higher salary than employees. One main point of criticism in this debate is that the German statutory minimum wage, which applies to employment in some industrial low-wage sectors only, does not apply to independent contractors. Thus, critics sense that employers in these low-wage sectors try to engage independent contractors in order to circumvent the applicable statutory minimum wage.

With this in view, the Federal Council of Germany has initiated a legislative procedure looking to extend the works council’s mandate and competence, which currently covers employees only, with regard to independent workers. By means of such extended competence, the works councils would take the role of a controlling body. The legislative initiative is looking to establish a right of the works council to be informed prior to the engagement of an independent contractor for a period exceeding one month. Furthermore, independent contractors who are engaged longer than a month shall be considered as employees with respect to the works councils’ co-determination rights, in particular regarding social matters within the scope of employment. And finally, the
initiative is looking to implement a veto right for the works council if the principal likes to engage an independent contractor for a position that can be filled with a permanent regular employee.

V. Conclusion

Under German law, the entrepreneur is generally free to decide whether certain tasks within its business operation shall be fulfilled by its own (employees) or external workforce (independent contractors). From a pure legal perspective, this decision should mainly be influenced by the nature of the work or project in question, as the main criteria when determining the legal status of the engaged worker refer to the place, time and exact manner of the work to be performed as well as a necessary integration into the principal’s business organization. However, a feasible solution in practice has to factor in more than just legal aspects. Still, when making its decision, the entrepreneur should be aware of the risk of a disguised employment, i.e. the possible consequences of a situation where a supposed independent contractor will be qualified as an employee. In many cases such risk can be significantly mitigated if the relationship with the independent contractor is prudently structured and managed.
ITALY

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I. Legal Framework Differentiating Employees From Independent Contractors

a. Factors that determine who is an employee and who is an independent contractor

The distinction between employment relationships and self-employment relationships is of fundamental importance under Italian employment law, from a number of different perspectives.

The Italian Civil Code defines an employee as a person who commits himself/herself for remuneration, to cooperate in the company's business by contributing his/her manual and/or intellectual activity in the service and under the control of the employer. This means that the main features of employment are cooperation\(^1\) and subordination\(^2\).

Employees are mainly divided into: open-ended/fixed-term employees, full time/part-time employees, and apprentices (an apprenticeship contract is aimed at both training and employing young people. At the end of the contract, if none of the parties withdraw, the relationship continues as an open-ended employment relationship).

Pursuant to the Italian Civil Code, an independent contractor (or self-employed person) is a person who undertakes to perform a job or a service for a consideration, without being under the principal party’s control and supervision.

The main categories of self-employed persons are the following: freelance professionals, the so-called “VAT number consultants”, coordinated and continuous workers (“Co.Co.Co.”), project-based workers and commercial agents.

Except for the cases provided for by the law (among others, services wherein the overall duration does not exceed 30 days in the solar year with the same principal, and whose remuneration does not exceed € 5.000, so-called ‘occasional services’, work in favor of amateur sports associations and companies, members of the board of directors and of the companies’ auditing body, people who receive an old age pension) the collaboration must be regulated by one or more specific projects, determined by the principal and autonomously managed by the worker.

Project work must conform to the provisions set forth in Legislative Decree no. 276/2003.

In this respect, the law requires, among other things, a written description of the specific project to which the worker should be “dedicated”. In addition, the project may not:

- simply describe the execution of the normal productive activity;
- be a mere list of the typical tasks to be performed by the worker;
- consist of the same business activity as the principal (i.e. its “oggetto sociale”);
- consist of merely mechanical, repetitive duties.

Furthermore, Legislative Decree regulates various aspects of the relationship such as:

- the form of the contract (which must be in writing);
- the remuneration (which must be proportionate to the quantity and quality of the service, and which however cannot be lower than the remuneration set forth by the applicable national collective agreements, for the employees who perform similar duties);

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1 Cooperazione: pursuant to some legal scholars, it means the employees fitting into the company’s organisation in a committed and systematic way.

2 Suordinazione: is defined as the employee being subject to the instructions that are given by the employer or by other employees under whose control he/she works. As a consequence, with respect to the contractual and legal provisions, employees have to perform their duties and carry out their work in a way that is established by the employer.
The employment relationship is regulated by the provisions set forth by Sections 2104 and 2106 of the Italian Civil Code (while, vice versa, such provisions are not applicable to a self-employed relationship).

Agents, who must be qualified and enrolled with the Chamber of Commerce, perform their activities at their own risk, undertaking to promote, in return for a commission, the execution of contracts in a specific territory, on behalf of one or more principals.

Agents must perform their activities according to the instructions received from their principal; however those instructions shall not cancel out the autonomy of the agent, who always remains a self-employed person.

Under Italian law, agency agreements may be established either for a fixed-term or an opened-term.

In case of termination, the Italian Civil Code provides for an indemnity to be granted to the agent.  

Social security contributions with ENASARCO, (the national institution providing assistance and welfare to trade representative and agents and their families) are compulsory for all commercial agents who perform their activity in Italy. The principal must enroll the agent with ENASARCO, which (i) provides social security benefits to agents in addition to the pension treatment granted by INPS, and (ii) pays to agents a part of the termination indemnity (so called FIRR) upon expiration or termination of the agency agreement for any reason whatsoever.

The applicable principles in order to distinguish an employee from an independent contractor can be found in case law.

The Courts constantly reiterate that, in principle, every activity may be indifferently fulfilled based on an employment relationship, rather than a self-employed one.

This means that the distinction between an employee and an independent contractor consists not in the kind of activity, but rather in the way in which it is performed.

The employment relationship is regulated by the provisions set forth by Sections 2104 and 2106 of the Italian Civil Code (while, vice versa, such provisions are not applicable to a self-employed relationship).

In particular, a worker is considered an employee if he/she is subject to the directive, organizational and disciplinary power of the employer. These powers consist in the employer giving specific orders as well as the exercise of a constant activity of vigilance and control on the execution of the employee’s duties, and in the giving of sanctions in case of breaches made by the latter.

On the other hand, the contractual typology formally chosen by the parties, and other criteria like the continuity of the activity, adhering to a predetermined working time, the appointment of a fixed workspace within the employee’s premises, the payment of an agreed remuneration at fixed intervals, the absence of an even minimal business structure (by the worker), are complementary to and of secondary value in qualifying the relationship.

Such criteria, however, could on the contrary, be considered decisive in case of duties which, given their intellectual nature, rather than the fact that they are merely repetitive, cannot be subject to a continuous supervision by the employer/principal.

b. Differences in tax treatment

Employee’s remuneration is subject to income tax (the so-called IRPEF). The employer, acting as a withholding agent, must withhold IRPEF as well as other local taxes in the pay slip and then pay them to the tax authorities.

The same applies to self-employment, although the remuneration of independent contractors also attracts VAT, payable by the principal.

Social security contributions for employees are around 40% of the employee’s remuneration; around 10% borne by the employee, the remaining 30% by the employer. The employer withholds the amount from the employee’s pay slip and is responsible for making payment to the relevant public bodies (INPS and INAIL). The employer will incur administrative sanctions for the delay or omission in payment.

With regard to independent contractors, generally the remuneration paid corresponds to the actual company cost, since social security contributions are then directly paid by the independent contractor (in certain cases the principal may be required to pay the worker a contribution towards social security contributions of around 4%). There is a peculiarity here in that for the so-called Co.Co.Co.’s and project-based workers, although considered independent contractors, two thirds of social security contributions (around 28%) are due by the principal, who is also responsible for payment to INPS and INAIL of all such contributions.

c. Differences in benefit entitlement

In general, mandatory benefits provided for by the law or by the collective agreements in favor of employees (holidays, sickness and injury benefit, parental leave, company car, PC or cell phone, etc.) do not apply to self-employed persons, who are compelled to perform their activity properly organizing the required time and all the necessary means, accepting all the relevant hazards.

The principal and independent contractor may however agree on specific benefits and in cases, even more favorable than those indicated above.

Furthermore, Co.Co.Co. and project-based workers are entitled to be treated similarly to employees in this regard.

d. Differences in protection from termination

From an Italian employment law perspective, the real differentiating factor between employees and self-employed persons can be found in the context of unfair termination
The same rule applies also to the employee/self-employed person. The typology of sanctions connected to unfair dismissals has been substantially modified by the recent Law no. 92/2012. The employer may be obliged in the worst case scenario to reinstate the employee in his/her place of work and to pay him/her all the remuneration and social security contributions due from the day of the dismissal to the effective date of reinstatement. The minimum award of damages against the employer is equal to 2.5 months of the employee’s total remuneration.

On the other hand, except for contractual provisions to the contrary, the principal may always freely terminate an open-ended self-employment relationship. The independent contractor is generally not granted any specific protection against the termination of his/her relationship (except in some cases the right to be given a notice period or to be paid the relevant payment in lieu thereof, or the right to be paid some particular indemnities - see the agency contracts).

Whereas in the case of a fixed-term relationship, regardless of its nature (employment or self-employment) the employer/principal cannot withdraw until the expiry date, except for (i) where there is a just cause for termination or, in project-based contracts, where the collaborator matter-of-factly shows his/her professional unfitness, (ii) cases which were specifically identified in the contract, and (iii) the general remedies against the non-performance provided for in the Italian Civil Code.

The so-called termination ante tempus (that is, before the expiry date) by the employer/principal entitles the employee/self-employee to claim the remuneration due until the natural expiry date.

e. Local limitations on use of independent contractors

With regard to the limitations on the use of independent contractors, Italian employment law establishes particular restrictions, even from a quantitative point of view, in compliance with the principle, provided for by the Italian Constitution regarding freedom of economic enterprise granted to the employer. The applicable collective agreements may however fix the maximum percentage of independent contractors (in particular for workers on project-based contracts) in relation to the total workforce.

f. Other ramifications of classification

There are some important ramifications of the classification, such as:

- self-employed persons are not entitled to temporary lay-offs schemes;
- self-employed persons cannot exercise union rights in the workplace, as provided for by Law no. 300/1970;
- if an employer becomes insolvent, its employees take priority over the other creditors (including self-employed persons) for unpaid remuneration and social security contributions.

The so-called termination ante tempus (that is, before the expiry date) by the employer/principal entitles the employee/self-employee to claim the remuneration due until the natural expiry date.

g. Leased or seconded employees

The use by an employer of employees hired by another employer is possible, but only in the ways and within the limits provided for by Italian employment law, since in general the “leasing” of manpower is not permitted.

First of all, the employer may use workers supplied according to the regulations on “somministrazione di lavoro” (staff leasing/temporary agency workers) set forth by Legislative Decree no. 276/2003. Through staff leasing, the user can request employment agencies authorized by the Ministry of Labor and registered in a special register, to supply manpower.

Staff leasing may be for a fixed-term (if there are technical, production, organizational and replacement reasons, even if connected to the ordinary business of the user), or open-ended (for the activities listed by Section 20 Legislative Decree no. 276/2003: for example, cleaning, custody and concierge services, or consultancy and IT services).

For the duration of the placement, supplied employees perform their duties in the interests of and under the instructions and control of the user (disciplinary powers however remain with the employment agency) and are entitled to the same working conditions as those equivalent employees of the user, and are also entitled to exercise union rights.

In the case of workers engaged under open-ended contracts with the agencies, the same are entitled to a monthly indemnity for their availability, in the periods where they do not have any job.

The user is jointly liable together with the agency for the remuneration and social security contributions due to the agency employees, and is also responsible for the damages caused to third parties by such employees in the execution of their duties.

The “somministrazione di lavoro”, as described above, presents the advantage for the user that it can avail, for the period of time deemed necessary, of a person who - on one hand - is for all intents and purposes an employee (and therefore who is subject to the directive and disciplinary power, as well as to other duties like that of fidelity), but - on the other hand - is not on its pay roll.

However, the “somministrazione di lavoro” means that the user has to bear the costs of work as well as the fees related to the agency’s service.

Furthermore, the unlawfulness of the supply of manpower (since it is fraudulent in the absence of the reasons justifying it) entitles the employee to claim the existence of an open-ended employment contract with the user.

The employer may also use seconded employees.

According to Italian law (Section 30 Legislative Decree no. 276/2003), the secondment of an employee for the execution of specific duties presupposes that his/her employer has a real and actual interest in it.

Secondment is temporary; however no set maximum duration is provided by the law.

In the course of the authorization process, the Ministry of Labor determines whether applicants meet the legal requirements. These requirements include minimum financial capital, adequate professional skills, and the “honorability” of directors (i.e., they should not have been convicted of criminal offenses relating to the labor law). In this case, a criminal sanction (fine) is also applied.
The worker’s employer remains legally responsible for all the economic and regulatory treatments due to him/her during the secondment (usually, the costs are then tipped over to the other employer).

The applicable collective agreements may contain provisions regulating specific payments (e.g., the reimbursement of the relocation cost related to the secondment) to which the seconded employee is entitled, or these are agreed directly with the seconded employee. The consent of the employee to his/her secondment is not required, unless the secondment involves a change of duties.

The secondment must be necessarily justified by technical, production, organizational or replacement reasons, when it entails the transfer of the employee to a production unit located more than 50 km from the one to which he/she was assigned before the secondment.

In case of violation of the main principles applicable to secondment (interest of the worker’s employer and temporary nature), the employee may claim the constitution of an open-ended employment contract with the end user of his/her services. Finally, the employer may enter into a service agreement, through which the contracting firm’s employees perform their duties in favor of the employer.

According to Section 29 of Legislative decree no. 276/2003, service contracts are characterized by the fact that the contractor organizes all the necessary means for the execution of the service or the work, assuming the business risk and exercising the organizational and directive power over its employees.

Also, in this case, the employer is allowed to (indirectly) use employees without the need to hire them, simply paying the costs for the services received, as agreed with the contractor.

However, there are possible disadvantages. Firstly, unless otherwise provided by the applicable national collective agreements, the principal is jointly and severally liable with the contractor and each eventual sub-contractor, for a period of two years from termination of the contract, to pay the employees of the contractor and/or any sub-contractors, their salaries as well as social-security contributions and insurance premiums owed in relation to the period of performance of the contract. Similar joint and several liability between principal and contractor is envisaged by law (Section 26 of Legislative Decree No. 81/2008) for any workplace accidents not covered by INAIL sustained by the contractor’s employees that occurred due to the violation of workplace safety statutes.

Secondly, in the absence of the elements indicating a true service contract, the contractor’s employee (again) may claim the constitution of an open-ended employment contract with the principal.

h. Regulations of the different categories of contracts

In Italy, the different types of employment and self-employed relationships are substantially regulated by the civil code or by specific laws.

In particular, the open-ended employment relationship is governed by the civil code; while some particular aspects (working time, health and safety at work, dismissals, etc.) are governed by separate and recently enacted laws.

The characteristic elements of fixed-term, part-time and apprenticeship relationships are regulated by ad hoc laws while other rules not expressed there can be derived - if not conflicting - from the rules applicable to open-ended contracts.

Each of the self-employed relationships, instead, has its own regulation, each one is very different from the other: therefore, common roots can rarely be found.

General civil law principles regarding obligations and contracts (the principles of correctness and good faith, resolution or suspension of the contract for intervened impossibility of the performance, etc.) may be used for both employee and self-employed relationships, in the absence of special regulations, provided that they are compatible with such relationships.

II. Business Presence Issues

a. How the use of one or more independent contractors creates a permanent establishment in country and the ramifications

Foreign employers that are interested in employing local workers may:

• establish a local company under Italian law and be represented in Italy by its legal representative; the legal representative of the company could maintain his/her establishment abroad and is liable in Italy; or
• create a branch office; in this case, the foreign employer shall need to have representation for social security purposes (by a labor consultant or a chartered accountant) in Italy.

Similar principles apply with regard to independent contractors.

III. Re-Characterization of Independent Contractors as Employees

a. Laws and Guiding Principles

The re-characterization of a self-employed relationship as an employment relationship is usually the result of mismanagement of the relationship.

In the absence of specific regulatory provisions, the applicable principles can be found in case law.

b. The Legal Consequences of a Re-Characterization

The main rule provides that once defects are ascertained, the relationship is converted ab origine (from the beginning) into an open-ended employment relationship.

This means that the employee is entitled to the following:

• to go back to work, performing the same or similar duties;
• to any differences in remuneration between remuneration actually received and the amount due for the type of activity performed, on the basis of the provisions of the applicable collective agreements;
c. Judicial Remedies Available to Persons Seeking ‘Employee’ Status

The re-characterization of the relationship requires the filing of “ordinary” proceedings before the employment tribunal, where the worker is required to prove he/she was subject to the directives and disciplinary power of the employer and must show other indicators of an employment relationship.

If for example, a project-based contract is devoid of a specific project, then it is automatically converted into an open-ended employment contract.

When the re-characterization is connected to acquiring legal protections against unfair dismissal, such a claim has to be filed accordingly to the specific rules of the new proceedings, introduced by Law no. 92/2012, for challenges against dismissals (a proceeding specifically introduced in order to allow a quicker execution and conclusion of such lawsuits).

d. Legal or administrative penalties or damages for the employers in the event of re-characterization

The employer will face administrative sanctions for delayed payment of social security contributions in the correct measure.

IV. HOW TO STRUCTURE AN INDEPENDENT CONTRACTOR RELATIONSHIP

Practically all self-employed contracts require a written form for two reasons: ad substantiam - that is, in order to allow the principal to demonstrate its existence.

Therefore, it is important to draft a contract in which the autonomous nature of the relationship is clearly expressed. With regard to managing the relationship, the self-employed person must be permitted to fulfill his/her services without any strict controls or interference by the principal. The latter must limit its intervention to a general coordination (e.g. a few meetings per year, just to be kept informed of the performance of the services or the evaluation of the results achieved by the worker).

No precise and detailed directives must be given to him/her.

In this respect, it is advisable to be very careful with written communications (above all, emails), since their meaning can be misunderstood, and later on used against the principal (as proof of the subordinate nature of the relationship).

The independent contractor is, in general, entirely free to decide whether and when to work or not; this means that he/she does not have to ask for leave or holidays, nor does the principal have the power to grant them.

Finally, the termination of an open-ended relationship has to be communicated in writing, avoiding comments on the performance of the worker and using a very neutral tone (so that such communication cannot be interpreted as part of a disciplinary process).

V. TRENDS AND SPECIFIC CASES

According to case law:

• it is possible to be both an employee (manager) and an independent contractor (member of the board of directors) of the same company: when such person, as a manager, is subject to the control of the president and the board of directors; while, as a member of the board, does not have full powers (Supreme Court, 18 September 1995, no. 9864);

• with specific reference to betting shops’ personnel, an employment relationship could be established even if the worker can decide whether to accept or not to work, and whether to actually come to work or not, without the need to justify such actions (Supreme Court, 5 May 2005, no. 9343);

• the activity performed by the so-called “pony express” can be considered that of an independent contractor if the worker uses his/her own means of transportation, bearing the relevant costs and risks, and if he/she decides all the aspects (itinerary, period of the day, etc.) connected to the deliveries (Supreme Court, 20 January 2011, no. 1238);

• since the journalist’s duties are characterized by a certain autonomy, an employment relationship occurs when the journalist is considered part of the company organization: that is, the journalist regularly writes articles on specific topics or columns, and he/she is available even between one assignment and the next. On the other hand, other factors like the place of work and the absence of a fixed working time are unimportant (Supreme Court, 9 September 2008, no. 22882);

• call-center personnel may be considered as employees if they make phone calls following directives on the number and the outcome of the same (Supreme Court, 14 April 2008, no. 2812);

• a “project-based contract” (“contratto di lavoro a progetto”), a specific type of self-employed relationship can be re-characterized as an employment contract if the worker is compelled to promote and sell a minimum number of products daily, visiting certain clients (Supreme Court, 25 June 2013, no. 15922);

• the communication sent by the employer to employees, clients, collaborators and suppliers, in which a consultant is qualified as responsible for a sector, and head of the sales department, cannot be considered decisive for the qualification of the relationship (Supreme Court, 27 July 2009, no. 17455);

• the presumption of subordination exists in the relationship between a pharmaceutical company and a pharmaceutical representative where the latter is subject to close supervision and control by his superior who deprives him of any kind of autonomy (Supreme Court, 23 October 2001, no. 13027);

• the job of training performed by a tennis coach in an academic sports center, where he organizes his own job, also with regard to attendance and schedule, cannot be re-characterized as an employment relationship (Supreme Court, 1 December 2008, no. 28525).

VI. CONCLUSION

In Italy, at present, the main type of employment relationship is still the employee/employer relationship.

Self-employed relationships are widespread and commonly used, but sometimes they are viewed by the Courts with suspicion, as if behind them lurks a subordinate employment relationship in disguise.
Case law on this issue, however, is fairly consistent and uniform, and the principles applied in order to establish the real nature of a relationship are clear. Therefore, the principal must pay particular attention to the actual management of the self-employed relationships it has entered into.

In fact, the “genuineness” of the relationship prevents the independent contractor from obtaining, after the termination of the service, a court order to come back to work in the company, this time as an employee.
I. Legal Framework Differentiating Employees From Independent Contractors

II. Business Presence Issues

III. Re-Characterization of Independent Contractors as Employees

IV. How to Structure an Independent Contractor Relationship

V. Trends and Specific Cases

VI. Conclusion
I. Legal Framework Differentiating Employees From Independent Contractors

a. Factors that determine who is an employee and who is an independent contractor

From the systematic and functional analysis of Mexico’s Federal Labor Law it is inferred that the essential element in the employment relationship is to render personal subordinated work to a person, through payment of wages, as stated in the following:

Under Mexican law, a “worker is the individual who works for another person or company, rendering personal subordinated services. For purposes of this provision, “work” is “any human, intellectual or material activity, regardless of the degree of technical preparation required by each profession or trade.”

Mexican law also states that the “employer is any individual or enterprise that uses the services of one or more workers. If the worker, in accordance with agreements reached or custom, uses the services of other workers, the employer of the former shall also be the employer of the latter.”

Finally, the law states that the “employment relationship shall mean the personal performance or work under the authority of another person, in return for payment of remuneration”. An individual employment agreement, irrespective of its form or title, is a contract by which a person binds himself or herself to perform a personal service for another under his management or supervision in return for payment of remuneration. Performance of work in the manner referred to in the first paragraph shall have the same effects as the conclusion of a contract.

According to these precepts and to the general regulations of the Federal Labor Law, the elements required to have an employment relationship, are:

- The employer, an individual or an enterprise;
- The worker, necessarily an individual;
- Provision of a subordinated service, that is, work or services performed under the power of command and management of the employer.
- This concept may be identified objectively by orders that are given or elements of the service relationship, such as a specific area of work, schedule, concrete obligations, etc.; and
- Salary or remuneration, as defined by the Labor Law, since it determines that salary means remuneration which must be paid by the employer to the worker for his work, and may be fixed according to unit of time (year, month, week, day), on a piecework or commission basis, in the form of a lump sum (prefixed amount for the work to be done) or in any other manner.

Subordination is the distinctive element of employment relationship. The Federal Labor Law establishes that an employment relationship must be understood as a personal subordinated service rendered by an individual in return for payment of remuneration. Consequently, the employment relationship has, as a distinctive element, legal subordination between employer and worker, in virtue of which the former at all times, can use the work of the latter, which in turn has the correlative obligation to obey the employer. Second Collegiate Court of the fourth circuit.

There are some special legal concepts, such as work-at-home, work usually done for an employer, at home or at a place chosen by the worker, without the immediate supervision or direction of the employer. It is considered work-at-home as one performed away from the office using information and communication technologies.

If the work is performed under different conditions from those provided by this article, it will be governed by the general provisions of the Federal Labor Law.
A contractor, instead, has a civil or mercantile relationship.

The following court precedent serves to illustrate when the authority sustains that among the parties there was no employment relationship, but a relationship governed by civil law.

As an example the following thesis:

If defendant presents an objection in the sense that the relationship with plaintiff was a provision of professional services, and offers during the labor action an agreement where this is specified, stating that the relationship is governed by the provisions of the Federal District Civil Code, this instrument in itself does not prove that the relationship was of that nature, because you need to study that document together with other evidence to solve this case - i) if during the labor action, elements of subordination are accredited, for example, the service provider is given orders about where and how his work must be performed, and is given tools which are the property of the company to perform the work; ii) if an ID identifies him as the company’s employee, and he is assigned economic compensation, which even if these are called fees as recorded in the agreement, in reality it is truly the compensation paid for his work. If these extremes are justified, then we must conclude that the real relationship existing between the parties was an employment relationship and not a civil one.

Furthermore, the Supreme Court of Justice held the following in regards to determining the nature of an employment relationship:

To determine the legal nature of an agreement we must not only consider its name, but its contents, because, in some cases, contracts named as commission agency agreements are truly employment agreements. Therefore, it is essential to take into account the terms and conditions agreed, in order to conclude if the so-called agent is or is not subordinated to orders given by the principal. We must not forget that according to the Federal Labor Law, subordination is the characteristic element of an employment relationship. Therefore, if analyzing the corresponding agreement; i) it is evident that the agent undertakes to sell and promote the products, merchandising and articles handed to him by the principal, as consignment, through the company or third parties, declaring that he has the resources and personnel appropriate to make the sale and promotion (that is, the sale is not necessarily done by the former); ii) it is evident that the agent may be present or absent any time he wishes, because he is not obliged to personally carry out the assignment, iii) that the contract does not confer exclusivity for any of the parties and therefore has full freedom to hire other agents, iv) that he may perform his activity independently (which excludes subordination), and v) it is evident that it is a commission agency agreement, even if it includes clauses regarding deposit of the sales, storing merchandising, shortages, cash cutoffs, inventories and audits, as well as those regarding limitations to hire other agents, then these are not orders, as understood in an employment relationship, but contractual rules that enable an adequate performance of the commission.

b. Differences in tax treatment

In an employment relationship, the employer must withhold and pay the federal tax authority income taxes on the salaries paid. In this type of relationship no Value Added Tax is paid. The payment voucher is a payroll receipt. The worker is affiliated to the Mexican Social Security Institute (IMSS) to Infonavit (housing institute) and to Infonacot (consumer fund) and pay the state taxes on payroll.

A contractor relationship is established to provide services. In most cases, value added tax is generated, in some cases the person receiving the services withholds part of the income tax generated by the operation and part of the value added tax generated by the service. In most cases, the payment voucher must meet special requirements established by tax laws. A contractor should not be affiliated to IMSS, to Infonavit and to Infonacot. Usually state taxes are not paid over payroll to service providers/contractors.

c. Differences in benefit entitlement

Contractors are not provided with benefits. They receive a fixed or variable pay according to their contract for professional fees. In an employment relationship a fixed salary is paid plus the minimum benefits provided by the law, which are:

- Christmas bonus
- Vacation leave
- Vacation bonus
- Seventh days
- Overtime
- Public holidays

The above plus the extralegal benefits agreed by the parties: Such as bonuses, pensions, food vouchers, gas, etc.

d. Differences in protection from termination

With regard to the employment relationship in Mexico we have the principle of stability in employment, for which an employer cannot dismiss a worker, unless it is on justified grounds, as established by article 47 of the Federal labor law. In case of non-union employees, the employer may terminate the employment relationship in case of reasonable grounds of loss of trust, even if it does not coincide with justified grounds for termination stated in the Law.

The Mexican law formulates the situation in which a worker can be dismissed:

- “If the worker in the course of his employment is guilty of a dishonest or dishonorable action, violence, threats or ill treatment towards the employer or any member of the employer’s family or the top management or managerial personnel of the enterprise or establishment, or against clients and providers of the employer, except in case of provocation or self-defense;”
- “If worker is guilty of immoral conduct, harassment and/or sexual harassment against any person in the establishment or workplace;”
- In the case of “an executor judgment sentencing the worker to a term of imprisonment preventing him from fulfilling his obligations under the employment relationship;”
- Default of any document required by laws and regulations, necessary to provide the services, where such default is due to the worker’s negligence and exceeds the period referred to earlier.

Nevertheless, a professional service provider contract may be terminated or rescinded before expiry, on the following grounds:

- When the work matter of the contract does not begin on the agreed date.
- When provider suspends without justified cause the work or refuses to redo any part of the work that the Client may have rejected as faulty or incomplete.
- When provider does not carry out the work as stipulated in the contract or without justified cause does not follow the orders given in writing by the Client.
• When provider does not comply with the work program, and in the opinion of the Client, the delay may hinder the satisfactory termination of the work within the stipulated term.
• When provider does not pay in time the wages to its workers and other employment benefits.
• When provider is declared to be in a mercantile bid in either of its two stages.
• When provider sub-hires part or all of the work matter of the contract and does not follow the stipulations therein.
• When provider does not give the Client the necessary facilities and date for inspection, surveillance, supervision of the materials, work and/or documents.
• When provider changes nationality, in case the nationality had been stipulated as a requirement.
• When provider, being a foreigner, appeals to the protection of his/her government in relation to the contract.
• In general, in case of non-compliance; or when provider infringes any of the obligations arising from the instrument or its schedules, or the laws and regulations applicable or to the Client’s orders.

An employer who dismisses a worker must serve written notice clearly stating the conduct or conducts that are grounds to be rescinded and the date or dates when these were committed.

The notice must be personally handed to the worker upon termination or, inform the competent Conciliation and Arbitration Board, within the five following days, in which case the last registered address of the workers must be given so the authority can serve notice in person.

The prescription term to exercise actions arising from a termination will begin to count once the worker has personally received the termination notice.

Failure to notify the worker personally or through the Board shall be sufficient grounds to consider that there was no cause for dismissal, and consequently the termination is null.

The worker may apply to a Conciliation and Arbitration Board to request reinstatement in the position the worker occupied, or compensation in the form of three months’ wages, according to the amount due on the date when payment is made.

The employer shall be released from the obligation to reinstate the worker by paying instead the compensation in the following cases:
• In case of workers who have been employed for less than one year in the enterprise;
• If sufficient evidence is furnished to the satisfaction of the Conciliation and Arbitration Board that the worker, on account of the work he/she performs or the nature of the work, is in direct and permanent contact with the employer and the Board is of the opinion, taking into consideration all the circumstances of the case, that continuation of the work is impossible;
• In the case of confidential employees;
• In domestic service; and
• In the case of temporary workers.

In civil matters, regardless of those stated by the Law, the parties may state specific grounds for termination, but this would be litigated in a civil court. A worker may sue the company before the labor authority (Conciliation and Arbitration Boards), whose integration is tripartite, with State, Worker and Employer representation and via an award or ruling will determine in each case if there is or not an employment relationship.

These rulings are contested in Collegiate Courts. When from the existing relationship elements or when subordination can be inferred, this relationship will be considered as an employment relationship, notwithstanding that a contract of a different nature was entered into because, for Mexican law, employment relationships are de facto.

e. Local limitations on use of independent contractors

Commercial agents who perform mercantile activities such as intermediation, or individuals or legal entities who perform activities specialized in their fields or that are hired to perform them, e.g., lawyers, accountants, architects, etc.

f. Other ramifications of classification

There is no prohibition regarding the use of independent contractors; however, if there is subordination, it will be an employment relationship.

g. Leased or seconded employees

Expatriate employees

The majority of expatriates who come to Mexican territory are originally hired by a foreign company according to the employment conditions that govern international laws, without taking into consideration that, according to Mexican Labor Law, these individuals, by the simple fact of working in our country, have the same minimum rights awarded by the Federal Labor Law, and these cannot be waived.

This problem often happens in medium and large enterprises, because the executives of the head office lack experience regarding Mexican legislation. As a general rule, they believe the laws in their country will apply outside their territory to the employment relationships of expatriate personnel working in Mexico. However, foreign laws only apply if they grant expatriates benefits above those provided by our legislation.

The Federal Labor Law applies in the two prior assumptions; the space where it is valid emanates from article 1, which provides that “This Law shall be generally observed throughout the republic and shall govern the labor relations”.

h. Regulations of the different categories of contracts

The Federal Labor Law regulates different kinds of special work: confidential workers, seafarers, flight crews, railroad workers, road transport workers, public service manual workers in zones under federal jurisdiction, rural workers, commercial workers and the like, professional athletes, actors and musicians, at-home work, domestic workers, mine workers, workers of hotels, restaurants, bars, and other similar establishments, medical residents in specialty training, workers in universities and higher educational institutes that are legally autonomous.

II. Business Presence Issues

a. How the use of one or more independent contractors creates a permanent establishment in country and the ramifications

Not applicable. For a company to be established in Mexico, it has to follow all incorporation procedures and comply with all necessary requirements and obligations.
b. How the employment of one or more individuals creates a permanent establishment in country and the ramifications

For purposes of Income Tax Law, permanent establishment is any place of business where entrepreneurial activities are performed, partially or totally, or where independent personal services are provided. Permanent establishments are, among others, branches, agencies, factories, workshops, facilities, mines, quarries, or any other exploration, extraction or exploitation of natural resources.

When a person who resides abroad acts in a country through an individual or legal entity different from an independent agent, it will be considered that the foreigner has a permanent establishment in the country, regarding all of the activities the said individual or legal entity performs on behalf of the resident abroad, even if he/she does not have a place of business, or a place to provide services in the national territory, if that person has faculties to execute contracts in the name or on behalf of the resident abroad, to perform activities of that person in the country.

If a resident abroad performs entrepreneurial activities in the country, through a trusteeship, the place where the fiduciary performs such activities and complies with tax obligations arising from such activities on behalf of the resident abroad, will be considered as a place of business of the resident abroad.

It will be considered that there is a permanent establishment of an insurance company that resides abroad, when it earns income for collecting premiums inside the national territory or issues insurance against risks in this territory, executed through a person who is not an independent agent, except in case of reinsurance.

III. Re-Characterization of Independent Contractors as Employees

As previously stated, subordination is the key element in an employment relationship; if a company has a service provider who in fact is a worker and not a provider, it is a violation of the employment and social security norms. In case of a lawsuit, the person shall be sentenced to fulfill these.

In order for an independent contractor to become an employee or vice-versa, you have to terminate the existing contract and enter into a new and different contract.

As well as in other countries, the number of workers has a bearing on the obligations provided by the law, for instance, work centers with more than 60 workers must have provide for disabled workers to have adequate access to the facilities and to perform their work.

The Social Security law establishes that an employer who is obliged to insure its workers against work risks and fails to comply, must pay the IMSS (Social Security Institute) in case of accidents, the constitutive capital of the benefits in cash and kind, according to the provisions of the Law, regardless of whether the IMSS provides the corresponding benefits.

IV. How to Structure an Independent Contractor Relationship

a. How to Properly Document the Relationship

A professional services agreement must be executed. The contractor or independent service provider must issue fee receipts or invoices and must pay taxes.

What matters most is ensuring that you are not establishing conditions that imply subordination, such as a strict schedule to be followed, giving them work tools and other similar conditions.

b. Day-to-Day Management of the Relationship

There must not be any element that can point to subordination or economic dependence, essential elements in an employment relationship. Furthermore there must be a professional services provider agreement.

V. Trends and Specific Cases

When the contractor relationship is not correctly managed, this may create an employment relationship. For this reason it is very important to sign an independent service provider agreement, the provider has to issue fee receipts or invoices, the enterprise must verify that the provider is paying taxes, and make sure that there is no subordination to the contracting party. Examples of subordination include, but are not limited to, giving instructions, giving tools for work, making payments that are not documented through invoices.

In Mexico, specific cases include labor lawsuits filed by professional service providers against a company that hired his/her services. The defense in these cases is to prove it is not an employment relationship but a civil relationship and for this you need to have the mentioned documents.

VI. Conclusion

In summation, an employee has an employment relationship; a contractor has a civil or mercantile relationship.
THE NETHERLANDS

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V. CONCLUSION 142
Understanding the distinction between an employee and an independent contractor begins with qualifying the agreement in force between the parties. The parties who enter into an “employment agreement” are an employer and an employee. These parties are not separately defined in the Dutch Civil Code (DCC). The parties who enter into a “contract for services” are known under Dutch law as an (independent) contractor and a principal.

The question whether an agreement between two parties should be qualified as an employment agreement or as a contract for services continues to provide new case law and legal literature. The Supreme Court first ruled that there is not a decisive element for answering this qualification question. All the elements characterizing the relationship must be taken into consideration and assessed jointly. None of these elements—which will be discussed later on—have to be decided in advance. According to the Supreme Court, the initial parties’ intention can yield for a future manner of execution. This means that for example, although parties may have labeled the agreement in force between them as an employment agreement, this (title on the agreement) is not necessarily decisive. It can be inferred from the case law from the Supreme Court; the court must first decide on the parties’ intention, as it then must determine, based on the actual manner of execution if - other than the original parties’ intention – the manner in which the agreement is executed, leads to the conclusion that there is a different kind of agreement in force between the parties.

The outcome of the qualification question is important for several reasons. One of them being: if the labour relationship is qualified as an employment relationship (eventually in court), the employer is/was responsible to withhold income taxes as well as the workers’ income contributions.

I. LEGAL FRAMEWORK DIFFERENTIATING EMPLOYEES FROM INDEPENDENT CONTRACTORS

a. Factors that determine who is an employee and who is an independent contractor

The Dutch Civil Code lays down three forms of contracts relating to the performance of work. Where work is performed for valuable consideration the legal relationship between the parties will fall into one of these categories:

- Employment agreement;
- Contract for services;
- Contract of work.

A contract of work (agreement) is defined as an agreement whereby one party as an independent contractor agrees to produce particular work of a tangible nature for a sum of money to be paid by the other party. There is no master and servant relationship between the contractor and the other party and there is no obligation for the contractor to perform his duties personally. In practice, it is generally relatively straightforward to distinguish a contract for work agreement.

This chapter will discuss the elements which should be taken into account to determine whether an agreement between parties should be qualified as an employment agreement or as a contract for services. The answer to this question will lead to the qualification of the worker, being an employee or an independent contractor.

1 In the so-called Groen/Schoevers judgment.
**Employees vs Independent Contractors – The Netherlands**

### Employment agreement

An employment contract is defined by the Dutch law: “Parties have entered into an employment agreement (relationship) when one party, an employee, commits himself to perform labor in the service of the other party, the employer, against remuneration during a certain period of time.”

Three core elements must be present in order for an employment agreement to exist under Dutch civil law:

- The employer is entitled to give orders as to how the work is to be carried out (relationship of authority). What is determinative is if the employer is entitled to give orders, not if he actually does.
- The work is to be carried out personally (exclusively) by the worker, and
- The worker receives remuneration (wages) for his work from the employer.

### Substance over form

As stated in the introduction, the parties’ intentions and the way they have given actual effect to the agreement, are relevant elements in deciding whether or not there is an employment agreement. If the situation meets the three core criteria, then, notwithstanding any arrangement which the parties have agreed upon to the contrary, the contract may be classified as an employment contract (substance over form) and an employment agreement is deemed to exist. Factual elements to take into consideration are discussed further on in this chapter.

### Legal presumption

If, for at least three consecutive months, work is performed for remuneration either for at least 20 hours per month or on a weekly basis, it is presumed that this work is performed under an employment agreement. This presumption of law is important in situations where it is unclear whether there is an employment agreement, either because no clear contract was reached or because the course of actual events differs from the agreements made in the contract. This legal presumption can be rebutted by evidence to the contrary.

### Categories of employees

Employees can be employed on different types of contracts, namely:

- Indefinite term;
- Fixed-term;
- Temporary (agency).

### Contract for services

A contract for services is defined by the Dutch law. There is a contract for services when activities are conducted that consist of anything other than the creation of a work of material nature, the retention of property, publishing works or the carriage or transportation of persons or property.

The independent contractor is contracted on the basis of a contract for services or a management agreement, which is a specific form of a contract for services. These contracts can be entered into with a natural person or the individual person’s management company (Service Company).

### Instruction right but no relationship of authority

The existence of an instruction right is not decisive in qualifying the agreement. Following the law, the independent contractor is obliged to give effect to timely and responsible instructions provided by the principal regarding the performance of the services. This instruction right is however, not comparable to the relationship of authority between an employee and an employer.

### Circumstances to take into consideration

So which circumstances (elements) in addition to any instruction right of the (potential) employer are relevant to determine whether a worker can be qualified as an employee or as an independent worker? Relevant circumstances include, but are not limited to:

- The freedom of the worker regarding the organization of his work;
- The nature of the remuneration;
- Whether payments are made directly by several clients;
- The extent to which the worker bears an entrepreneurial risk;
- The extent to which the worker supplies his/her own raw materials and consumables and tools;
- Whether there is continued payment during vacation time, illness and leave;
- The extent to which, in addition to the agreed work, other work is performed;
- The occasional nature of the work;
- Any deduction of social security contributions and payroll taxes by the (potential) employer and any payment of VAT by the worker.

### b. Differences in tax and social security laws

If an employment agreement is held to exist from an employment law perspective, it will be an employment agreement from a social security and tax law perspective. From a social security and tax law point of view, however, some working relationships are considered to be employment relationships, even though they do not meet all requirements of the Dutch Civil Code. However, as soon as the supposed employee can prove that he/she is, in fact, a self-employed worker, this presumption will be rebutted.

If there is an employment agreement, payroll taxes must be withheld and paid. The Income Tax Act 2000 and the Salaries Tax Act 1964 do not contain a definition of what constitutes an employment agreement. The tax laws are in line with the private criteria as stated under the subject ‘employment agreement’.

The employer is responsible to determine whether the labour relationship qualifies as an employment relationship for tax and employed persons’ income contributions (‘social premiums’). If the labour relationship is qualified as an employment relationship (eventually in court), than the employer is/was responsible to withhold income taxes as well as the worker’s income contributions.

Tax and social security authorities have developed guidelines containing criteria by which it is to be determined whether the worker is performing his activities as an employee (Dutch Civil Code), an employee for tax and social security reasons or as an independent contractor. Relevant circumstances include the number of expected assignments. An independent contractor may request that the tax authorities issue a ‘declaration of an independent contractor status’ (‘VAR-wuq’) or the so-called..."
'Declaration of income from activities at the company’s risk and expense' (‘VAR-dga’). The employer who enters into a labour relationship with an independent contractor with a VAR-wuo or VAR-dga is thereby indemnified for a possible additional tax and social premiums assessment, if the labour relationship should qualify as an employment relationship for tax and employed persons' income contributions. It is therefore advisable to request a VAR declaration from the independent contractor before entering into the services agreement. It should however be noted that the Dutch tax authorities have already indicated that this system will change as of January 1st 2015.

c. Differences in benefit entitlement

The most important differences in benefit entitlements and other rights and obligations between an employee and an independent contractor are stated below.

<table>
<thead>
<tr>
<th>Employee</th>
<th>Independent Contractor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unemployment benefits</td>
<td>Not applicable</td>
</tr>
<tr>
<td>Entitlement to 70% of salary during the first two years of illness</td>
<td>Not applicable</td>
</tr>
<tr>
<td>Holiday, holiday pay and leave entitlements</td>
<td>Not applicable</td>
</tr>
<tr>
<td>Minimum wage</td>
<td>Minimum wage</td>
</tr>
<tr>
<td>Pension scheme</td>
<td>Non-competition</td>
</tr>
<tr>
<td>Non-competition</td>
<td>&amp; confidentiality clause</td>
</tr>
<tr>
<td>&amp; confidentiality clause</td>
<td>&amp; confidentiality clause</td>
</tr>
<tr>
<td>Unfair dismissal protection</td>
<td>Not applicable</td>
</tr>
<tr>
<td>Health, safety and working hours</td>
<td>Health, safety and working hours</td>
</tr>
<tr>
<td>Equal treatment</td>
<td>Equal treatment</td>
</tr>
</tbody>
</table>

d. Differences in protection from termination

General

Dutch law gives employees fairly extensive job security. Once entered into, an employment agreement can only be terminated unilaterally if certain conditions are met and certain formalities complied with.

Although the rules are rather restrictive, it is not the intention of the Dutch labour law to impose unreasonable restrictions on the employer where dismissals are justified.

The protection from, and the conditions under which unilateral termination of an employment agreement is possible under Dutch civil law, do not apply for independent contractors.

Employment agreement for a definite period

It is possible to enter into an employment contract which terminates without having to comply with any particular formalities simply by fixing the term of the agreement for a definite period. The agreement will then terminate automatically at the end of the fixed period of time.

Employment for an indefinite period

If no specific period is mentioned, or the agreements exceed the legally permitted period or number of consecutive contracts, an employment contract will be deemed to be a contract for an indefinite period of time. This employment agreement will not terminate automatically.

Consent of Labour Office (‘UWV’)

An employer who wishes to terminate an agreement for an indefinite period of time (or a specific employment contract where notice of termination must be given as a matter of law) must first obtain the approval of the UWV before serving notice of termination and must state the reason(s) for the intended termination. Employees are not required to obtain the approval. The purpose of this procedure is for the UWV to prevent unfair or socially unjustifiable dismissals.

BBA

The requirement for an employer to obtain a dismissal permit is based on a specific statute, the BBA, which comes into play in addition to the Civil Code employment law rules on notice and compensation. Without a dismissal permit, where required, the notice given by an employer may be declared null and void by the competent court at the request of an employee. The requirement for a dismissal permit applies to all employment agreements entered into for an indefinite period of time. Certain employment agreements fall outside the scope of the BBA, e.g. employment contracts for a definite period of time and temporary employees (hired through a staffing agency) whose employment relationships expire automatically and without notices. The general rule is that the employers typically have to request a dismissal permit in order to terminate someone, but this rule does not apply to the contracts that fall outside the scope of the BBA, such as the ones detailed above.

Notice periods

Minimum notice periods must be observed in terminating an employment agreement.

Dismissal without UWV consent

Termination of an employment agreement without the approval of the UWV is null and void, unless the termination:

• is by mutual consent; or
• is for urgent reasons; or
• has been decided on by a Court; or
• occurs during the ‘trial period’; or
• is of a fixed-term agreement; or
• is in respect of the employment of a managing director as defined in the company’s articles of association.

Dissolution by the County Court; the ‘County Court Formula’

Where a contract has been dissolved by the County Court (or where the County Court finds that a termination is manifestly unfair) the Court may order the employer to pay a ‘reasonable compensation’ to the employee. There are no statutory rules with respect to the amount of compensation to be paid on termination of the employment agreement. However, the County Courts have made recommendations as to how the amount of compensation should be calculated in the event of dissolution of the contract by the County Court.

The original recommendations provide, briefly, that the compensation to be awarded will be determined using the following formula: A x B x C, in which:
It should be noted that the Dutch legislature has introduced a bill on November 29th, 2013 – which is currently still pending – that will (dramatically) change the Dutch dismissal system as stated above. There is currently no concrete term set when this bill will come into effect or if the bill will pass as is or will undergo any changes.

**Contract for services**

As stated, the protection from, and the conditions under which unilateral termination of an employment agreement is possible under Dutch civil law, do not apply for independent contractors. As an employment agreement, a contract for services can be concluded for a definite or for an indefinite period. The contract for services should include an earlier termination clause as well as a reasonable notice period, because an independent contractor can otherwise be entitled to a severance pay. If these criteria are met, a principal can easily terminate the contract for services by giving notice while observing the applicable notice period.

There is an important exception to this rule. In the event that the independent contractor does, in general, not perform work for more than two different employers, the principal will still have to file a petition with the Labour Office (‘UWV’) to receive a permit to give notice to terminate the contract for services.

e. Local limitations on use of independent contractors

There are no limitations on the use of independent contractors under Dutch Law.

f. Leased or seconded employees

If a business does not want to hire (more) employees and does not want to come to a contract for services either, there are several possibilities under Dutch Law to attract workers. This chapter discusses temporary-agency workers, so-called ‘pay rolling’ and secondment.

**Temporary/agency workers**

An agreement under which an employee is supplied to a third party (the recipient), by the employer (the supplier), in the practice of the profession or operation of business of that employer, to carry out the third party’s work under the third party’s management and supervision in accordance with the orders/instructions given to the employer/supplier by the third party, will be held to be an employment agreement between the supplier (‘uitzitter’) and the temporary worker (‘uitzendkracht’). Temporary employment agencies, placement agencies and labour pools fall within this definition.

All standard labour law provisions apply to this temporary employment agreement, (although exceptions apply in relation to consecutive fixed-term agreements). Other terms can be laid down by collective bargaining agreements. There is a collective bargaining agreement for temporary workers. The provisions of this collective bargaining agreement have been declared generally binding by the Minister of Social Affairs and Employment.

The recipient of the temporary services is liable for all damage suffered by temporary workers during the performance of their duties. Temporary workers who have been working for the recipient for 24 months or more, count towards the recipient’s group of regular employees, adding to the number of staff required to establish a works council.

‘Payrolling’

Payrolling makes a distinction between the material and the formal employer. The payroll company is the employer by paper, but the principal is the employer which exercises the authority over the employee. Payrolling can vary from outsourcing the payroll administration and formal employership, to transferring all existing employment contracts to the payroll company. Distinguishing formal and material employership may lead to a discussion of which party has a certain obligation towards the employee. For instance reintegration obligation when the employee is sick.

The collective bargaining agreement for payrolling states payrolling, consists of a triangular relationship where the principal recruits and selects the employee. The employee then enters into an employment contract with the payroll company, to then be exclusively available to the principal.

The legal status of payrolling is unclear. Payroll companies usually see themselves as a (special) temporary employment agency. In a temporary employment agreement there is also a triangular relationship where the employee, in the context of the exercise of the profession or business, is made available to carry out under the supervision and guidance of a third. There are however important differences between the two. The first one being that with payrolling, the workers are being recruited and selected by the principal, while with a temporary employment agreement the temporary employment agency recruits and selects the workers. Therefore, it can be stated that the payroll company does not have an allocation function, namely bringing supply and demand of temporary work together.

The employers’ desire for a payroll construction does not have to do with needing more employees in situations of high work pressure or sickness. It stems from the desire to mitigate administrative and labour costs, obligations and liabilities and increase the flexible use of manpower. Usually, not a temporary but a permanent provision is intended. Another related issue of difference between payrolling and temporary employment agreements is that with payrolling there is in general exclusivity: without the consent of the principal, the payroll company is not allowed to redeploy ‘its’ employees.

Increasingly not only newly recruited staff are employed by a payroll company, but also existing contracts of the employer are acquired by a payroll company. Payrolling is relatively common in the primary sector, especially agriculture. In other parts of the business, payrolling is also established, ranging from the cleaning sector, catering, retail and education. Payrolling is (partly due to the mentioned increase) increasingly criticized due to the fact it is sometimes unclear to the employee who is indeed his employer and therefore to whom he can turn in case of a claim. It is also relatively simple for the principle to terminate the contract for services with the payroll company. The payroll company then has to obtain permission of the UWV to terminate the employment agreement with the employee. The risk of using a payroll construction to evade permanent employment...
contracts, has been discussed in parliament several times. Legislative proposals have been announced in order to counteract this.

The Act allocation of labour through intermediaries (‘WAADI’) already states that workers who are supplied by a third party (which may include payrolling) should be rewarded in the same manner as comparable workers. This also applies to inter alia working hours, overtime, breaks, rest periods, night work, and holidays.

**Secondment**

Employers who do not provide intermediate services on the labour market or only occasionally supply manpower services to fellow employers do not fall into the category of ‘employer/supplier’. The most important difference is that the specific provisions for suppliers and temporary workers, as set out above, do not apply to such secondments.

An employee who is seconded to a third party to perform his job under that party’s management and supervision, in accordance with the orders given by that third party, will remain employed by his employer. The conditions under which the employee is employed will remain the same and must be adhered to by the third party. A secondment will usually be for a fixed period or for the duration of a specific project.

It is advisable for the employer and the third party to set out the conditions of secondment in an agreement which should specify the terms on which the secondment will take place, including any terms in relation to indemnities, confidentiality, non-solicitation, notice periods and the method of payment for the services rendered.

**III. Re-Characterization of Independent Contractors as Employees**

**a. Laws and Guiding Principles**

The employment contract has been defined in Article 7:610 of the Dutch Civil Code and the contract for services has been defined in Article 7:400 of the Dutch Civil Code. The legal criteria and guiding principles on the basis of which the type of contract is determined have been explained above in part one.

**b. The Legal Consequences of a Re-Characterization**

If a labour relationship is qualified as an employment contract, the employee is protected by Dutch employment laws, e.g. regarding minimum wages, holidays, sickness, termination, pensions rights, collective bargaining agreement. Please see part one for a short overview of the most important differences in benefit entitlements and other rights and obligations between an employee and an independent contractor.

Furthermore, the employer will be responsible for withholding income tax and national insurance contributions from the employee’s salaries. The Tax Authorities can claim payment of income tax and national insurance contributions due by the employee from the employer.

**c. Judicial Remedies Available to Persons Seeking ‘Employee’ Status**

If a person is of the opinion that his or her labour relationship meets the criteria for an employment relationship, this person could request a declaratory decision from the courts about the qualification of the employment contract.

d. Legal or administrative penalties or damages for the employers in the event of re-characterization

The employer may be confronted with employee benefits in arrears such as outstanding holiday payments, salary entitlements during sickness and/or pension entitlements. The employer could also be imposed fines by the Tax Authorities for not complying with the obligation to withhold income tax and national insurance contributions.

**IV. HOW TO STRUCTURE AN INDEPENDENT CONTRACTOR RELATIONSHIP**

In order to prevent a relationship of authority – which is one of the key elements of an employment relationship – it is common that a contract for services explicitly includes the independent contractor shall be at liberty to carry out his/her duties to perform the services at his/her own discretion. This also means the specific days and hours on which the independent contractor will perform the services on a weekly basis. However, it is possible to agree to a limitation (maximum number) of hours per week in which the independent contractor will perform the services.

**No exclusivity**

Seeing as the independent contractor should be entitled to perform professional services for other companies as well, exclusivity in respect of labour is also a key element of an employment relationship. Therefore, it is advisable the independent contractor performs professional services for other companies at the same time. This should also be included in the consideration of the contract for services as an assumption based on which the contract for services was entered into by the principal.

**The employer’s perspective**

If the relationship between parties does not meet the requirements for self-employment, the employer/principal may be faced with claims for tax and social security contributions (under the “pay-as-you-team” system, by which an employer must deduct income tax and social security contributions from an employee’s wages or salary and must pay this to the government once a month), and may also have to pay fines and, possibly, damages and compensation for termination of the agreement. Since almost all payments made under such claims cannot subsequently be recovered from the former employee, it is advisable for the employer/principal to make provisions for social security contributions for which he might be/become liable.

**V. TRENDS AND SPECIFIC CASES**

In recent years, the trend in The Netherlands, much like in other countries, has moved towards an increased use of independent contractors and short-term contracts, making the independent contractors a growing and increasingly more important group in the Dutch employment market.

Due to the economic crisis a lot of redundant employees are let go only to start (continue) working for their previous employer as an independent contractor. Therefore, they lose many of the rights and protections they had as an employee, while often doing the same work as before. Some have argued in legal literature there is – or there should be – a distinction between these so-called ‘dependent contractors’ versus the independent contractors, who are less dependent on one particular principal and have a better labor market position.
In response to the increase of independent contractors, the Dutch legislature has determined (mid-2012) that independent contractors are entitled to the same level of protection for health and safety at work as employees. The aim is to prevent the independent contractors and employees from competing with each other. To further strengthen the position of independent contractors and remove unnecessary barriers, the legislature has also taken several other measures. Among other things, the government passed a law on 1 April 2013 to give smaller businesses – including independent contractors – a better chance for procurement. The government has also taken measures to reduce the administrative burden for independent contractors.

VI. Conclusion

The foregoing summarizes some of the distinctions between an employee and an independent contractor under Dutch employment law. Understanding the distinction between an employee and an independent contractor begins with qualifying the agreement in force between the parties. There is not a decisive element for answering this qualification question. All the elements characterizing the relationship must be taken into consideration and assessed jointly. A few elements which have proven to be of importance in case law are the freedom of the worker, the nature of the remuneration and payment during vacation time, illness and leave.

It is important to realize, the initial parties’ intention can yield for a future manner of execution. The court must first decide on the parties’ intention, as it then must determine, based on the actual manner of execution if - other than the original parties’ intention – the manner in which the agreement is executed, leads to the conclusion that there is a different kind of agreement in force between the parties.
NEW ZEALAND

I. LEGAL FRAMEWORK DIFFERENTIATING EMPLOYEES FROM INDEPENDENT CONTRACTORS

II. RE-CHARACTERIZATION OF INDEPENDENT CONTRACTORS AS EMPLOYEES

III. CONCLUSION
I. LEGAL FRAMEWORK DIFFERENTIATING EMPLOYEES FROM INDEPENDENT CONTRACTORS

New Zealand’s Employment Relations Act 2000 (the “Act”) applies to all employees, and is predicated on “good faith” in all aspects of the employment relationship. This obligation requires the parties to an employment relationship to be “active and constructive” in establishing and maintaining a productive employment relationship in which the parties are, amongst other things, “responsive and communicative”\(^1\). The Act is intended to promote observance in New Zealand of various International Labour Organisation Conventions. The Act therefore follows a relatively protectionist approach with respect to those engaged as employees.

In contrast, no such statutory requirements of good faith or mutual trust and confidence apply to any contractual relationship in the nature of independent contracting. In essence, a contractor is subject only to the general law of contract. Importantly, a contractor is not entitled to use the mechanisms for resolving personal grievances prescribed in the Act. This article considers the differences between contractors and employees in New Zealand and the process whereby such a relationship can be re-characterised.

a. Factors that determine who is an employee and who is an independent contractor

The Act deals with the meaning of the term ‘employee’. Section 6 prescribes a requirement for the Employment Relations Authority when deciding whether a person is employed by another person under a contract of service to determine “the real nature of the relationship” between the parties.

Previously, under the Employment Contracts Act 1991, the New Zealand courts had placed heavy emphasis on the terms of the written contract between the parties and had tended to frame the question as “is the person who has engaged himself to perform these services performing them as a person in business on his own account?”\(^2\)

Section 6 of the Act provides the definition of an “employee”, and states:

6  “Meaning of employee

(1) In this Act, unless the context otherwise requires, employee—

(a) means any person of any age employed by an employer to do any work for hire or reward under a contract of service; and

(b) includes—

(i) a homeworker; or

(ii) a person intending to work; but

(c) excludes a volunteer who—

(i) does not expect to be rewarded for work to be performed as a volunteer; and

(ii) receives no reward for work performed as a volunteer; and

(d) excludes, in relation to a film production, any of the following persons:

(i) a person engaged in film production work as an actor, voice-over actor, stand-in, body double, stunt performer, extra, singer, musician, dancer, or entertainer:

(ii) a person engaged in film production work in any other capacity.

(1A) However, subsection (1)(d) does not apply if the person is a party to, or covered by, a written employment agreement that provides that the person is an employee.

(2) In deciding for the purposes of subsection (1)(a) whether a person is employed by another person under a contract of service, the court or the

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\(^1\)Section 4 Employment Relations Act 2000 (NZ).
\(^2\)TNT Worldwide Express (NZ) Limited v Cunningham [1993] 3 NZLR 681 (CA).
Authority (as the case may be) must determine the real nature of the relationship between them.

(3) For the purposes of subsection (2), the court or the Authority—
(a) must consider all relevant matters, including any matters that indicate the intention of the persons; and
(b) is not to treat as a determining matter any statement by the persons that describes the nature of their relationship.”

Accordingly, the main consideration under section 6(2), when determining whether a person should be treated as an employee, is the real nature of the working relationship between the parties, rather than the “label” given by the parties to it. That is made plain by section 6(3) which states that the authority is not to treat as a determining matter any statement by the parties describing the nature of their relationship, i.e. whether they have said that the relationship is that of principal and an independent contractor or employer and employee.

However, at the same time, section 6(3)(a) provides that in making its determination, the authority must consider “all relevant matters” including any matters indicating “the intention of the parties”. As any written contract between the parties at least purports to record their common intention, this requires in every case, an assessment of what the parties have in fact set out in their agreement.

The authoritative decision on the application of section 6 is the decision of the Supreme Court in Bryson v Three Foot Six Limited. In that decision, the Court stated:

“All relevant matters” in s 6(3)(a) ERA certainly include the written and oral terms of the contract between the parties, which would usually contain indications of the common intention concerning the status of their relationship. They will also include any divergences from or supplementation of those terms and conditions which are apparent in the way in which the relationship had operated in practice. It was important that the Court or the Authority should consider the way in which the parties have actually behaved in implementing their contract. How their relationship operates in practice is crucial to a determination of its real nature. “All relevant matters” equally, clearly requires the Court or the authority to have regard to the common law tests."

In that passage the Court referred to the application of the “common law tests”. Bryson and Koia v Carlyon Holdings Limited are authority for the proposition that, in addition to considering the intention of the parties, the real nature of the relationship can be ascertained by applying the common law tests of:

- Control;
- Integration; and
- The fundamental test of whether the person performing the services is doing so on their own account.

Bryson and Koia have made it clear that none of these tests can be considered decisive in its own right and the circumstances and facts of each case must be considered as a whole in determining the real nature of the relationship between the parties. However, despite the apparent relegation of the written terms of the agreement to only one of many “relevant factors” to be evaluated, it still has considerable importance. Bryson reconciled section 6 with the need to consider the terms of the agreement this way:

“It is not until the Court or authority has examined the terms and conditions of the contract, and the way in which it actually operated in practice, that it will usually be possible to examine the relationship in light of the control, integration and fundamental tests. Hence the importance, stressed in TNT, of analyzing the contractual rights and obligations.”

Accordingly, in the normal course of events, the authority will undertake an assessment of each of these tests, together with the terms of the written agreement, in forming its conclusion on the issue and will adopt a balancing of those matters in order to determine the question. Plainly, cases under section 6 are heavily fact specific. Therefore, while statements of principle such as those outlined above assist determination of status, the intensely factual nature of cases means that trends in this area are difficult to determine.

Intention of the Parties

In assessing the intention of the parties, the authority will normally take into account some or all of the following factors:

- Whether there is any written contract or statements specifically describing the nature of the relationship and containing indications of the parties’ common intentions;
- Whether there have been any divergences from those terms and conditions in practice;
- Whether there is any evidence of any relevant discussions or oral exchanges, conduct or correspondence;
- Whether the parties have always acted consistently so as to indicate one relationship rather than the other.

The starting point for determining the parties’ intentions is the written terms of the agreement between the parties.

As stated by the Act, the intention of the parties is relevant, but is not a decisive factor. However, the Employment Court stated:

“It is a very serious matter for the Authority or the Court to find, notwithstanding the clear intention of highly capable and knowledgeable persons who have equal contracting strength and sound reasons for the arrangements they have mutually entered into, that, after those arrangements have been terminated, the real nature of their relationship was completely different.”

Further, intention may be decisive where all other factors are evenly balanced. In the Court of Appeal’s decision in Bryson11 (in a passage which was not disturbed on appeal), the judge stated:

“The Act’s emphasis on the real nature of the relationship requires that, in cases where the real nature of the work as constituted by the agreement’s substantive terms and its objective features point clearly to an employment relationship, there

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3. Above n4 at [32].
5. Above n4 at [32].
6. Above n9 at [30].
8. Above n11 at [23].
9. Above n4 at [32].
will be little scope for the parties to agree that the relationship is nonetheless a contract for services. In cases where the real nature of the relationship is less certain, the parties will have greater freedom to constitute their relationship in either way.”

Control Test

The degree of control a principal/employer has over the contractor/employee is an indication of the true nature of the relationship. Historically, the test looked at whether the employee worker was subject to the over-arching control and direction of the principal party in assessing whether a person was an employee or a contractor.

However, the importance of the control test has been diminished for some time in New Zealand. In TNT the Court of Appeal emphasized the terms of the written employment agreement between the parties and rejected the notion that the degree of control exercised by the alleged “employer” was a decisive factor in determining the true nature of the contract. It stated that while the Employment Court was correct to attach weight to the control test, it could no longer be regarded as the sole determining factor, and could not be decisive.

Despite these statements, the control test has some remaining relevance as made clear by the Supreme Court in Bryson. Then the Employment Court13, in assessing the control test, asked various questions of the person’s role including:
• Whether the individual was left to his own devices;
• Whether the individual had a degree of autonomy; and
• Whether he could come and go from the alleged employer’s premises as he pleased.

Integration Test

This test considers whether the work performed by the alleged employee is an integral part of the business and whether he or she has effectively become “part and parcel of the organization”. The test has become inter-mingled with the “economic reality” test14, when it was stated:

“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 that the person or organization for whom work is performed.”

In Clark it was stated by Judge Perkins that in a situation with only a single employee/contractor, the integration test is not all that suitable as a measure to be applied.15

Accordingly, the focus of the test is the extent to which the person is, in all respects, an integral part of the organization for which he or she works. Factors to be considered in determining this question include:
• Is the person performing a role that is part and parcel of the organization?
• Is the person paid a set fee or payment by results?
• Does the person use their own equipment and tools in undertaking the tasks?

Fundamental Test

This test has been variously described over the years as the “fundamental test”, the “economic reality test”, and the “business test”. The test asks whether the person is in business on their own account. The authoritative formulation of the test was brought by jurisprudence16:

“Is the person who has engaged himself to perform the 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.”

The test has been similarly stated by the Employment Court in another case17 where the judge stated:

“This test examines whether the person performing the services is doing so as a person in business on his or her own account”.

A few years later, the Employment Court considered18, in attempting to collect the relevant strands of the particular case together:
• What were the payment and taxation arrangements?
• Was the individual registered for goods and services tax?
• Was it a non-exclusive relationship?
• Did the individual have a separate business account?
• Was the individual able to increase his profits by his own efforts?

Ultimately, the fundamental test is where the Authority collects the evidence together regarding the assessments that it has made in applying the other relevant tests. The Authority attempts to resolve any conflicts in the evidence and forms its view of what the “real nature of the relationship” between the relevant parties is in accordance with section 6 of the Act.

Re-characterisation of the Relationship

It is open to a person to apply to the authority for a declaration that they are an employee. The authority then applies the test provided in section 6 in deciding whether or not to provide the declaration sought. Section 6(5) of the Act provides:

(5) The Court may, on the application of a union, a Labour Inspector, or 1 or more other persons, by order declare whether the person or persons named in the application are—
(a) employees under this Act; or
(b) employees or workers within the meaning of any of the Acts specified in section 223(1).

(6) The Court must not make an order under subsection (5) in relation to a person unless—
(a) the person—
(i) is the applicant; or
(ii) has consented in writing to another person applying for the order; and
(b) the other person who is alleged to be the employer of the person is a party to the application or has an opportunity to be heard on the application.

14as in Challenge Realty Ltd v Commissioner of Inland Revenue [1990] 3 NZLR 42 (CA).
15Above n13 at 46.
17Curlew v Harvey Norman Stores (NZ) Pty Limited [2000] 1 ERNZ 114 (EC).
In practice, however, re-characterisation is most commonly attempted by a person after a relationship, which on its face is an independent contracting relationship, has been terminated. In that case, the person will attempt to raise a personal grievance23, and the alleged employer will defend that personal grievance on the basis that the person is not an employee. In the ordinary course of events, the authority will resolve the person’s personal grievance by first resolving a preliminary question regarding whether the person is, in fact, an employee, following which the authority will determine whether their personal grievance(s) can be pursued.

b. Differences in tax treatment

There are fundamental differences in tax treatment for individuals characterised as employees or independent contractors. Although arguably this treatment stems from the way the parties have described that relationship and ought not to be given significant weight in describing the true nature of it. In determining whether a person is an employee under the section 6 test, the New Zealand courts have confirmed that the taxation position is not a neutral factor24. The Employment Court25 found that payment of withholding tax was not a neutral factor when determining the existence of an employment agreement, but rather indicated against a contract of service. In the same way, invoicing of services to a principal and payment of Goods and Services Tax on those invoices is also not a neutral factor and indicates against a contract of service.

In terms of treatment, every employee is required to pay income tax in the form of PAYE tax (“Pay As You Earn”). PAYE taxes are progressive and the rates at which the various taxes apply are as follows:22

<table>
<thead>
<tr>
<th>Annual Income</th>
<th>Marginal Tax Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>up to $14,000</td>
<td>10.5 cents</td>
</tr>
<tr>
<td>from $14,001 to $48,000</td>
<td>17.5 cents</td>
</tr>
<tr>
<td>from $48,001 to $70,000</td>
<td>30 cents</td>
</tr>
<tr>
<td>$70,001 and over</td>
<td>33 cents</td>
</tr>
</tbody>
</table>

PAYE (as a payroll tax) is paid as the employee earns income. PAYE is deducted at source and remitted at the appropriate rate (annualised for employees) and paid to the Inland Revenue Department (“IRD”), New Zealand’s taxation authority. Accordingly, it is an employer’s responsibility to correctly calculate an employee’s PAYE, deduct that from earnings to which the employee is entitled and to remit that sum to the IRD when an employer is required to do so. An employee will not have any involvement in calculating and paying this PAYE component; that responsibility falls to their employer in managing payroll. From an employee’s perspective, there is no involvement in the mechanism by which this PAYE tax is actually paid.

An employee will also be required to make contributions towards New Zealand’s Accident Compensation Scheme by way of ACC earner levies. The rates of those levies are set annually by law and are currently:

<table>
<thead>
<tr>
<th>Earners’ levy rate</th>
<th>Maximum income earners’ levy charged on</th>
<th>Maximum levy anyone can pay</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employee</td>
<td>$1.70 per $100 (1.70%)</td>
<td>$116,089</td>
</tr>
<tr>
<td>Self-Employed</td>
<td>$1.70 per $100 (1.70%)</td>
<td>$113,768</td>
</tr>
</tbody>
</table>

All employees subject to PAYE have an additional ACC contribution deducted from their PAYE. As such, in the same way as PAYE, employees have no involvement in this calculation and remission to the IRD.

Independent contractors are not subject to the PAYE system. Depending upon the nature of the services that an independent contractor provides they may be subject to payment of withholding tax. Withholding tax implies a contract for services, as it is a form of provisional tax obtained at a lower rate than most PAYE deductions and it entitles the reimbursement of business expenses through tax returns.24 Different rates are applicable to different types of services. The party engaging such an independent contractor is required to deduct withholding tax and remit that to the IRD, however, an independent contractor remains liable for his or her own ACC earner levies and ultimately for payment of income tax above the amounts remitted through.

If a person establishes a company in order to provide their services as an independent contractor then that person will be required to pay company tax on all profits earned by the company in its financial year. The current rate of company tax is 28 cents on the dollar for all profits earned in the 2013 income year.26 If the contractor does not trade through a company or other relevant vehicle, he or she will be liable to pay income tax at the same personal rates as an employee, set out above.

If an individual or entity is registered for the Goods and Services Tax (the current threshold above which registration is mandatory is $60,000 of turnover per annum)27 then that individual is required to levy an additional 15% as GST for a taxable supply of goods and services. The levy is required on any good or service produced and sold or supplied by the person. The individual or entity is able to claim an imputation of 15% for GST expended. The net sum of GST levied and expended is then required to be remitted to the IRD on either a quarterly or six month basis in settlement of a person’s GST obligations. In many cases, an independent contractor will be required to register for GST because their taxable supply of services will exceed $60,000 per annum.

c. Differences in benefit entitlement

Employees are entitled to various benefits by law as a result of their status as employees. In particular, the Holidays Act 2003 (the “HA”) provides a suite of benefits for the purposes of certain types of leave. Those forms of leave are annual holidays, public holidays, sick leave and bereavement leave.

The purpose of annual leave is to allow an employee an absence from their employment for the purposes of rest and recreation.28 An employee who has completed 12 months’ continuous employment with an employer is entitled to four weeks’ annual leave in that year and in each subsequent 12 month periods of employment.29 An employee is

23See below “Differences in Protection from Termination”.
25Above n19.
28Section 2(a) HA 2003.
29Section 16 HA 2003.
A person may be entitled to payment for public holidays. If the day would “otherwise be a working day” for the person (i.e. the person would be working on the day but for the public holiday occurring) then they are entitled to be absent on the day and to receive their relevant daily pay for the day. If the day would not otherwise be a working day for the employee then they are not entitled to payment for the public holiday if they do not actually work on the day. If a person works on the public holiday they are entitled to time and a half of their relevant daily pay for all hours worked on the day. If the day would otherwise be a working day for the employee then, in addition to time and a half of their relevant daily pay for working on the day, an employee is entitled to an alternative day’s holiday to be taken at a later date in substitution for the public holiday.

The HA provides for sick leave for employees for the purposes of recovering from sickness or illness, or to care for a person who depends on the employee and who is sick or injured. A person is entitled to five days’ sick leave after six months’ continuous employment, and to a further entitlement for each subsequent 12 month period of employment. Fifteen days’ sick leave can be carried over from one period of entitlement to another up to a total of 20 days’ sick leave in any one period.

An employee is entitled to bereavement leave for the purposes of recognising the death of a relative or for the death of a person where it is accepted that the person has suffered a bereavement. For certain categories of familial relationships, a person is entitled to three days’ bereavement leave. In any other case where the employer accepts that the person has suffered a bereavement, the employee is entitled to one day’s bereavement leave.

An independent contractor is not entitled to any form of leave under the HA, because the Act applies strictly to employees. Accordingly, in situations where an independent contractor may wish to take leave for any of the reasons provided for by the HA it will ordinarily be taken by the person as unpaid absence.

The KiwiSaver Act 2006 (the “KS Act”) is applicable for the majority of New Zealand employees. KiwiSaver is a work-based contribution scheme to private superannuation accounts for individuals. Membership is voluntary for employees. If a person is a KiwiSaver member and an employee, then the person will be required to make employee contributions to their scheme. The employee contribution rates that an employee must elect are 2%, 4% and either 8% of gross salary or wages. An employer is required to calculate the employee’s contributions and deduct that at source from an employee’s pay during payroll. The employer is then required to remit the KiwiSaver deductions to the IRD for onward transmission to the employee’s KiwiSaver provider.

At the same time, an employer is required to make compulsory employer contributions to an employee’s KiwiSaver scheme. The current contribution rate is an additional 3% of an employee’s gross salary or wages. That additional amount is required to be transmitted to IRD for onward transmission to the employee’s KiwiSaver provider.

An independent contractor is not entitled to receive payment of employer contributions to KiwiSaver as the employer contribution rules only apply to employees. However, any New Zealand citizen or person entitled to be in New Zealand indefinitely is entitled to become a member of KiwiSaver. Accordingly, if the person is not employed, but is an independent contractor they can still make their own contributions to KiwiSaver. An independent contractor can therefore maintain their own KiwiSaver scheme, but will not be entitled to any form of employer contribution.

There are various other forms of benefits that apply to employees in the form of tax credits and parental leave payments which may or may not apply to independent contractors. d. Differences in protection from termination

New Zealand’s employment framework is protectionist in the sense that employees are protected from unjustified dismissal. In essence, this protects an employee from dismissal except for cause. The limited exception to this is that an employer is entitled to terminate a person’s employment within the first 90 days of employment if an employee is employed on a “trial period” allowing for termination within this initial period.

The Act provides that, outside a trial period, an employee may only be dismissed if the employer’s actions in doing so and how the employer acted were within the scope of what a fair and reasonable employer could have done in all the circumstances at the time the dismissal or action occurred.

The Act provides for a system of “personal grievances”. An employee has a personal grievance if, during the course of their employment, their employer takes any action against the employee which disadvantages them or dismisses them and which is not

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justified with reference to the section 103A test. Personal grievances may be raised by an employee for determination by the Employment Relations Authority. The personal grievance system allows for reimbursement of monies lost as a result of the grievance and to compensation for hurt and humiliation suffered as a result of the unjustified actions by the employer.

As they are not subject to the provisions of the Act, independent contractors are not entitled to personal grievance remedies, nor are they entitled to the protection that section 103A of the Act affords. In contrast, these individuals are only entitled to the protections that the common law provides, or are provided by the Contractual Remedies Act 1979 in terms of contractual remedies. If an independent contractor has a claim for breach of contract for which damages are sought, he or she would be required to issue any such claim in the Courts of ordinary jurisdiction. Their remedies would ordinarily be the contractual remedies provided by the common law and the Contractual Remedies Act 1979. While the authority also has the power to provide for ordinary contractual remedies arising out of an employment relationship, it has access to the additional remedies provided by the personal grievance system.

Further, the authority is empowered to order reinstatement of an employee to their former position or to a position no less advantageous to the employee in the event that they have been unjustifiably dismissed. Reinstatement must be a remedy claimed by an employee in order for it to be awarded by the authority. In determining whether reinstatement should be ordered, the authority must consider whether reinstatement is both “practicable” and “reasonable”. That remedy is not available to independent contractors.

e. Local limitations on use of independent contractors

There are very few limitations on the use of independent contractors in New Zealand law. There are some limited restrictions on the characterisation or workers as employees. The Act precludes volunteers who receive no reward for work as a volunteer from being characterised as employees. The Act also excludes from the definition of an employee a person who is engaged in “film production work” in any capacity, unless the person is specifically employed on a written employment agreement providing that the person is an employee.

The film production work exception was a recent amendment to the Act which arose in late 2010 as a result of the production of The Hobbit movies in New Zealand. The amendment related to a dispute between the producers of the films and certain New Zealand unions involved in representing various performers and others engaged in providing services to the films. The provision was intended to clarify the supposed contractual uncertainty in the film industry as a result of the Bryson decision. Individuals in the film production industry are therefore normally engaged as independent contractors rather than employees.

f. Leased or seconded employees

There is nothing in New Zealand law that prevents or regulates employees from being leased or seconded. Likewise, there is nothing that otherwise generally regulates the terms of “triangular” relationships. Those relationships are therefore subject to the section 6 test. However, where a person has structured their arrangement to introduce a corporate vehicle into their arrangement (or some other additional party) it is more likely that they will not be considered to be an employee for the purposes of the Act.

II. HOW TO STRUCTURE AN INDEPENDENT CONTRACTOR RELATIONSHIP

a. How to Properly Document the Relationship

As outlined above, while section 6(3) of the Act provides that the authority may not treat as a determining matter any statement that describes the nature of a relationship, parties to an independent contracting relationship should properly record its terms in writing.

In order for a principal to ensure, as far as possible, that a person engaged as an independent contractor is not an employee, the contract should provide that the person is in all respects an independent contractor and not an employee, partner or subsidiary of the principal. The contract should make clear that the independent contractor is solely liable for all of its debts, losses, expenses and taxation on its income. The contract should also provide that the person will not at any stage, either during or subsequent to the termination of the contract, allege that the person is an employee of the principal.

It would also be expected that the rates paid for services will be expressed with reference to GST, and that payment for services would be following provision of an invoice. Additional matters which will separate an independent contracting arrangement from an employment agreement will include provisions addressing indemnification, warranties and insurances. Parties to such an agreement should also consider whether the dispute resolution provisions of the Arbitration Act 1996 can be incorporated into their agreement. Each of these matters is not commonly provided for in ordinary employment agreements and, accordingly, may assist in establishing, consistent with the relevant tests that the intention of the parties was to enter into a contracting relationship.

Finally, it would be expected that a person be encouraged to obtain legal advice at the time that the independent contractor agreement is negotiated.

b. Day-to-Day Management of the Relationship

At all stages of the relationship with an independent contractor, consideration should be had to whether, applying the common law tests, there may be a risk that the person is in fact an employee. If that is the case, then there should be consideration of whether it is appropriate to terminate the independent contractor agreement and re-engage the person as an employee. Doing so potentially reduces the risk of re-characterisation at a later time. It may be that the individual confirms his or her desire to be engaged as an independent contractor notwithstanding the risk of a later re-characterisation. In those circumstances, those discussions/negotiations should be documented as a way to demonstrate the clear intent of the parties.

60Section 123(1)(b) of the Act.
61Section 123(1)(c)(i) of the Act.
62Section 123(1)(a) of the Act.
63Section 125(2) of the Act, see also Angus v Ports of Auckland Limited [2011] NZEmPC 160.
64Section 102 and 103 of the Act.
65Section 125(1)(b) of the Act.
66Section 125(1)(b)(ii) of the Act.
67Section 126(1) of the Act.
68Section 162(c) of the Act.
69Section 123(1)(a) of the Act.
70Section 125(1) of the Act.
71Section 125(2) of the Act, see also Angus v Ports of Auckland Limited [2011] NZEmPC 160.
III. Conclusion

Section 6 of the Act requires the authority to consider the real nature of the relationship between parties in order to determine whether a person is an employee or independent contractor. In making its determination, the authority will apply the common law tests of control, integration and the fundamental test, together with a consideration of the terms of the written agreement. Plainly, cases under section 6 are heavily fact specific. Therefore, while statements of principle such as those outlined above assist determination of status, the intensely factual nature of cases mean that trends in this area are difficult to determine.
I. Legal Framework Differentiating Employees from Independent Contractors
II. Business Presence Issues
III. Re-characterization of Independent Contractors as Employees
IV. How to Structure an Independent Contractor Relationship
V. Trends and Specific Cases
VI. Conclusion
I. Legal Framework Differentiating Employees From Independent Contractors

a. Factors that determine who is an employee and who is an independent contractor

The difference between an employee and an independent contractor in Norway is based on whether or not the person performing a work task is determined to be an “employee” according to the 2005 Norwegian Working Environment Act (“Arbeidsmiljøloven”). Similar definitions are relevant for tax treatment and benefit entitlements.

The notion of “employee” is a discretionary term. The meaning of this term is determined by case law. Based on this case law, the distinction between an “Employee” and an “Independent Contractor” is made by the questions of:

- Which party is responsible for the result of the work that is performed?
  - The most important rule is that the independent contractor bears the risk of delivering a specific result, whether this is to deliver a finished project or build a house. The “Employee” however, is responsible for performing his work tasks as best as he can from day-to-day, leaving the responsibilities for the result to his employer.

- Is the person performing the work tasks obligated to follow the other party’s day-to-day instructions, or can he decide for himself how to receive the result he is supposed to deliver?
  - If the person performing the work tasks is obligated to follow the other party’s day-to-day instructions, he is most likely seen as an “employee”.

- Is the person performing the work obligated to perform the work himself, or can he use another person to perform the duties to fulfill his obligation?
  - If the person performing the work tasks is obligated to perform the work himself, this is seen as a sign that he is an “Employee”. If he can use another person to deliver his result, he is more likely an independent contractor.

- Which party is responsible for the work tools and assets that are necessary to perform the work?
  - If the person performing the work tasks holds his own work tools, he is more likely an independent contractor than if he uses the other party’s tools and assets. In many cases, however, this can be different due to the character of the services delivered.

- Is the person performing the work tasks only working for one principal, or does he have several customers?
  - If the person performing the work tasks entitled to have many customers and actually able to do it, he is more likely an independent contractor than a person who is obligated to only work for one customer.

b. Differences in tax treatment

The Employer must pay the Social Contribution Tax, calculated on the salary which the employee is paid. Furthermore, the employee shall pay income tax.

The independent contractor, however, is obligated to pay taxes and VAT himself.

c. Differences in benefit entitlement

An employee is entitled to holiday pay from the employer, while the independent contractor is not. In addition, an employee is entitled to official sick pay and earns official pension benefits through the Social Benefits Act. Employers are also obligated to establish a private collective pension scheme for all employees.

The contractor has to pay or cover these kinds of benefits himself.
d. Differences in protection from termination

Independent contractors are not protected from termination at all – their rights related to termination are solely based on the wording of the contract. Employees in Norway are, however, protected from unfair dismissal by the 2005 Working Environment Act. The validity of these contracts and termination of such contracts are regulated by the 1918 Contracts Act and general Civil law.

According to the 2005 Working Environment Act section 15-7, an employee may not be dismissed unless this is objectively justified on the basis of circumstances relating to the enterprise (redundancies).

One typical example of circumstances connected with the enterprise is rationalisation measures. Dismissal due to these circumstances is, however, not objectively justified if the employer has other suitable work to offer the individual employee. Further, when deciding if a dismissal on these grounds is warranted, the needs of the enterprise shall be weighed against the inconveniences a dismissal will involve for the individual employee.

Each employee must be evaluated individually. This implies that there can be just cause for notice in relation to one employee, but not in relation to another employee.

Further to the Norwegian court practice the relevant selection criteria include:

- Competence (e.g. education and work experience, quality of performance).
- Seniority.
- Personal suitability (e.g. leadership abilities, cooperation).
- Social aspects (e.g. family responsibilities/financial situation, health, age, opportunities in the job market).

For a dismissal to be “fair” grounded on non-performance from the employee, an employer must be able:

- To prove that the employee was very well aware of what kind of performance was required from him, including his work tasks and other kinds of obligations.
- To prove that the employee did not perform in accordance with the employer’s requirements.
- To prove that the employee was informed regarding his discrepancies and was given a chance or to improve his performance but did not do so.

Based on these guidelines, every case has to be considered individually.

e. Local limitations on use of independent contractors

There are no limitations.

f. Leased or seconded employees

The other typical mechanism in Norway is the use of temporary work agencies, with the main purpose of hiring out their employees to other companies hiring an extra workforce without having to employ them. The “hiring out” is defined as situations where:

“the employees of the provider of labour are placed at the disposal of the principle (the requisitioner of labour) and are subject to the principle’s management and instructions. The requisitioner also has the financial risk for the result of the work. The employees hired on are employed by the provider. The provider is responsible for payment of salary, etc. and is responsible for ensuring that the employees hired on possess the qualifications assumed for the assignment.”

The Supreme Court ruled in June 2013 regarding the difference between a subcontractor company and a company hiring out their employees:

The case was filed by an employee employed by a subcontractor/temporary agency, who had handled one of the oil company Statoil’s internal post offices for many years. This employee had been working at this internal post office as an employee of the subcontractor/temporary agency and not by Statoil. As Norwegian law provides that an employee hired out from a temporary agency for more than 4 years is entitled to employment from the requisitioner of labor, he filed a court case claiming that the contractual relationship between Statoil and his employer was a hiring contract and not a subcontracting agreement. Consequently, he claimed permanent employment with Statoil.

Due to the same points as stated under section i a) above, the contract was ruled as a subcontract and not a hiring from a temporary agency. The most important point was that the employees employer was responsible for delivering a finished result to Statoil, a post office, and not only responsible for delivering a group of employees.

This group of hired out employees are covered by the Temporary Agency Work Directive, and are entitled to primarily the same salary and working conditions as if they were employed directly with the company hiring them in.

It is important to note that hiring of labour from temporary-work agencies is only lawful in cases where temporary employment is permitted. Hiring of labour may therefore be an alternative to temporary employment in connection with unforeseen peaks and seasonal fluctuations.

g. Regulations of the different categories of contracts

In Norway, the different groups of contracts are defined by mandatory legislation in regards to employment law, tax law and social benefits law. If an individual is not considered an “Employee”, the relation is regulated by the general civil law. Consequently, there are very few case related to these issues.

II. BUSINESS PRESENCE ISSUES

a. How the use of one or more independent contractors creates a permanent establishment in country and the ramifications

The term “permanent establishment” is defined in the Nordic tax treaty. Permanent establishment means a fixed place of business through which the business of an enterprise is wholly or partly carried on. The term permanent establishment includes especially:

- a place of management a branch
- an office
- a factory
- a workshop, and
- a mine, an oil or gas well, a quarry or any other place of extraction of natural resources.
A building site or a construction, installation or assembly project, or activities consisting of planning, supervising, consulting or other auxiliary work by personnel connected with such a project, constitutes a permanent establishment only if the project lasts more than 12 months and is carried out in the same place.

When a person is acting in another Nordic country on behalf of an enterprise and he has, and habitually exercises, an authority to conclude contracts in the name of the enterprise, the enterprise shall be deemed to have a permanent establishment, so-called dependent agent. An enterprise shall not be deemed to have a permanent establishment in a Contracting State merely because it carries on business in that State through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business.

In addition, see section d) below.

b. The Legal Consequences of a Re-Characterization

If the person who has performed work tasks for the employer is re-characterized as an “employee” by the courts, the re-characterized employee is normally entitled to permanent employment with the employer. This gives him full protection from the 2005 Working Environment Act, related to i.e. protection against dismissals, working time and overtime regulations. In addition, an employee is entitled to holiday pay in accordance with the 1988 Holiday Act and full social benefits according to the 1997 Social Benefits Act.

In addition, see section d) below.

c. Judicial Remedies Available to Persons Seeking ‘Employee’ Status

The person Seeking “Employee” status may seek negotiations, but will normally have to file a lawsuit in the Courts claiming his employee status.

d. Legal or administrative penalties or damages for the employers in the event of re-characterization

If the employee is granted “employee” status according to the 2005 Working Environment Act, he may be entitled to compensation for any economic loss or holiday pay for the last 3 years.

If the re-characterization is done by the tax authorities related to tax questions, both the employer and the person performing the work tasks may be liable for extra tax payments and punitive tax payments. Such tax obligations may be claimed for work performed during the last 10 years.

IV. HOW TO STRUCTURE AN INDEPENDENT CONTRACTOR RELATIONSHIP

a. How to Properly Document the Relationship

If you want to properly document that a relationship is with an independent contractor and not an employee in reality, you need to make sure that the contract between the party is clear on the facts that:

• You must describe a precise “result” that the contractor is responsible for delivering, and not only for performing day to day tasks within his field of expertise.
• Normally the “result” will indicate a kind of temporary period until the result is actually delivered. Estimated delivering dates may be practical. In other cases this will not be practical, cf the “Foster Mother” case as described under section V below.
• The payment is based on delivering of results and not on hours spent working.
• It is the contractor’s responsibility to use his own tools, unless the work performed is dependent on tools and assets from the principal company.

In addition, it is important that you, during the work period, document that the provisions as mentioned above are also respected during the contract period.

Especially from a tax perspective, the independent contractor should be registered with his own company, and preferably as a company and not a sole proprietor.

b. Day-to-Day Management of the Relationship

It is important that the day-to-day management of the relationship with an independent contractor is based on the respect that the contractor is not one of your employees and is not supposed to be instructed as if he was an employee. The more the principal company feels the need to instruct and control the contractor’s day-to-day work, the more it is possible that he will be considered as an employee by a court.

It is also important that the invoice from the independent contractor is based on the delivery of a defined target and not based on the number of hours work has been performed.

The normal situation is that independent contractors are performing work for you for a temporary period of time, even if this time period may not be that specific. In some businesses we find very long relationships, where the independent contractor has performed his work tasks for the same company for 10-15 years. These kinds of more permanent work by independent contractors may more easily be seen as a “hidden” employment relationship.

If the contractor is able to actually perform work for other principals in addition to you, this would indicate that he actually is a contractor and not an employee.
V. Trends and Specific Cases

Trends

As the labour market in Norway is very good from a European perspective with regards to the employees or independent contractor’s possibility to find work, many people performing the work want to be independent contractors. When the market is good, many persons prefer the freedom of being independent, in addition to the payments that are most often higher than for employees.

During times where the market is not so good, however, or the person performing work tasks becomes ill or in need of other kinds of benefits, we have the court cases related to the distinction between employees and independent contractors.

Many employers also tend to use independent contractors instead of own employees, especially when it comes to jobs within the IT sector or the building/construction sector. When considered independent, the employers free themselves from benefits and especially the strong protection against dismissals of employees. Due to the implementation of the Temporary Agency Work Directive and the very strict conditions for hiring from temporary agencies, we see a trend where the use of independent contractors are even more interesting for employers than before.

Recent Case Law

In 2013, the Norwegian Supreme Court announced two verdicts regarding the difference between an “employee” and an “independent contractor”. The first judgment was related to a municipal “support contact” for a family, while the other case was related to a foster mother.

In the two cases the “support contact” had made a claim for holiday pay. The foster mother, however, had made a claim for sick pay. In both cases, they had contracts with a municipality as “independent contractors”. In the first judgment, the “support contact” was considered to be an “employee” with the right to holiday pay. In the second judgment, the foster mother was considered to be a real “independent contractor”.

The Supreme Court mentions 7 points to take into consideration when defining whether or not a person is an “employee”. The Court also states that these points must be reviewed on a discretionary basis from case to case:

- The duty to perform the work personally and not use substitutes
- The duty to subordinate and follow the employers instructions and control
- The employer holds the work premises, equipment etc.
- The employer is responsible for the result of the work performed
- The payment is executed by some kind of salary
- The contractual relationship is stable, with an agreed period of notice
- The work is mainly performed for 1 single principal

When there is doubt, the answer must come from a discretionary review where all points are taken into consideration.

In addition to these 7 points, the Supreme Court based their decision on whether practical circumstances should indicate that the person was an employee or an independent contractor. In the last judgment regarding the foster mother, the majority of the judges regarded foster care as such a distinctly different relationship as a normal employment relationship, as the core tasks of foster care is to take a foster child into their home to, as much as possible, become part of the foster mother’s own family.

VI. Conclusion

The use of independent contractors – as well as subcontracting companies – is increasing in Norway. The reasons for this may be numerous, but we believe an important reason is the Norwegian employers’ belief that the protection against dismissals in Norway is especially high (if an Employer actually follows the law, however, it is not especially difficult to terminate an employment relationship in Norway).

The distinction between an employee and an independent contractor in Norway is defined by mandatory law interpreted by the courts, both regarding employment protection, holiday pay, tax, pension and social benefits. These definitions are very similar, but the cases related to tax law indicates a somewhat different evaluation as the topic is not protection of individuals, but the question of tax liability for companies and individuals.

When having to distinguish between an employee and an independent contractor, the content of the contract is very important. The most important factor is, however, the question of how the parties conduct themselves during the day-to-day management.

The main indicator when deciding whether or not a contractual relationship is considered as employment or not, is the question of whether or not the contractor is responsible for the results of his work or only for using his expertise and doing his best for a period of hours or days.
# POLAND

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In Poland, the legal basis for performing work may be based on a relationship governed by civil law or by administrative law, or the employment relationship. The most common form of performing work is either performing it within the employment relationship based on contracts regulated by the Labour Code, or within the framework of civil law contracts ('contract of mandate', contract for a 'specific task') regulated by the Civil Code.

a. Factors that determine who is an employee and who is an independent contractor

Performing work on the basis of the contract of employment

Definitely the most common contract regulating the performance of work is the contract of employment. Polish law provides for several types of such contracts. The Labour Code lists the following contracts: for a trial period, for a fixed period (including for replacement), for the time of completion of a specified task, and for an indefinite period. Only an individual person having the capacity to conclude the contract of employment may be an employee. The employer, on the other hand, may be a legal person as well as a natural person, and also an organizational unit without the status of a legal person, if they employ workers. Therefore, one does not have to run a business to be an employer.

The Polish Labour Code lists the obligatory elements of every employment relationship. This listing can serve as a basis for the construction of a legal, positive definition of the employment relationship concept. The employment relationship arises when an employee undertakes to perform work of a specified type for the employer, under the employer’s supervision and in the place and time indicated by the employer, and the employer commits itself to employing the worker for remuneration. It is, therefore, a mutually binding relationship, in which the two parties to the contract, both the employee and the employer, are at the same time bound and entitled to specific considerations. However, the fact that the contract of employment is mutually binding does not at all result in the considerations of the parties being always mutual and fully equivalent.

According to the rulings of the Supreme Court, the constitutive elements of each employment relationship, which always have to occur jointly, are: voluntary character of performing the work, personal performance of the work in a continuous manner, the employee’s subordination to the employer, performing work for the employer, and the paid character of employment.

The voluntary character of performing work by an employee assumes in the first place that forced labour is inadmissible. The Constitution of the Republic of Poland specifies that the obligation to work may be imposed only by law (art. 65 par. 2 of the Constitution of the RP). At the same time, the voluntary character of performing work manifests itself in the fact that an employee is not obliged to perform work of another type other than that resulting from the content of the concluded contract of employment. Thus, the employer cannot order an employee to do work of a type different than the type specified in the contract, unless there is a clear statutory base. Otherwise, this could be considered as forced labour. An employee’s consent to perform a different type of work alone is not sufficient, either. If the parties intend to permanently change the type of work performed by the employee, they have to change the terms of the contract either by terminating these terms, or by mutual agreement.

The employer may demand personal performance of work from an employee. Therefore, it is not admissible for an employee to relieve himself from his obligation to perform work by appointing a replacement or a subcontractor. Even in the case of a passing obstacle in personal performance of work (e.g. the employee’s illness), the employee cannot authorize a third person to perform the work in his place.
The employment relationship is a continuous relationship, which should be understood functionally, as being performed in a repeated manner. The employment relationship cannot be restricted to a one-time action or a one-time completion of a certain work. The continuity of the employment relationship does not mean that it has to be performed every day. It is important for the work to be performed in a repeated manner, so it is acceptable that work is performed either on an everyday basis or in specified intervals of time.

Another, crucial and characteristic element of the employment relationship is the employee's subordination. It is the employer who manages the work of his employee, and it is he who decides about the way it is to be performed. An employee cannot decide about the way the work is to be performed himself, even if he were a specialist in a given field, and even if it could result in a positive outcome for the employer. The employer may give the employee binding orders relating to work which, unless illegal, have to be respected by the employee. In the body of the Supreme Court's rulings, failure to carry out the employer's orders at work without a legally justified reason is considered to be a gross violation of the employee's basic duties, and such behaviour by an employee justifies the termination of the employee's contract of employment without notice (so called disciplinary dismissal).

Performing work for the employer means that, as a rule, the effects of an employee's work and the profits thereof should belong to the employer. This does not mean that the effects of the employee's work can be used or consumed only by the employer. The employer has the effects of the work of his employees at his disposal. The effects of an employee's work, as long as their properties allow it, can be the subject of a sale contract between the employer and a third party (e.g. a work produced by the employee, a work made as part of the employment), and they can even be abandoned, destroyed, or altered. At a rule, however, a situation where the effects of an employee's work go exclusively, or in the first place, to a third party that is not the employee's employer, is inadmissible. An exception is temporary employment, under which an employee who is temporarily employed by an agency performs work for and under the supervision of a third entity which is not his direct employer (the so called user employer). The construction of temporary employment resembles the lease institution in property law, and being an exception from the principle of work for the employer, it is regulated in whole outside the Labour Code in the Temporary Employment Law.

Work based on an employment relationship can be performed only for remuneration. An employer's obligation to perform work "at the risk" of the employer is invalid. Furthermore, an employee cannot effectively relinquish his right to remuneration. However, it is admissible to perform work at no charge outside the employment relationship, e.g. as a voluntary service, gratuitous training, or under a civil contract.

Work performed within an employment relationship is characterized by the fact that it is performed "at the risk" of the employer. In an employment relationship, the employer's risk appears in three forms. The first is personal risk – it is the employer who bears the consequences for non-culpable mistakes made by an employee in the process of work. In other words, an employee is not responsible if, despite his efforts and good intentions, he fails to achieve the effects of his work expected by the employer, or even those he himself expected. The employer's second type of risk is the economic risk – the employer is responsible for the economic results of the business he runs. Thus, even if the financial balance is negative, the total loss of the workplace bears on the employer and not the employees, even if the loss is caused by failure to reach the assumed effects by the employees. The employer's third type of risk is the technical risk – the employer is obliged to meet his obligation to an employee even during disturbances in the functioning of the workplace. A situation where an employee does not work because, for example, the workplace does not have orders for a specific product, the production line has broken down etc. does not free the employer from the obligation to pay the remuneration for the time of such stoppage.

The above means that a contract of employment is a best-efforts contract rather than a contract to achieve a specific result. The parties to a contract of employment cannot specify in a binding way the expected results of the work and to make the employee's right to receive remuneration dependent on these results. It results from the nature of the employment relationship that an employee is to perform employee actions in a manner adequate to the type of work and possessed skills, and as effectively as possible.

Work based on a civil law contract

The actual actions defined as "work" by one entity for another entity are not always performed and do not always need to be performed on the basis of a contract of employment. The rising trend to use civil law contracts in place of the contracts provided for in the Labour Code is caused mainly by the obligations which the employer has to meet when concluding a civil law contract and, to be more specific, the obligations which the employer does not have to meet in a civil relationship. The Labour Code is employee-centred, which means that the labour law regulations, and definitely the legal scholars and case-law, are centred on the so called protective function of labour law. According to the currently prevalent trend, labour law should protect the employee, as the weaker party of the employment relationship, from the stronger party. As can be observed in practice, contracts of employment are less common in the market and more often replaced by civil law contracts at a rate directly proportional to the process of increasing employee protection. From the employer's point of view, these latter contracts ensure better flexibility of labour (among other things, regulations regarding working time do not apply to such contracts), offer a greater ability to react to changes in the workplace, as they arise by allowing easier termination of the legal relationship between the parties, and above all, they lead to reduced labour costs, which seems to be the strongest argument in today's economic relations.

The Polish Civil Code provides for several contracts by which one of the parties commits itself to performing certain actions for the other party. These contracts are 'contract of mandate', 'contract for a specific task' and 'contract of agency'.

The contract of mandate is the most frequently occurring civil-law basis of providing services (including work). As specified in legal regulations, by entering into a contract of mandate, the party receiving the mandate (the 'mandator' or simply the employer) commits itself to performing a specified legal action for the person granting the mandate (the 'mandatory') - art. 734 of the Civil Code. Although a strict interpretation of the quoted regulation does not seem to include the performance of factual mandatory actions (e.g. work), the opinion that factual actions can also be performed on the basis of the contract of mandate is justified by the reference that the regulations regarding the contract of mandate should be applied to all contracts for providing services not regulated in the Civil Code.

Both natural persons and legal persons may be parties to a contract of mandate. The contract of mandate cannot be concluded by an organizational unit which does not have the status of legal person, because a party needs to have full capacity to legal transactions to conclude the said contract. Also a minor, who does not have at least a partial capacity to legal transactions, as well as a fully incapacitated person, cannot enter into a contract of mandate.

The Civil Code introduces the presumption that a contract of mandate is entered into for remuneration. Thus, if the parties agree that the party receiving the mandate will perform a certain legal or factual action for no remuneration, then the mandate will...
be free of charge. If there is no clear indication by the parties that remuneration will not be due for the accomplishment of the mandate, the person receiving the mandate is entitled to receive remuneration corresponding to the performed work, unless the parties specified the amount of the remuneration in the contract.

The mandate relationship lacks subordination, which is characteristic of labour law, and the contractor does not remain at the disposal of the employer. However, the employer may give the contractor instructions regarding the way of performing the mandate. Even then, the contractor may withdraw from carrying out such instructions if a situation occurs where obtaining approval from the mandator is not possible and there are reasons to believe that the mandator would approve the change if he or she knew the actual state of affairs. Therefore, the contractor has much more freedom during the performance of the work based on the contract of mandate because, as indicated above, an employee performing work on the basis of the contract of employment may never withdraw from the way of performing the work as indicated by the employer, unless such way violates the law.

As a rule, the contractor should perform the mandate in person. However, this is not an unconditional regulation, as withdrawal from personal performance is allowed either on the basis of the concluded contract, if the parties provided for such possibility, or if such possibility is allowed by custom, or if the contractor is forced to do so by the circumstances. In the latter case, the contractor will be responsible for damages, if such damages are caused by entrusting the performance of the work to a third person (subcontractor).

The contract of mandate, like a contract of employment, is a best-efforts contract. The mandatory is not required to achieve specific results. He is only to perform the agreed actions in a manner adequate to the type of work and possessed skills, and as effectively as possible. The fact that the contract of mandate is a best-efforts contract distinguishes it from another civil law contract, the contract for a specific task.

As the Labour Code regulations do not apply to contracts of mandate, persons carrying out a mandate have only such rights as result directly from the content of the concluded contract.

The contract of mandate provides the parties with an option to freely specify the place and time of performing the work. The place where work is to be performed can be either a workplace or any other place specified by premises or by area, not excluding the contractor’s home. Also the working time is freely specified by the parties, because the parties are not restricted by working time limits, or daily or weekly periods of uninterrupted rest.

By entering into the contract for a specific task the person taking the order undertakes to perform a specific task, and the person placing the order, to pay remuneration (art. 627 of Civil Code). It follows from the above that the contract for a specific task is, like the contract of employment and the contract of mandate, a bilaterally binding agreement. It is also a contract for remuneration. The feature which very clearly distinguishes the contract for a specific task from the contract of employment and the contract of mandate is its character – because it is a contract for a result. The parties to the contract define within it a specific, individual result, which can have both a corporeal (e.g. preparing an opinion, a list) or incorporeal (e.g. giving a lecture) character.

The contract for a specific task does not assume personal performance by the person taking the order. If, however, the performance of the work depends on specific, individualized attributes of the contractor (e.g. preparation of a legal opinion by an indicated individual lawyer), then the obligation to perform personally must be assumed. Such situations should be settled by the content of the contract.

As regards the contractor’s rights, the definition of the place of work, the working time etc., the comments referring to the contract of mandate remain applicable to the contract for a specific task as well. That is so, because the parties to the contract for a specific task may freely agree on all issues not prohibited by law, in agreement with the principle of the autonomy of the parties.

b. Differences in tax treatment

Conclusion of a contract under which an employee will perform work, both a contract of employment and a civil law contract, gives rise to obligations of a public nature. These obligations are: payment of the personal income tax advance to the tax office and payment of contributions to the Social Insurance Institution (ZUS). The amount and type of deductions from the employee’s remuneration depends on the type of the concluded contract.

**Contract of employment – social insurance contributions and funds, income tax advance**

When concluding a contract of employment, the parties are obliged to bear the public burdens. The first such burden is the personal income tax advance paid to the tax office. The way of calculating the amount of the tax advance is regulated by the income tax law. The amount of the tax is calculated by the employer and the employer is obliged to pay the said tax to the tax office. The amount of the tax advance depends on the amount of pay due to the employee. Although the tax is paid by the employer, it is charged to the employee, because the amount is deducted from the remuneration received by the employee.

Another public burden connected with the contract of employment is social insurance contributions. In the employment relationships, the parties are obliged to pay contributions to ZUS in respect of the following insurances: retirement pension, disability pension, sick benefits, and health insurance, as well as the contributions for the Labour Fund and the Guaranteed Employee Benefits Fund.

The insurance contributions are paid by both parties, in different amounts. The employee finances a part of the contributions for the retirement pension, disability pension, sick benefit, and health insurances. The rest of the above contributions are financed by the employer. The employer is also responsible for financing the contributions for accident insurance and employee funds.

**Civil law contracts**

A person entering into the contract of mandate is liable for the following compulsory insurances: retirement pension insurance, disability pension insurance, and health insurance. In addition, a person performing work on the basis of the contract of mandate in the seat of the employer is liable for compulsory accident insurance. The sickness insurance is voluntary.

The compulsory social insurances (retirement and disability) and the health insurance are also compulsory for contractors who have already acquired the right to the retirement or disability pension.

On the other hand, the compulsory social insurance and the health insurance do not apply to students up to 26 years old performing a contract of mandate.

Contrary to the contract of mandate, the contract for a specific task is not an independent title to insurance. The social insurance and health insurance contributions have to be paid
only if the parties to the contract for a specific task are also parties to an employment relationship. Therefore, if the only relation between the parties is the contract to perform a specific work, the employee does not need to be covered by any insurance. The employer is obliged to pay income tax on each civil law contract. Depending on the amount of the remuneration received by the person performing work under a civil law contract, the employer pays either the income tax advance or a flat rate tax. These questions are regulated by income tax law.

c. Differences in benefit entitlement

All employee benefits are regulated by labour law. These regulations are not only the regulations of the Labour Code, but also of other laws. Additional entitlements may also be granted to employees by internal sources of labour law, such as work and pay regulations, the collective agreement, and also by individual contracts of employment.

As a rule, only employees performing work on the basis of the contract of employment have the right to the above mentioned employee entitlements. The regulations under discussion apply to such employees ex lege.

Persons performing work under a civil law contract have no rights to any employee entitlements based on labour law. This is connected with the fact that they are covered neither by Labour Code regulations nor by other sources of labour law. The above means that regulations concerning such issues as the minimum wage, working time standards, the admissible number of overtime hours and work on Sundays and public holidays, annual leave, or maternity leave do not apply to employees performing work on the basis of the contract of mandate or the contract for a specific task.

This does not mean that the parties to a civil law relationship cannot decide about the application of these regulations to independent contractors. Such practice is fully admissible. The parties to the contract have the possibility to terminate the contract by mutual agreement, which is the case, for example, when the parties agree on the admissibility of the employer's earlier termination by either party with two weeks' notice. When concluding a contract for a fixed period of time shorter than six months as well as a contract for a period longer than six months but not more than 4 years to his or her retirement age, if the employee's seniority allows him to acquire the right to retirement pension by reaching this age. Also, the employer cannot terminate by notice or without notice an employment contract with a pregnant woman or during her maternity leave, unless there are reasons for disciplinary dismissal.

The requirements for the existence of a justified reason for the termination of the employment contract and for a statement of that reason in the text of the notice by employer, applies only to contracts for an indefinite period. Therefore, legal termination of contracts of employment for a fixed period does not depend on the existence of any reason. Nonetheless, on the grounds of the Polish Labour Code, not every fixed-period contract can be effectively terminated.

The notice period for the contract has been made and it ranges from three working days to two weeks. The replacement contract may be terminated with a notice of three days.

When concluding a contract for a fixed period of time longer than six months, the parties can agree on the admissibility of its earlier termination by either party with two weeks' notice. We could conclude from the above, that a contract concluded for a fixed period of time shorter than six months as well as a contract for a period longer than six months but without the termination clause, cannot be terminated by a party. Such opinion is justified and the doctrine of labour law finds arguments for this opinion. Nevertheless, according should specify a justification of his decision of termination is when the cause of the termination is mobbing and the employee demands compensation.

The Polish Labour Code distinguishes the common and special protection against termination of the contract of employment by employer.

The common protection covers only contracts of employment concluded for an indefinite period. For the employer to be able to legally dismiss a person employed on the basis of such contract there must be a specific, justified reason for dismissal. In addition, the reason must be firstly an objective reason, because subjective feelings of the employer towards an employee do not justify a dismissal, and secondly, the reason for dismissal must actually exist and the burden of proof of its existence rests upon the employer. The Labour Code does not contain a catalogue of events which would justify an employee's dismissal by notice. As the Code uses a blanket clause, directions should be looked for in case-law. And so, according to the rulings of the Supreme Court, in a specific situation, the reason justifying termination by an employer of a contract of employment concluded for an indefinite period can be inter alia: inability to work in a team, repeated and long-lasting absences caused by sickness, lack of the employee's cooperation with the employer, professional uselessness or incapability, minor violation of employee duties which do not justify a disciplinary dismissal, alcohol consumption at work or appearance at work in a state of intoxication, behaviour against the principles of community life, the employee's irascibility, or theft of the employer's property. Clearly, the catalogue of reasons is not a closed catalogue. Whether a given reason is justified or not can be decided only in a specific, individualized actual situation.

The special protection against termination of the contract of employment applies to employees who, due to special circumstances, are entitled to a temporary limitation of the possibility to terminate their contract. And so, according to the Labour Code, the employer cannot terminate the contract of employment with an employee who lacks not more than 4 years to his or her retirement age, if the employee's seniority allows him to acquire the right to retirement pension by reaching this age. Also, the employer cannot terminate by notice or without notice an employment contract with a pregnant woman or during her maternity leave, unless there are reasons for disciplinary dismissal. The employer is not free to terminate the contract with a person who is a member of or has a specific function in a trade union, both at the company or above-company level. Labour law regulations require either consultation with the relevant labour union before terminating the contract of employment in the former case, or the union's consent to the termination in the latter.

The requirements for the existence of a justified reason for the termination of the employment contract and for a statement of that reason in the text of the notice by employer, applies only to contracts for an indefinite period. Therefore, legal termination of contracts of employment for a fixed period does not depend on the existence of any reason. Nonetheless, on the grounds of the Polish Labour Code, not every fixed-period contract can be effectively terminated.

The notice period for the contract for a trial period depends on the period for which the contract has been made and it ranges from three working days to two weeks. The replacement contract may be terminated with a notice of three days.

When concluding a contract for a fixed period of time longer than six months, the parties can agree on the admissibility of its earlier termination by either party with two weeks' notice. We could conclude from the above, that a contract concluded for a fixed period of time shorter than six months as well as a contract for a period longer than six months but without the termination clause, cannot be terminated by a party. Such opinion is justified and the doctrine of labour law finds arguments for this opinion. Nevertheless, according
to the present line of Supreme Court decisions, even such contracts can be effectively terminated. However, in a situation where a reason justifying a disciplinary dismissal did not exist, the employee would be owed damages.

A contract for the time of performing specific work, due to the fact that it is a contract of result and that the Labour Code does not regulate the question of possible periods of its termination, seems to be a non-terminable contract. However, bearing in mind the above presented opinion of the Supreme Court on the ability to terminate a fixed-period contract, we may conclude that in the case of contracts for the period of performing specific work, the Supreme Court will use the same arguments for the admissibility of its earlier termination. Therefore, as in the case of a fixed-period contract, if the employer terminates a contract concluded for the time of performing specific work in a situation where there is no reason for disciplinary dismissal, the employee will be entitled to claim damages in court.

**Termination of a civil contract**

Due to the already discussed fact that the regulations of the Labour Code do not apply to civil law contracts (mandate and specific task), their termination is regulated in the Civil Code. From the point of view of the person performing the work, these regulations are unquestionably less favourable, as they neither offer protection against unjustified dismissal in such extent as labour law regulations do, nor do they provide notice periods. Therefore, a contract of mandate or a contract for a specific task can be terminated overnight if the contract does not provide for otherwise.

According to the regulations of the Civil Code, the employer may withdraw from the contract at any time before the completion of the work, but then he is obliged to pay the agreed remuneration after deducting the amount which the contractor saved due to the non-completion of the work.

A similar situation applies to the contract of mandate, - the employer (‘mandator’) may withdraw from it at any time, but he should return the expenses incurred by the contractor (‘mandatary’) to properly perform the obligation. In addition, if the mandate was paid, the mandator is obliged to pay a part of the remuneration corresponding to the mandatary’s actions so far. If the termination was without an important reason, the mandatary is obliged to return any incurred damage. The restitution for damage in the case of termination without important cause resembles the construction of employer’s liability for unjustified termination of the contract of employment. However, in the case of termination of the contract of mandate, the employer’s liability will be civil liability. The amount of compensation will not therefore be limited as is the case with contracts of employment, but the contractor will not have a claim for the completion of the mandate or the work in imitation of the claim for reinstatement in employment provided in labour law.

Of course, in the civil contract, in compliance with the principle of freedom of contract, the parties may both include the reasons for termination and introduce the notice period. These will not be, however, labour regulations, but civil regulations, and hence the claims can be sought for only under the Civil code.

e. Local limitations on use of independent contractors

Polish law does not restrict the use of civil contracts. The parties are completely free to choose the basis for employment. Furthermore, there are no general rules concerning specific types of work or positions on which employees may be employed exclusively on the basis of the contract of employment or exclusively on the basis of a civil contract.

It should be remembered that the substitution of a contract of employment by a civil law contract while maintaining the terms of employment as specified in the Labour Code is inadmissible. Therefore, if an employee undertakes to perform work of a specific type (1) for the benefit of an employer, (2) under the employer's supervision, (3) and in a place and time fixed by the employer, (4) the work will be performed on the basis of the contract of employment, even though the parties label it a contract of mandate or a contract for a specific task. The establishment of the employment relationship is automatic if all the conditions defined by the Code are fulfilled. This is understandable, as contracts of employment are socially more readily acceptable than civil law contracts, which is the reason why the legislator introduced the described mechanism.

Additionally, the Penal Code contains penal regulations according to which an employer employing an employee on the basis of a civil law contract in a situation in which according to the Labour Code the employer should conclude a contract of employment with the employee commits an offence and thereby is liable to a fine of PLN 1,000 to 30,000 (EUR 250 to 7,500).

f. Leased or seconded employees

In today’s social relations, a certain level of flexibility in the employment relationship is desirable. This is understandable, since it is mainly the employer who bears the burden of comprehensive care for the prosperity of the workplace, and who carries the economic risk carried by running a business and employing people therein. If an employer is to quickly react to the demand of the market and the workplace, he must have at his disposal a mechanism of “shifting” free labour forces to places where, in the given moment, the demand for labour is the greatest.

A constitutive element of every contract of employment includes the parties defining in the employment relationship, the type of work performed, the place of work, the amount of the remuneration, and the working time (full- or part-time). As mentioned above, the requirement to specify the type of work to be performed by the employee in the contract is the consequence of the constitutional prohibition of forced labour. An employee has to agree to the type of work performed, and the employer cannot unilaterally order an employee to perform work other than what was agreed upon. Besides protection against forced labour, the definition of the type of work in the contract of labour is an element organizing the employment relationship, and the definition of the type of work offers the employer the ability to indicate duties which are connected with the given position and which the employee is obliged to carry out.

To reconcile the employees’ right to confidence in the type of work performed with the employer’s right to flexibly use the employees’ potential, not to allow a situation where employees are forced to perform labour which has not been agreed on (forced labour), and at the same time influence employment flexibility, the Polish legislator included into the Labour Code the construction of secondment (temporary transfer) of an employee to other work/other place of performing work.

**Secondment (temporary transfer) of an employee to other work/other place of performing work**

Change of the type of work performed by an employee is, as a rule, possible by a notice altering the terms of work. However, regulations about termination of contracts apply to a termination of the contract terms and therefore, in the case of contracts concluded for an indefinite period, the employer may terminate the terms of such contract only when there are justifiable reasons to do so. A corresponding application of the regulations about the final termination of contracts of employment to the altering termination, leads to a conclusion that the termination by the employer of the terms of contracts (and
therefore of the type of work performed) with a pregnant employee, an employee during maternity leave, and an employee during the pre-retirement protection period, as well as an employee who is a member of a union or who has a specified union function, is not admissible without consultation with that union.

The Polish Labour Code provides for one exception to the above rule. The employer has the right to unilaterally transfer an employee to other work if all conditions provided in the Code have been fulfilled. The employer has the right to temporarily transfer an employee to other work without the need to terminate the terms of work of such employee in the following situations: the existence of a reasonable need of the employer (1) and in addition, the other work has to correspond with the employee’s qualifications, (2) the period of secondment cannot exceed three months in a given calendar year, (3) and the secondment to other work cannot cause a reduction in remuneration (4).

When all of the above conditions have been fulfilled, secondment of an employee to another type of work is allowed. The secondment we are talking about can refer not only to the type of work, but the place in which it is performed, as well. For the employer, the advantage of a secondment under the said Labour Code regulation is that the employer does not have to bear additional costs, e.g. travelling expenses, which in lack of secondment would be associated with the necessary business trip to another place of work.

**Temporary employees**

A form of employment relationship which makes this relationship more flexible is the institution of temporary work. The Temporary Employees Employment Law of July 9, 2003, implementing Council Directive 91/383/EEC of June 25, 1991, introduced the notion of temporary employment to the Polish legal order. Since then, this peculiar form of employment has become a stable element of the Polish labour market. The reasons for the popularity of temporary employment are complex. It seems that the party who benefits the most from this form of employment is the employer, though certain advantages for temporary employees can be seen, as well. This applies particularly to novice employees on the labour market and employees who have other duties in addition to work. It seems plausible to theorize that the greater the inflexibility of typical employment (based on the Labour Code), the more popular temporary work will become.

Temporary employment is characterized by the fact that the user employer for whom and under whose supervision the temporary employee performs work, does not remain in a legal relationship with the latter.

A temporary employee is employed by a temporary work agency for a fixed period of time or for the time of performing a specific work. Between the agency and the temporary employee there is a classic employment relationship regulated by the Labour Code. The user employer is not an employer within the meaning of the Labour Code for the temporary employees. On the basis of an agreement with the agency, the temporary employee is sent to work at the user employer’s workplace, the user employer being a third person for the temporary employee.

Due to the fact that an employment relationship occurs between the temporary work agency and the temporary employee, duties resulting from this relationship rest with the agency and the employee, and not with the user employer. That is why the user employer does not pay remuneration to the temporary employee. The user employer’s duties towards the temporary employee are limited exclusively to those provided for by law (e.g. assurance of safe and healthy working conditions, assurance of the use of the annual leave by the temporary employee) or those agreed upon with the temporary work agency which has “rented out” its employee.

The above means also that the user employer cannot terminate the employee’s contract of employment. This can be done only by the temporary work agency. If the user employer desires to end the employment of a temporary employee, it will be necessary to terminate the legal relationship between the employer and the agency.

An employer who intends to “rent” an employee from a temporary agency agrees with this agency in writing on the type of work to be entrusted to the temporary employee, the qualifications required to perform the work with which the temporary employee is to be entrusted, the expected period of performing the temporary work, the working time of the temporary employee, and the place of performing the temporary work. Additionally, the user employer informs the temporary work agency in writing about the remuneration for work which is to be entrusted to a temporary employee, specified in wage regulations in force at the user employer’s workplace, and about the conditions of performing temporary work regarding health and safety at work.

The user employer’s duties towards a temporary employee are generally limited to obeying industrial safety regulations, keeping of the employee’s working time records, granting the annual leave due to the employee, and non-discrimination in employment. These duties may be extended in the contract with the temporary work agency. Such provisions, however, will be civil obligations and not labour obligations and, in addition, the person entitled to claim damages in court will not be the temporary employee but the temporary work agency.

From the relation linking the temporary work agency with the user employer, arises the agency’s liability for damage done to the user employer by the temporary employee. The agency’s liability is based on the Civil Code.

A temporary work agency bears liability for damages in case the user employer infringes on the rule of equal treatment in employment with regard to the temporary employee. This is understandable, because there is no employment relationship, which could be a basis for liability, between the temporary employee and the user employer. The temporary agency is entitled to a recourse claim towards the employer “renting” an employee in respect of paid compensation.

**II. Business Presence Issues**

**a. How the use of one or more independent contractors creates a permanent establishment in country and the ramifications**

Conclusion of a civil law contract by a company having its seat outside the territory of Poland, with a Polish national, for performing work in the territory of Poland, does not give rise to tax or insurance obligations of that employer towards the appropriate Polish offices. Such contracts, as a rule, are governed by the national law of the employer. Tax obligations (income tax), if any, may concern the employee performing work in Poland for a foreign entity.

**b. How the employment of one or more individuals creates a permanent establishment in country and the ramifications**

Employment of a Polish national on the basis of the employment contract in the territory of Poland, by an employer who has neither its seat nor a branch in Poland can, contrary to civil law contracts, give rise to certain obligations.

If the employer is an undertaking from an EU country, such employer must register itself as a payer of the Polish insurance contributions with ZUS and pay social insurance
contributions for the employed employee. This duty arose with Polish accession to the European Union, i.e. on 1 May 2004. Due to the fact that the abovementioned duties could discourage an employer from the EU (the language barrier, international transfers), it is possible to shift them to the employee employed by the foreign undertaking. This requires an agreement between the EU employer and the employee who is to perform work in Poland. Under such agreement, the duties of the payer (filling of the forms and payment of the contributions) will be shifted to the employee.

If the employer is an undertaking from outside the European Union and it has neither a seat nor a branch in Poland, the duty to pay social insurance contributions does not arise. The employee will be free to decide whether he will pay such contributions or not.

III. Re-Characterization of Independent Contractors as Employees

a. Laws and Guiding Principles

Replacement of the contract of employment by any civil law contract while maintaining the terms and conditions of labour employment is not admissible under the regulations of the Polish Labour Code. Conclusion of a contract by which one of the parties undertakes to perform work of a specified type for the other party, under its direction and in the indicated place and time, and the other party commits itself to pay remuneration for work causes ex lege the emergence of the employment relationship between the contracting parties, irrespective of the name of the contract concluded by the parties. The main intention of this regulation is to prevent the pathology consisting in labour law evasion in relations between employers and employees.

b. The Legal Consequences of a Re-Characterization

The consequence of the conclusion of a civil law contract while keeping the terms and conditions of labour employment is that the employee may submit claims for ascertainment of the existence of an employment relationship. An employee with whom a civil law contract has been concluded on the terms of the contract of employment may submit the case to the labour court and demand the ascertainment of the relationship. Such a claim may also be filed by a non-governmental organization within its statutory activities, if the employee agrees. Also a labour inspector may institute an action against the employer if a civil law contract is found to have been concluded on the terms of a contract of employment. In the judicial proceedings, both the NGO and the labour inspector are a party in the formal (for the purpose of court proceedings) sense, as there is no legal relationship between them and the sued employer.

c. Judicial Remedies Available to Persons Seeking ‘Employee’ Status

Despite the code prohibition on conclusion of civil law contracts on the terms of the contract of employment, this regulation is very often bent nowadays. That is because civil law contracts are more favourable to employers, as they are free from most obligations which would be a burden to them under the regulations of the Labour Code. The action for the ascertainment of the existence of the employment relationship is meant as a remedy for this practice and protection of employees’ interests.

A demand for the ascertainment of the existence of the employment relationship can be made if there is suspicion that a given person was not employed on the basis of a civil law contract, but a contract of employment. The action may be brought to the labour court by any person who has a legal interest in the case.

The petitioner can be either an employee who claims to have been a party to an employment relationship, or a Labour Inspector. In the latter case, there are two options. The Inspector can demand the ascertainment of the existence of the employment relationship on his own initiative, which does not require approval of the person for whom the Inspector acts, but he may also join any pending proceedings, to which however, the person who has brought the case to court has to consent. Other persons may also demand the ascertainment of the existence of the employment relationship, even though this relation does not concern them directly, if they can prove their legal interest. For example, such persons can be relatives of a deceased employee who, in their opinion, was employed on the basis of a contract of employment.

When deciding whether a given relationship had the character of an employment relationship, the labour court takes into consideration the will of the parties to the concluded contract and the features of the relationship between the parties. In most cases, the features typical for civil law contracts and contracts of employment overlap, so the court has to establish which of those features prevail. It is not possible to unambiguously outline the practice in a case of ascertainment of the existence of the employment relationship, as everything depends on the specific facts of the case. The court indicates the prevalence of specific features of the contract and can either allow the claim and pronounce the existence of the employment relationship, or dismiss the claim.

d. Legal or administrative penalties or damages for the employers in the event of re-characterization

The possibility that the court may ascertain the existence of the employment relationship is not the only consequence of concluding a civil law contract on the terms of the contract of employment. The Labour Code contains penal regulations according to which an employer employing an employee on the basis of a civil law contract in conditions where, in compliance with the Labour Code, this employer should conclude the contract of employment with this employee, commits an offence and is subject to a fine of PLN 1,000 (ca EUR 250) to PLN 30,000 (ca EUR 7,500).

IV. How to Structure an Independent Contractor Relationship

a. How to Properly Document the Relationship

Performance of work on the basis of a civil law contract is not governed by labour law regulations, which has already been mentioned many times. That is why regulations describing the way of documenting the employment relationship do not apply to civil law contracts.

In the first place, it is not necessary to open and keep the employee's personal file in a civil relationship. Such files are a peculiar set of documents appearing only in the employment relationship, and collecting data regarding an employee outside this relationship is inadmissible in view of the Personal Data Protection Law.

In a civil relationship, it is also not necessary to record the employee’s working time, since neither daily nor weekly working time limits apply to such an employee. An employee employed on the basis of the contract of mandate or a contract for a specific task enjoys a relatively large flexibility of performing work, at least from the theoretical point of view. Of course, there is nothing to prevent the parties from specifically indicating in the contract what working time limits will apply to the employee. The employer also has the full right to document the working time of employees performing work on the basis of civil law contracts, if only for accounting purposes. However, this will only apply to the employer’s internal documentation and only for the employer’s use.
During the whole period of the civil relationship on the basis of which the employee performs work, and until claims that could arise from this relationship fall under the statute of limitation, the employer should keep the original document or a certified copy of the concluded contract for evidence purposes. Although evidence from hearing witnesses or the parties is admissible in proceedings before a civil court, a document, as long as its credibility is not questioned, has a definitely stronger legal validity than testimony. Besides, especially if the parties fixed numerous detailed provisions of the contract, differing from regulations that are standard in the given relationship, proving such provisions before the court can be extremely difficult without a written contract.

V. Trends and Specific Cases

The growing importance of civil law contracts as well as increasingly more common use, at least at the statistical level, of temporary employment, signifies a tendency among employers to “free” themselves from the employment relationship in favour of more employer-friendly relationships. Rules governing the labour market are relentless and in every situation the general mechanism of performing work will tilt towards economically more favourable solutions. The legislator, for the time being, is turning the scale towards solutions that are more favourable socially, which understandably mean solutions less economically favourable for the labour market. Although the social character of labour law is economically favourable for employees, it is certainly not the case for employers. And, since employers employ employees and not the other way round, they are not willing to accept more public duties towards the employees. As a consequence of that, employees employed on the basis of contracts of employment are pressed out of the labour market by persons performing work on the basis of civil law contracts. This closes the vicious circle into which the legislator seems to fall sometimes, when by introducing into the Labour Code regulations intended to protect employees, the legislator leads de facto to a situation where employees are losing jobs. The less flexible the model of an employment relationship, the less frequently it will be used by potential employers.

VI. Conclusion

In the days of economic crisis, stiffening the employment relationship should not take place. On the contrary, introduction of regulations making this relationship flexible is justified both socially and economically.

Until that happens, the tendency to supplant contracts of employment by civil law contracts, which are more favourable for employers, will become the norm and understandably so. One cannot disregard the fact that when it comes to choosing the basis for employment, the decision-making entity is mainly employers. An employee wanting to take up employment, especially at the outset of his career, has very limited potential for negotiation or does not have it at all.
I. Legal Framework Differentiating Employees From Independent Contractors
II. Business Presence Issues
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VI. Conclusion
I. Legal Framework Differentiating Employees From Independent Contractors

a. Factors that determine who is an employee and who is an independent contractor

Legal definition of dependent activities – “those carried out by individuals in a relationship of employment”, and independent activities – “those carried out regularly by an individual, other than dependent activities” - is provided for in the Romanian legislation by tax law regulations - the Romanian Tax Code outlining the differentiation between these two categories of activities. As a result of being regulated as distinct activities by tax law they have different legal regimes and they are submitted to different tax regimes.

Dependent activities, meaning those arising from an employment relationship, are subject to special regulations of employment law, while independent activities carried out by individual contractors are - as a rule - subject to the general provisions of civil law. In order to perform dependent activities an individual employment contract between employer and employee must be concluded according to the Romanian Labour Code, while independent activities are provided on the basis of civil contracts concluded in the general conditions stipulated by the Romanian Civil Code.

Individual employment contracts are extensively regulated by the Romanian Labour Code, which provides a framework of strict rules on the conclusion, enforcement, amendment, suspension and termination of such contracts, while independent activities can be provided by individual contractors under a variety of civil contracts, some of which enjoy a special regulation in the Romanian Civil Code - such as the mandate contract, others just observing common rules stated in the Romanian Civil Code. Romanian legislation does not regulate a special contract under which the independent activities are carried out. However, indirect legal provisions and common language, use the general term of “service providing contracts” when referring to the legal basis on which independent activities are provided by individuals.

Employment status is acquired by individuals only by entering into an individual employment contract that must be concluded in writing in order to be valid. The individual employment contract must be registered in the records of regional institutions that monitor and control the correct application of employment law, prior to the beginning of the dependent activity. The existence of an individual employment contract validly concluded is what distinguishes the legal status of employees to the legal status of independent contractors.

Both individual employment contract and civil contracts, under which independent activities are provided by individuals, are subject to the general principle of mutual consent involving an agreement between the two contracting parties – the individual providing the activity, both dependent and independent, and the beneficiary. However, for the employment contract there are minimal legal limitations under which the parties cannot negotiate certain terms, such as the guaranteed minimum wage or the minimum number of days of annual leave enjoyed by employees, while in civil contracts there can be negotiated clauses without restrictions other than those imposed by general civil legislation on prohibited clauses in any type of civil contract - such as the prohibition for the inclusion of clauses that are a fraud under the law, or immoral clauses. Of these general restrictions arises a discussion of the simulation of an employment relationship by concluding a civil contract, in order to avoid the legal limitation imposed by employment law. In these cases, the re-characterization of the civil contract as an individual employment contract and the establishment of the existence of a simulation must be made by the court.

In order to limit these attempts to avoid the legal limitation imposed by employment law, individual contractors that provide independent activities are subject to prior
authorization under strict regulations. In case of concluding contracts with unauthorized individuals that provide activities for a beneficiary we can find the premises for unlawfully recruiting individuals for work, a conduct sanctioned as a contravention or exceptionally even as a criminal offence according to national law.

In fact, the only legal definition of the individual contractor generated by transposing Directive 89/391/EEC into national law by Government Decision No. 300/2006, referring to the work performed on permanent or temporary sites, it qualifies them as “any person authorized to carry out a professional activity independently and assume contractual duty to the beneficiary... to achieve... works for which he is authorized”.

A separate category of individuals that provide independent activities for a beneficiary is those of the liberal professionals or freelancers – for example health professionals, lawyers, notaries, experts, mediators, etc. Usually these professions have independent regulations and they are organized according to their own statutes. Given the fact that each liberal profession is exercised under different conditions, for each of them a regime was regulated for the registration, authorization, effective performance of work, membership of professional bodies, their contributions under pension schemes, the possibility to provide the specific activity under the liberal profession status or as an employee (as in the medical staff case). The liberal professionals usually provide their activity on the basis of a collaboration contract regulated by the same statutes.

The employees are conducting their activity in a subordinated relationship with the employer, while the individual contractor is engaged in a civil legal relationship with the beneficiary of the activity, which is characterized by the equality of the parties. Employees carry out their work for the benefit of the employer who assumes the risks of the activity performed for him, while the independent contractor bears the risk of the contract under common law.

Regarding the remuneration of the activity provided, the employee is legally entitled to a proper salary for his work, while the individual contractor can negotiate the pay for such activity that he performed. A special mention must be made of the fact that the work performed under a full-time individual employment contract is entitled to a minimum compensation for the employees established by government decision – i.e. a minimum gross salary per economy guaranteed for payment. A lower remuneration of an employee cannot be settled upon. On the other hand, individual contractors do not receive a guaranteed minimum income, even in the situation in which they are providing an activity comparable to full-time employment. For some independent activities legal provisions establish minimum limits for the remuneration of at least part of the individual contractor’s work.

b. Differences in tax treatment

As noted at the beginning of this analysis, the tax treatment of the two categories of individuals providing dependent or independent activity is regulated differently. Regarding income tax, whether the income is a result of a dependent activity based on an individual employment contract or the income is a result of an independent activity provided by an individual contractor, the Romanian fiscal system establishes a unique 16% income tax regime that differs in the way in which the income tax is withheld and remitted by the two categories of individuals. Thus, for employees the 16% income tax is calculated, withheld and paid to the tax authorities by employers, while independent contractors must declare income subject to income tax, owing advance payment of income tax or final payments of income tax, according to the tax treatment of their choice.

Regarding social contributions for the employment relationship, they are paid jointly by the employee and the employer, the latter having the obligation to calculate, withhold and remit both the employee quota and an additional quota owed by him for the use of employee labor. As for the individual contractors, they are required to pay social security contributions in a direct declarative system. Efforts have been made in order to equalize the quotas owed by the employees and the individual contractors. For the individuals providing activity, social rates of contributions are aligned, with the additional quotas being paid by the employer for the use of employee labor. Given the fact that the employer has to pay additional social contributions for each employee, the cost of work performed is higher for employers than for the beneficiaries of the activities performed by the independent contractors. It is also one of the main reasons why beneficiaries, requiring the work of individuals choose to contract under the civil law rather than establishing an employment relationship.

Regarding persons exercising liberal professions, most of these professions have organized their own pension systems, and professionals are no longer required to contribute to the public pension system. However, a special situation arose with notaries who recently established their own pension system, but still have the existing obligation to contribute to the public pension system. There are also liberal professions for which there is no organized personal pension system; these professionals are contributing to the public pension system.

c. Special protection of employees

Social protection measures are recognized by law for the employees. These measures include employees’ health and safety, working conditions for women and young people, establishing a minimum gross salary per economy, weekends, paid annual leave, work in special conditions, training, and other specific situations. This general recognition of social protection rights has its basis in the constitutional regulations governing each of these issues being alternatively established. Individual contractors do not enjoy legal protection on these rights and will negotiate in accordance with the principle of mutual consent the conditions under which they will provide their activities.

Though both the employment contract and civil contracts under which the individual contractors provide their activities involve a negotiation between the parties, for the individual employment contract, the Romanian Labour Code provides a number of essential clauses to be necessarily included in all the contracts, while the content of civil contracts under which individual contractors perform independent activities is not regulated.

An important aspect for the activities performed by employees is that the working program is regulated and a number of rests and benefits for working overtime are guaranteed. Also, there are strict regulations on work performed during the night and work performed during the holidays. For the individual contractors these rights are not guaranteed, so there are no laws regulating their daily rest, their weekly rest, overtime rewarded with time off or extra pay, just as there are no rules in place for the activity conducted during the night or during holidays. This situation may open the possibility of abuses committed by beneficiaries of the independent activities that may require the contractors to work on short deadlines or require an amount of activity that forces the independent contractor to work continuously for a long period of time. Not benefiting from the legal protection of these minimum rights, individual contractors must negotiate civil contracts in such a manner as to avoid taking an excessive workload for a short period of time, or accepting tasks that imply working extensively by night without proper rest time.

Another legally recognized right for employees is the right to paid leave. The Romanian Labor Code establishes a minimum number of days of annual leave that employees may...
benefit from their work, with the possibility of negotiating a greater number of days of annual leave by individual negotiation, or collective negotiation, at each employer’s discretion, while usually independent contractors are paid only for the time they perform the independent activity. Usually civil contracts are concluded for a determined period of time, or for a specific campaign and have no provisions on periods of time in which the contractors are paid the specified amount of remuneration for that period without any activity being conducted during the specific period – similar to a paid leave. As for the right of sick leave, even if the independent contractors are contributing to the public health system, there are no regulations stating the conditions in which the contractors may not perform the activities they were contracted for by the beneficiary due to health reasons. Independent contractors do not benefit from paid sick leave, but can negotiate clauses with the beneficiary on this matter.

Employees have the right to associate freely to participate in union activity, while independent contractors cannot be members of a trade union while having this status. By joining a trade union or by being designated as employee’s representatives, an employee will be represented or will effectively participate in collective bargaining; they can only negotiate individual benefits thought their civil contracts.

Employees have the recognized right to strike - as limited by law (the right to strike is recognized in specific terms), while a cease of the independent activity provided under a civil contract may constitute a wrongful execution of the contract by the contractor, which can lead to sanctions under the civil law.

Regarding the imputation of amounts for material damages caused by the employee in his activity in relation to professional liability can be imposed by the employer unless the employer obtains a court judgment, or the express consent of the employee on complete coverage of the material damages caused. Individuals performing independent activities can be imputed directly for the material damages they caused, according to the rules of common law or under contractual arrangements. It should also be noted that the amounts of remuneration due to imputation is not limited for the independent contractors, while for employees there are strict rules on the amounts that can be withheld from their wages.

On the other hand, given the socio-economic situation that developed in recent years, the situation that led to extraordinary economic and financial measures applied to employees in the Romanian public services - measures that have included cuts of wages for the employees of public institutions, reducing, ceiling or removing of bonuses and/or financial benefits, such as overtime that was no longer required in public institutions, or, in the absence of express contractual provisions on this matter.

The most significant differences in the two types of contract termination can be observed in the case of termination of the contracts by the initiative of the beneficiary. The beneficiary may initiate termination of the civil contract, in a similar, symmetrical way that the independent contractors providing independent activities can, according to common law, or to the negotiated provisions of the civil contract, with a reasonable notice period as previously mentioned. As for the employer, it may take the initiative of the individual employment termination for his employees only in the cases stated by the Romanian Labor Code. Thus, the employer may dismiss his employees for reasons regarding the employee’s own character, or for reasons not related to the employee’s person in case of motivated dissolution of the work position, in which case the dismissal can be individual or collective. Termination of the individual employment contract by the employer in situations other than those covered by the Romanian Labor Code is not possible.

Another important issue related to the termination of contracts by the initiative of the beneficiary is the handling of disputes that may arise from abusing of the beneficial position. If independent contractors, if they consider that the beneficiary has abusively terminated the civil contract, can only use actions based on common law and such disputes fall under the jurisdiction of judges that handle general civil litigation. As being submitted to common law, most of these disputes are assigned to lower courts, under the criteria of the value of the matter. As for the dismissed employees, the Romanian Labor Code provides a separate section on control and punishment of unlawful dismissals. As a result of these special provisions, the annulment of dismissal disputes fall under the jurisdiction of specialized judges at higher courts. There are also special rules of procedure regarding labor disputes, including overturning the legal burden of proof, so that the employer is the one that must prove the legality and validity of the dismissal, even if the claim comes from the employer. These exceptions are a consequence of the subordination relationship between employer and employee, which generates the need for additional protections to employees that are considered to be at a disadvantage.

Regarding the restoration of the anterior situation as a result of a court ruling finding the unfairness of termination by the employer, the employee is provided with the legal right to be reintegrated and the right to receive damages equal to the wage indexed, actualized and updated and all other rights to which he would have received if he had been a contract employee.
not been dismissed, while for the independent contractors only common law provisions apply in terms of damages.

The labor law provides a number of special cases of rightful termination of the individual employment contract, while civil contracts follow the common law rules for the rightful termination of contracts. Some cases of rightful termination of contracts operate in both individual employment contracts and civil contracts, such as the occurrence of the death of the individual provider of the activity – employee or independent contractor, or the death of the beneficiary – if the beneficiary is an individual, or the completion of the period for which the contract was concluded. On the other hand, there are some special cases of rightful termination of the individual employment contract, cases that do not apply to civil contracts. One such case is the rightful termination of the individual employment contract in the event of a simultaneous fulfillment of standard age and minimum period of contribution conditions in the public pension system. While independent contractors contribute – as a rule – to the public pension system, the civil contracts under which they provide their activities, do not terminate on the simultaneous fulfillment of the two conditions for retirement. Independent contractors are entitled to pension on demand, and the retirement does not have any effect on the existence of the civil contract. For certain categories of professionals – such as lawyers – that contribute to their own pension system, if they retire under their statute provisions, they no longer have the right to fully practice their profession.

II. Business Presence Issues

According to Romanian law, there is no minimum number of employees that are required in order for an employer to have a permanent establishment. Such an establishment is recognized with the first employee, as long as all the other legal provisions are met. Similar rules apply to the use of independent contractors for a specific activity.

Service providing contracts

An alternative for beneficiaries who do not want to enter individual employment contracts or civil contracts directly with independent contractors, is entering into the so-called “service providing contracts” with other entities that will provide personnel to the beneficiary. The personnel provided will not gain the employee status at the beneficiary company and will not be in any contractual agreement directly with the beneficiary. In such case, there is no direct contractual relationship established between the beneficiary of the work performed and individuals that will perform the work. A direct contractual relationship is established between the beneficiary and the entity that provides the personnel. The staff is paid by the entity that provides the personnel, while the beneficiary pays any negotiated amounts for the services provided by the entity. In such cases, the entity that provides personnel can be an employer for the leased employees, or just an intermediary for legally authorized individuals that will perform their activities for the beneficiary the intermediary chooses and in the terms the intermediary negotiates for them.

The work is performed by the personnel on behalf of the beneficiary, but in case the activities are not conducted as stated in the contract or requested by the beneficiary, being the fact that there is no contractual relationship between the beneficiary and the personnel that performs the activities, there is no direct action against the personnel, instead the beneficiary has a direct action against the entity that provides the personnel.

The personnel not being hired by the beneficiary, the latter is not bound by specific legal provisions of labor law, but by the contractual provisions that were negotiated with the entity which provided the personnel and the general provisions of civil law common to all contractual relationships. If the personnel is employed by the entity that contracted with the beneficiary, all special labor law provisions will apply between the personnel and their employer.

In some areas, however, to avoid the use of under-qualified personnel for work under special conditions and in important fields that require rendering tasks with a high degree of risk by individuals who may not enjoy the special protection of employees, legal provisions prohibit service providing contracts for the activities the beneficiary is legally authorized to perform. This is the case for port operation activities that can be performed only under strict conditions, meaning the authorized port operators have the obligation not to enter into contracts for the provision of services by other companies, which the latter would provide activities in connection with the operation of ships in the beneficiaries’ perimeters, activities the beneficiaries themselves have been authorized for. Entering service providing contracts is sanctioned with the suspension of the beneficiary’s authorization for the port operation activities conducted by leased personnel.

As stated earlier, civil contracts under which independent contractors provide independent activities and the service providing contracts between the beneficiary and an entity that provides personnel do not enjoy independent regulation under Romanian legislation so that they are governed by common law rules.

For those aspects regarding individual employment contracts and employment relationships in general, not specifically regulated by labor law, the rules of common law will be used as well, as a result of the fact that the employment contract is a variety of civil contracts. This being the case, in some situations the distinction between an individual employment contract and a civil contract tends to be very subtle and the correct characterization of the contract by the court can be required.

III. Re-Characterization of Independent Contractors as Employees

As mentioned previously, entering into civil contracts with individuals that are not authorized to perform the activity stated in the contract, or entering into a civil contract with an individual that is authorized, but under similar conditions as an individual employment contract, can be qualified as unlawfully receiving individuals for work, a conduct sanctioned by law.

A legal qualification of a civil contract as being an individual employment contract is usually an attribute of the courts, which are usually referred to by independent contractors that provide activities in conditions similar to an individual employment contract, but do not enjoy specific protection legally recognized for employees. Another situation that may occur is that of questioning the type of contract that exists between the individual and the beneficiary by the local labor inspection bodies. Following such an inspection, these local bodies can ascertain that the activities provided by the independent contractors are specific to typical work activities performed by employees, without the existence of a legally concluded individual employment contract.

In this case the beneficiary will receive the sanction for unlawfully receiving individuals for work, which is equivalent to a re-characterization of the legal relationship between the parties, but in order to achieve the effects of the recognition of the labour relationship between the parties, the court must make a ruling for every individual case. Thus, although the labor inspection bodies ascertain that the activities performed by the independent contractors are specific to typical work activities performed by employees for the period in which the activities were conducted under a civil contract, the contractors are not automatically granted specific rights of employees and are not
provided with specific protections for the employees, unless they obtain a court ruling stating so.

The beneficiary that unlawfully receives individuals for work without perfecting an individual employment contract is sanctioned progressively for his action being a betrayal – if the number of individuals he receives for work without perfecting an individual employment contract is under 5, or a criminal offense punishable under the Romanian Labour Code and general rules of criminal law, if the number is higher than 5.

Regarding the activities performed by individuals exercising liberal professions, if the re-characterization of their cooperation contracts as individual employment contracts by the court is not possible, being the fact that these professionals cannot achieve the employee status.

The differences in legal status between individuals having the employee status and the independent contractor status under the Romanian legislation caused by the under-regulation of civil contracts, under which individual contractors perform their independent activities, can lead to situations in which beneficiaries will use different types of contracts that suit their purposes without a proper protection for the individuals providing the independent activities, or in some cases, such as those mentioned in the public institutions, with the overpayment of individual contractors. Both situations are a source of inequity that the law does not sanction. In order to prevent such inequities an improved regulation for civil contracts under which individual contractors perform their independent activities should be enforced.

IV. HOW TO STRUCTURE AN INDEPENDENT CONTRACTOR RELATIONSHIP

In order to prevent the re-characterization of a civil contract as being an individual labor contract, the distinction between the status of the employees and that of the individual contractor must be differentiated.

The first step in making this differentiation in reality consists of the conclusion of a civil contract that clearly states the independence of the contractor from the beneficiary of the activities in question. Clauses specific to labor contracts – such as clauses regarding the subordination of the contractor to the beneficiary, or clauses regarding the beneficiary’s interference in the activity of the contractor must be avoided.

As stated previously, there are only a few rules in concluding a valid civil contract, but this does not mean that finding a proper form for such a contract is an easy thing. The Romanian Civil Code states that in every area that a special type of contract is regulated, special rules stated for that contract must apply. So a valid civil contract between the beneficiary and an independent contractor does not have to allow for the possibility of the re-interpretation of the contract as being a special type of contract – in this case a labor contract.

This distinction must also apply to the activities conducted for the beneficiary – meaning that the activities conducted by independent contractors usually are not activities with a permanent and constant character and are different from the current activities that employees are conducting for the beneficiary.

The control over the activities conducted by the independent contractor is circumscribed to the contractual provisions, meaning that every disagreement regarding the activities conducted must be settled according to these contractual provisions or in court.

V. TRENDS AND SPECIFIC CASES

As mentioned, the most important issue in using independent contractors is keeping their activities independent in order to avoid the re-characterization of the civil contract as a labor contract. Recently, this re-characterization as a judicial practice was joined by a similar fiscal procedure. The difference between the two occurs in the consequences for each – meaning that the judicial procedure has, as stated, important legal implications, while the fiscal procedure has limited implications (the parties having to jointly pay taxes for labor contracts).

When examining a contract, in order to establish its nature, judges look for clauses showing clear dependence of the contractors on the beneficiary (for instance, whether the work schedule of the beneficiary will be met by the contractors, whether the internal rules of the beneficiary is mandatory to contractors, if the creation of intellectual property of the contractors is owned by the beneficiary, if the beneficiary will use the material created in his own interest, etc.).

Fiscal inspectors have a legal guideline when examining contracts in order to establish which fiscal regime shall apply. Romanian Tax Code establishes the criteria by which an activity performed by an individual in order to obtain income can be reconsidered as dependent activity:

- the contractor is in a subordination relationship with the income payer and its governing bodies and observes the working conditions imposed by the income payer - specific duties that are to be carried out at a specific place and during an imposed program;
- while performing activities the contractor uses only the material basis of the income payer - the corresponding endowment space, special equipment, protection materials, or other work tools and only contribute with physical performance or intellectual ability, not with equity capital;
- the income payer supports, in the interest of its activity, the travel expenses of the income beneficiary, or other benefits such as delegation/secondment indemnity in the country or abroad, and other expenses of this nature;
- the income payer supports annual leave allowance and the indemnity for temporary disability, for the income beneficiary.

Meeting any of these criteria allows the fiscal inspectors to qualify the contract as a labour contract for tax purposes only. This has become a more frequent practice than the re-characterization of civil contract as individual labor contracts by court rulings.

VI. CONCLUSION

The differences in legal status between individuals having the employee status and the independent contractor status under the Romanian legislation caused by the under-regulation of civil contracts, under which individual contractors perform their independent activities, can lead to situations in which beneficiaries will use different types of contracts that suit their purposes without proper protection for the individuals providing the independent activities, or in some cases, such as those mentioned in the public institutions, with the overpayment of individual contractors. Both situations are a source of inequity that the law does not sanction. In order to prevent such inequities an improved regulation for civil contracts under which individual contractors perform their independent activities should be enforced.
I. Legal Framework Differentiating Employees From Independent Contractors

a. Factors that determine who is an employee and who is an independent contractor

The legislator does not provide a clear definition on the concept of "contract of employment", but we can figure it out by looking at the Workers’ Statute and its delimitation of the scope: it refers to workers who provide their services voluntarily, paid by others, and within the organization and direction of another person or legal entity, called employer or businessman.

Then, characteristic features of wage labor can be found, and so forth, on the contract of employment, as a link that regularizes the provision of such services, and for which a person (the employee) agrees to carry out an activity, for some time (definite or indefinite), in the context of organization under the direction of another (the employer) in return for payment.

However, for a relationship to be born, a real service taking place or a precise activity made personally and voluntarily, whether paid or unpaid, is insufficient: we need to join those other elements, which are precisely the provisions allowing us to qualify it as "work", particularly the assumption of the costs, risks and individual economic results of productive activity by the service receiver (alienation), as well as dependence or subordination of the worker on the employer, being within its disciplinary and organizational circle.

The employment relationship has a "statutory assumption" status in Spain as the Statute of Laborers (Estatuto de los Trabajadores) establishes that there is an employment relationship every time work is performed under someone else’s direction, organization and account, for remuneration.

It is important to know that the qualification of the contract does not depend on how it was determined by the parties but by the effective configuration expressed in the obligations accepted under the agreement and its performance - "primacy of facts" principle.1

To this extent, the factors that will determine the distinction between an employee and an independent contractor are the following:

- Dependence
- Alienation
- Personal nature of the relationship
- Payment
- Exclusivity and assiduity

Dependence

The employment nature of the bond is not denied by the breadth of the degree of autonomy available to the worker when performing the service, but to consider a services relationship as "work", it must happen within the scope of organization and direction of the employer, jointly providing personal services, and the consequent alienation to the company’s risk taking action.2

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2Supreme Court 20/09/84; TS 11/10/83.
Case law has even held that “dependence” is the most decisive vertebral element in the employment relationship.5

However, this element cannot be understood as a strict subordination of the employee to the employer, so in order to appreciate it, it is enough for the worker to be within the rector and disciplinary circle of the company.6 It involves conducting professional activity within the organization and direction of the employer, so that the employer can permanently modulate the content of the delivery required for the worker.

In contrast, there is no labor relation when a person has his own business and acts as a labor entrepreneur.5

The Courts nowadays are declaring that there are common signs of dependence: the assistance at work or a place designated by the employer and the submission to a timetable, the personal performance of work, supported in certain services with an exceptional regime of substitutions or replacements, the participation of workers in the employer’s workplace organization, which is responsible for scheduling his activity and, on the contrary, the absence of the worker’s own business organization.

Alienation

This concept is useful to explain that the employee is rendering his services to another, which is called the employer.

They hold different criteria to apply it:

- Alienation because of the fruits. - It reveals that the essential and defining facts on an employment contract lay on his fruits, fruits that, from the first moment of production will belong to someone else, but never to the worker.
- Alienation because of the risk. From this perspective, three essential characteristics are required:
  - Labor costs to be assumed by the employer;
  - The fruit or result of the work to be incorporated into the assets of the employer;
  - Economic results depending on the employer, but the worker is not affected by it, nor is his participation in the economic risk.
- Alienation because of the market. - The product of the work provided by the employee is not going to the market directly but has to pass through another person: the employer or the business.

Alienation assumes that the worker does not retain ownership of the outcome of his work, which is transmitted to the employer, who incorporates it as its own market. Thus, there will not be a labor relationship if both profits and losses are taken as a risk by the worker.

The company contribution of appliances, instruments and necessary equipment for the worker.

A contrario of what was said hereinabove, workers who personally and directly carries out an economic activity for gain is classified as a self-employed worker.

The existence of arrangements for payments under the benefits or outcomes (profit sharing, commissions, performance bonuses) considering that a minimum wage is guaranteed for the worker, is not an obstacle to the consideration of alienation.

Very personal nature

The personal side of the employment relationship is based on two different affirmations: First of all, we have to bear in mind that the employee can only be a natural person – and not a legal person. Then, this employee cannot be exchanged. The employment contract is an intuitor personae relationship. The employer hired his employee because of his own skills, experience and identity and those elements are essential to the contract.

Payment

In order to appreciate the existence of a labor contract, it is compulsory that the activity is made in an exchange with the compensation coming from the employer, without regard to its precise form (wages, bonuses, etc).

On the contrary, an independent worker will be paid thanks to services or fees paid by his/her clients.

Exclusivity and assiduity

Both notes have been deeply studied and analyzed by case law.

a) Exclusivity is not a required point, unless there is a full-time agreement7, or other work involving unfair competition.8

Moreover, the exclusivity clause, during a long period of time and designed in strict terms, enforces the labor consideration of services providing dependence on a relationship of subordination between the parties.9

b) The note of assiduity can be considered a clue that guides us to the existence of an employment relationship.

As part of an antithetical concept of assiduity, briefness of service is another factor which may exclude the qualification of a relationship as a labor one.

Thus, we can see that the independent contractor does not comply with the feature notes described above, as there is no dependence, because he confronts the whole organization of his own work. In addition, the independent contractor assumes the financial risk of the business (both benefits and losses), not collecting a fixed amount, but one depending on the work performed, and that is the reason why neither alienation and compensation notes can be appreciated here.

b. Differences in tax treatment

In this section, we will make a comparison of tax issues between independent contractor and employees. The taxes that, basically affect both parts, are Personal Income Tax (IRPF), VAT and social security contributions.

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5Supreme Court 05/14/90.
6Supreme Court 10/22/83; 11/11/83; 23/09/85.
7Supreme Court 4.7.87.
8TSJ Madrid 15/03/02.
9TSJ Madrid 15/03/86; TSJ País Vasco 19/11/91.

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Personal Income Tax

This is a personal, direct and progressive tax that affects incomes earned by individuals in a calendar year. According to that definition, between an independent contractor and an employee, both earning the same income, great differences would not exist when paying this tax, unless, as with the deductible expenses by person, the independent contractor may also deduct that one in addition to its activity.

Both the independent contractor and employee must fill in an annual statement (D-100 model) of personal income tax. Also, the independent contractor will be required to submit quarterly statements of personal income tax installment payments of their incomes (130 or 131 models) as well as the quarterly and annual summaries of withholdings, the incomes practiced in the payroll to their workers and the invoices of professionals (111 model quarterly and 190 model as an annual summary).

Value Added Tax

It is an indirect tax on consumption and falls on the final consumer, so both the independent contractors and employees have to pay VAT on their purchases.

The independent contractor also acts as an intermediary, paying the difference between the VAT that they have passed on to their customers and the VAT that they have incurred on their purchases allocated to the activity, taking into account the quotes of VAT that have affected his bills, regardless of whether he has earned it or not.

Additionally, the independent contractor must submit quarterly VAT self-statements (303 or 310 and 311 models) and also an annual summary (model 390) for informational purposes.

Social Security Contributions

Here is where we can find greater differences between the two figures, both in the determination of the base, as in the types to be applied and for which coverage is protected. Fees for both are calculated in the same way, applying a percentage to a contribution basis.

The base price of the worker, between a minimum and maximum limit depending on the payroll in turn, also depends on the working hours among others. Instead employed workers choose between a minimum and maximum cap base by going public irrespective of time to devote to the activity and income. Attention must be attracted on the fact that specialties exist in the case of independent contractors who have more than 47 years and being the baseline of 850.20€. The base can be modified twice a year.

The contribution rates vary significantly depending on whether we speak about employees or independent contractors. For the former, the rate is 6.35 % or 6.40 % depending on the type of contract and the employer is required to enter the Social Security Fund fee.

For independent contractors, the total percentage depends on the coverage to which he subscribes, with a minimum of 29.80 % or 26.50 % if not quoted by IT derived from common contingencies.

A worker, quotes compulsorily for common, professional training, Social Guarantee Fund and unemployment.

Independent contractors are required to quote for the coverage of IT for common contingencies, except those that are already covered by another social security scheme (i.e., multiple jobs). The coverage by AT and E. P. is voluntary, except for the dependent independent contractors worker for which it is required. The price for cessation of activity is also voluntary, but if the latter is quoted it is mandatory.

Also at birth and extinction of the obligation to contribute there are differences: as long as a worker quotes by the working period, the independent contractor quotes in full months.

There are other aspects to be taken into account only in the case of independent contractors:

Business Tax

The vast majority of independent contractors are exempt from this tax, a fact which will be reflected in his statement filled in the Tax Office census prior to the beginning of its activity (036 or 037 model). Otherwise, they must fill in the 840 model.

Annual Statement of operations with third parties

It is a statement (347 model) with character information to be submitted during the month of February, since 2013, indicating those persons or entities, customers or suppliers, with whom the independent contractor has exceeded 3,006 € in the previous year.

c. Differences in benefit entitlement

Social Protection programs offered to independent contractors have suffered from significant changes over recent years up to the current configuration of the protective action set to enter into force soon - the Special Scheme for Independent Contractors.

The protective action of the Special Scheme for Independent Contractors includes the following features:

- Healthcare
- Temporary disability
- Maternity and paternity
- Risk during pregnancy and breastfeeding
- Care for children affected by cancer or other serious illness
- Permanent disability (total, absolute and severe disability)
- Retirement
- Death benefits
- Professional Contingencies
- Provision for cessation of activities
- Social care
- Social services

We can say that the main differences between the General System of Social Security and the Special Scheme for Independent contractors are in pension benefits as well as maternity and paternity.

As for retirement, its regulation is the same as the RGSS with some specialties:
Age

As of 2013, the normal retirement age is:

- 65, if they quote 35 years and 3 months or more;
- 65 years and 1 month, if they quote less than 35 years and 3 months.

However, in response to the toxic, dangerous or arduous nature of the pursued activities, and in the terms established by regulations, even those which development is still pending, affected independent contractors who meet the conditions to be entitled to order to receive the retirement pension, except for age reasons, can access retirement faster on the same assumptions and collective rights as for employed persons. Also, independent contractors with disabilities will be understood in the same conditions as employed persons.

On the possibility of access to early retirement for a worker who had mutual status to 01.01.1967 and to collect contributions in various regimes and, by applying the rules of reciprocal calculation, the pension should be recognized for according to the rules of the RETA, provided acknowledgment of the age requirement in any of the other schemes that have been considered for the aggregation of insurance periods. Access to early retirement person concerned to the age of 65 years is suspended until 31/03/2013 (RD 29/2012 disp.adic.1ª).

Amount

In order to calculate the amount of pension applied to the regulatory base, compute the percentage obtained exclusively from the effective contribution years of the beneficiary. The amount to be received as a pension is paid monthly in two bonuses.

Regulatory base

It is calculated in the same way as with RGSS. If there are gaps, in periods when there was no obligation to contribute, they are not complete as in the RGSS, but these months are overdrawn and yet they are computed as divisor. That is, the corresponding divider was no obligation to contribute, they are not complete as in the RGSS, but these months.

Origin of the pension

The time of the event originating the pension is:

- For those who are already registered, the last day of the month in which work termination occurs;
- For those who are in a similar service, the last day of the month in which the presentation of the application happens;
- For workers who are not registered, or similar situation, from the application moment.

Leave

The waiting period requires 15 years of contributions, 2 of which must be within the 15 years immediately prior to the contingency. No scale is applied, according to attained age on 01.01.1967, when calculating the contribution years.

As for maternity and paternity leave, independent contractors are entitled to maternity benefits (contributory and non-contributory ones) and also paternity to the same extent and on the same terms and conditions provided for workers in the RGSS, with specialties indicated.

The periods of cessation of activity during which they are entitled to receive the maternity and paternity match, in terms of duration and distribution, the labor rest periods established for employed persons. The only difference is the possibility of receiving the subsidy more compatible with a part-time job, in which case the perception of the subsidy and the reduction of activity can only be made in a percentage equal to 50%.

If, while collecting the subsidy on a part-time job regime, a process of IT starts, without caring about contingency may, where appropriate, also perceived IT allowance. In this case, the regulatory base of IT allowance is reduced to 50%.

Thus, the difference with the general scheme is that, by agreement with the employer, resting part-time workers employed by maternity leave, do not set a specific percentage reduction.

d. Differences in protection from termination

Upon termination of employment, the employer must provide the employee with:

- Company certificate and listing documents useful to the employee, if appropriate, in order to prove and be able to ask for unemployment benefits.
- A document proposing settlement of owed amounts, when communicating the complaint settlement of the agreement or, where applicable, the notice of termination.

He must also make knowledgeable to the company council, documents relating the termination of the employment relationship. A failure to comply with them is punishable as a serious offense in labor with a fine.

As evidence, to prove the termination of the agreement by mutual agreement or will of the worker, the worker may be required to sign the settlement receipt, albeit without it being mandatory.

Indeed, upon termination of the employment contract between an employer and a worker, the first has to pay the employee, in any case, accrued and concepts, such as unpaid wages, the share of bonuses and the amounts of unused vacations.

However, independent contractors do not enjoy such protection, as they are individuals who perform on their own and outside the scope of management and organization of another person, a business or professional activities for profit.

Thus, the main difference in the termination of contracts is that in the case of independent contractors, they do not have a liquidation or compensation to attend the no dependency note, however workers under employment relationships do have the right to rely economically on the employer.

However, it should be taken into account that economically dependent worker (TRADE), which are a unique category of independent contractors, to apply it as a general rule, the common system established by the status of self for all the collective independent contractors, subject to certain peculiarities that presents its professional status.

One of those quirks refers to the contract termination and the consequent compensation, which is regulated by Spanish Law, unlike the independent contractors.
Thus, the contractual relationship between TRADE and his client may be terminated for any reason provided by law, as well as the causes that the parties have agreed to in the contract, unless they constitute abuse of law, and in particular, by any of the following circumstances:

- Mutual agreement of the parties.
- Death, retirement or disability incompatible with professional activities.
- Withdrawal of TRADE, and there must be the advance notice provided or according to custom.
- Will the TRADE, found in serious breach of contract by the counterparty.
- Will the client for cause, and there must be the advance notice provided or according to custom.
- By decision of the employee who was victim of violence.

In addition, the termination of the contract between the customers TRADE may lead to compensation in any of the following circumstances:

- Breach of contract by the other party that sometimes results in damages.
- Will the client without cause.
- Withdrawal of the TRADE, subject to fulfilling the obligation of notice, when the cause is material injury to halt or disrupt the normal conduct of its business.

### e. Other ramifications of classification

As we know, independent contractors are a group which operates financially as professional or independent contractors in different economic sectors (agriculture, fishing, handicrafts, trade, transport, diverse professional, etc.). Within this large group we can distinctly distinguish, together with the figure of the classic or ordinary independent contractors, other figures that include the autonomous nature of their business, have their own characteristics, such as economically dependent independent contractors (TRADE). Those particular contractors meet all requirements of any independent contractors themselves and conduct their business primarily for a single client, the economically dependent.

In the previous section, we mentioned one of the peculiarities of this figure as in the contract termination, but this time we must speak further on what constitutes economically dependent workers (TRADE). They are economically dependent independent contractors who:

- Perform an economic or professional activity for profit;
- Perform this activity in a usual, personal and direct way.
- Work mainly for one person or entity, named Customer, and;
- Perform their activity for a client or a company but still receive 75 percent of the working income of this activity.

Also, for the performance of economic or professional activity as economically dependent workers, it must cumulatively meet the following additional requirements:

- They must not be responsible for employees or contract or subcontract all or part of the activity with others, both in terms of the customer contract activity which depends economically as activities that could contract with other customers.
- They must not run their activity indistinctly with workers providing services under any form of recruitment provided by the customer.
- They must have their own production infrastructure and equipment necessary for the conduct of business and independent of their client, when in such economically relevant activity.

- They must develop their own activity organizational criteria, subject to the technical indications that his client could receive.
- They must receive a payment based on the result of their activity, according to the agreement with the customer and taking on risk and responsibility thereof.

### f. Leased or seconded employees

As mentioned above, the working relationship established between the employer and the employee has a personal nature, that means that it is a very personal obligation, which cannot be transferred to a third party, partner, associate or employee not related to the employer for any legal connection.

However, independent contractors gather double circumstances of being independent contractors and entrepreneurs, with the possibility of hiring, in turn, other employed persons. This double circumstance determines the right of independent contractors to join unions either existing or to be established and also to join any of the existing business associations established or to be established, without prejudice to the possibility of self-employment associated specifically.10

Thus, Spanish case law has ruled that labor cannot be regarded as personal service delivery when substitution without the permission of the company is possible.11

Therefore, the employed persons, to be subject to the guidelines of an employer cannot delegate its functions to another person or hire another worker; while independent contractors can give employment to employed persons.

However, it should be noted that the TRADE, this special form of independent contractors cannot be responsible for employees or contract or subcontract all or part of the activity with others, both in terms of outsourced activities with the client’s economically dependent as activities that could contract with other customers.

### g. Regulations of the different categories of contracts

In Spain, there are a variety of employment contracts and all of them are properly regulated in the Statute of Workers. There is a common root that weaves all contracts, since they must follow certain general principles of law.

In terms of capacity, we can say that, those who can sign a contract are:

- The elderly (18 years).
- All children under 18 legally emancipated.
- Over 16 and under 18 if they have parental permission or from whom it is responsible. If living independently, with the express or tacit consent of their parents or guardians.
- Foreigners in accordance with the laws applicable to them.

On the form, there is a principle of freedom of form, which means that it can be made orally or in writing.

Writing is mandatory when required by statute, and always in the contracts regarding:

- Practices.
- Training.

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10TCO 98/1985
11TS 6/10/17
• To carry out a work or service.
• Part-time jobs, fixed relay discontinuous.
• At home.
• Workers hired in Spain for Spanish companies abroad.
• The term contracts which duration is longer than four weeks.

However, each party may require the agreement to be written, at any time during the course of the employment relationship.

The types of contracts can be further classified into two categories: indefinite contracts and temporary contracts. The first category, includes part-time contracts (if the ratio is undefined), and ordinary and indefinite permanent employment promotion; the second group, all of the others.

In principle, any labor contract is permanent and full time, unless the employment contract states otherwise.

The rules governing each type of temporary contract, establish what the minimum and maximum duration of the contract is.

Furthermore, there a number of common principles of temporary contracts, which are:

**Exceptionally**

The possibility of setting a term of relationship or hold a final term, exceptionally supported when justified by an objective reason, pointing out the legal provisions that can hold fixed-term contracts in the event that the own specific standard, to cover temporary nature needs, and provided that, in the case, attend specifically the objective cause is to be held.

However, in Spain, this exceptionally has not prevented the excessive growth of temporary contracts. The significant weight of temporary workers (around a third of all salaried employees) is an anomaly in the European context, and has led to a strong segmentation between permanent and temporary employees.

**Typicality**

Contracting temporarily is limited to the legally regulated cases, existing in this field a reserve of law derived from the Constitution and an expressed authorization to the regulations to complement the legal regulation of the procedures laid down in the law.

**Causality**

In all of these contracts, the principle of causality is present as an element that defines and classifies. The temporary contract requires a cause that justifies it, that is, in Spain, temporary hiring is eminently causal.

**Rules of necessary rights**

The determination of the cases of temporary contract and its nature constitutes a rule of necessary rights core. Legal regulations authorize collective agreements to supplement the contents set by law, in the aspects that the effects are determined but cannot overlap the legally imposed limits.

As for the reference to civil law, note that as a general rule, in our system, the provision of labor for the production of goods and business services is subject to labor law and, therefore, qualifies as a juridical labor. The use of commercial or business figures to define personal activity services still remains an atypical formula to qualify the performance of work within a productive organization.

Therefore, the legal employment relationship arises from a bilateral legal business, the contract between the two subjects, worker and employer, who agreed to it.

Finally, as for the limits, it can be said that, although the employment contract is a regulated contractual relationship, there are two legal precepts of diverse origins and functions, which block the ability of the parties to the employment contract to alter the legal and conventional working and employment conditions in which you insert the worker performing the services in specific industry productive with a specific qualification.

(A) On the one hand, the non-withdrawal rule provides for individual autonomy, less favorable conditions or simply anti - labor and employment regulations or conventionally fixed. The will of the parties specified in the employment contract cannot establish the prejudice of the worker, less favorable or contrary to the laws and collective agreements.

(B) On the other hand, the law imposes a principle of unavailability or inalienability of rights granted to workers imperatively by law or by collective agreement. The workers cannot validly use, before or after given, the rights that are recognized by rules of necessary rights, nor of those recognized as unavailable by collective agreement that extend to the transaction or waive of the rights recognized by rulings favorable to the employee, subject to the possibility of transaction within legal limits.

**II. Business Presence Issues**

a. How the use of one or more independent contractors creates a permanent establishment in country and the ramifications

It will be stated that a person or an entity operating through a permanent establishment in Spanish territory:

• When he acts in Spain, in any capacity and continuously or habitually, facilities or workplaces of any kind in which he performs all or part of the activity.
• When he acts in Spain through an agent authorized to contract on behalf of the non-resident, provided that such powers are habitually practiced.

Specifically, permanent establishments are considered every place of management, branches, offices, factories, workshops, warehouses, shops or other establishments, mines, oil or gas, quarries, farms, forestry or livestock or any other place of extraction or exploitation of natural resources and construction, installation or assembly project which existed for more than six months.

When a taxpayer has various centers of activity in Spanish territory constituting different permanent establishments, each of them should be named differently and if it is a legal entity it must also obtain a different tax identification number for each permanent establishment.

Thus, we see how the concept of “permanent establishment” is not strictly linked to the provision of services by an autonomous, since it can provide its services with or without the existence of a permanent establishment.
b. How the employment of one or more individuals creates a permanent establishment in country and the ramifications

Spanish law provides a general definition of what a Permanent Establishment is. In this way, a permanent establishment is defined as a fixed place of business through which an enterprise is wholly or partly carried on. As noted in the comments to MCID, the following three notes are to be given in the general definition of Permanent Establishment:

- the existence of a “place of business”
- the place of business must be “fixed” and,
- through this place of business must be “conducted business activities”.

The Committee of the Organization for Economic Co-operation and Development (OECD) of Fiscal Affairs considers the term “place of business” to include any premises or facilities to be used for the realization of economic activity of the company, whether or not exclusively used for this purpose. Note that for there to be a place of business would be enough to have a space available for the development of the activity. In this sense, it is irrelevant whether the use of the premises is done as the owner or lessee.

Moreover, it would not even require the existence of any legal right of use on the space used so you can come to understand that there is a permanent establishment because, as just noted, what is truly important is the effective and simple arrangement of a certain physical space for the development of the activity.

The term “place of business” is thus a term that can encompass diversity of possibilities, from the traditional offices to spaces as would be located in a business center. Also included in this term, is the space that could be given by a company to another of their group who were not resident in the development of the activity of the latter, but this assignment was free and was not formalized in a contract.

III. Re-Characterization of Independent Contractors as Employees

a. Laws and Guiding Principles

In Spain, the workers’ primary regulation and situations of independent contractors economically dependent autonomous workers are regulated by the Law. In addition, in the process of re-characterization of an independent contractor, one must also take into account the general principles of law. Indeed, the most widely used mechanism in the re-characterization is the individual autonomy of the parties who hire the services not subject to labor legislation. The provision of work under a labor contract has to be registered, but not for a civil or commercial one. Leasing of civil rules, commercial contracts or supply transport ones are contractual types and channel the work to a legal firm which excludes the application of labor law and prevents the owner of the company from having to be registered on the RGSS as an employee working for this employer. Normally, these operations are associated with productive decentralization scenarios outsourcing and professional services tend to frame new types of work arising from the society of services and information, both highly-skilled and poorly educated.

Individual autonomy and contractual documentation are the basic elements of such normally un-imposed re-characterization. Individual autonomy of the parties is to choose the type of relationship they both agree to engage in labor as including it in a civil or commercial contractual typology. The intention and the will of the parties directly regulate the content of the service and conditions govern it. Therefore, the content of the contract document expresses not only the specific content of the provision of work and the conditions under which it should be put into practice, but also, and very specifically, which established mandatory relationship between the parties is excluded from the rules governing wage labor, notably labor regulations, union activity and collective regulation of working conditions.

Clearly these operations, which at the time of establishment of the relationship of services excluded from consideration as labor, can cause a drastic reduction of rights for people. Nevertheless they should enjoy effective protection as workers. So, there is a possibility that these mechanisms will create a possible concealment of the existence of an employment relationship.

In short, it affirms the principle that we must address specifically how he handles the work performed for the production of goods and services in the company and not so much the content of the contract which sets the document signed by the parties as a way to qualify as providing work or outside work, which has been called the principle of primacy of reality in the qualification of labor relations. Spanish case law, consistent with this, has denied the parties the power to determine the nature of the relationship of services. It must be determined by the particular way in which the activity takes place, which is both labor if it meets the characteristics of the employment contract described in the law.

Therefore, the name that the parties give to their relationship is not binding on its nature, but it does not mean that in reality such provision cannot be defined as labor.

b. The Legal Consequences of a Re-Characterization

In the first place, the false independent contractor should sue the employer to claim to be hired as a salaried worker by filing a claim for recognition of law to the Courts. In this situation, the false independent contractor has two possibilities: Sue the employer when he is still in the company or sue the employer since he was fired.

If the worker filing of the application while he was still in the company and finally got to show the existence of an employment relationship, the employer would be required to register as indefinite with the salary he had been receiving, plus recognizing initial seniority.

However, if the worker files the application after he has been fired, and wins the trial, it will be recognized as the existence of an employment relationship and, therefore the contract termination would be classified as null or unfair.

In both cases, if the employee has obtained a ruling in his favor, the next step would be to sue the company before inspection work to pay their Social Security contributions in the last 4 years prior to the filing of demand.

c. Judicial Remedies Available to Persons Seeking ‘Employee’ Status

Independent contractors who want to be recognized for the right to be employed persons in the trial will have to prove that there is an employment relationship and therefore, meet the characteristics of a contract of employment. This employment relationship exists when, for example, there is a specific schedule (holidays are taken, leave and rest, use of the technical and material resources of the employer and the services are provided under the direction and supervision of company staff).

First, the person who wants to be recognized as a worker should reflect the existence of an agency relationship, proving that some of the following factors concur:
The framework or hierarchical insertion into the company, the worker must follow orders, mandates and guidelines;

- Subordination to the person or persons who have powers of command;
- Submission to a schedule and appropriate disciplinary standards;
- Monitoring which is subject to certain employees under the use of new technologies;
- Monitoring of performance;
- Control of timing;
- Presentation of work;
- Making regular reports to account the work.

Second, it must be proved that a number of signs that indicate that there is strangeness in the fruits and risks are concurring. Some of the common signs of alienation that could claim to prove the existence of an effective working relationship would include:

- To deliver or make available to the entrepreneur products made or services performed;
- The adoption by the employer of the decisions concerning market relations or relations with the public, such as:
  - fixing prices or rates
  - selecting clientele
  - indicating people to care
  - fixed or periodic character of labor remuneration
  - calculating the compensation or the main concepts under the same criteria that keep a certain proportion to the activity of the employer or the free exercise of professions.

Third, you should prove the remuneration for the provision of services, as Spanish law recognizes as worker just persons whose services, voluntarily rendered to another, natural or legal, are paid by it. The lack of wage determines the absence of labor contract "for lack of cause". However, it is not crucial how the remuneration is perceived: under invoices and documentation of commercial transport contracts and subject to VAT tax regime or the regime implementing autonomous Social Security. Neither the amount of the remuneration is a percentage of what the company bills the customer keeps its configuration as salary compensation.\(^{13}\)

In labor law it is common to afford greater protection to the worker who is weaker party in an unequal relationship. This protection in such cases means that if there are several indications that the employment relationship is working, the company will have to fight the evidence, not with other circumstantial evidence.

d. Legal or administrative penalties or damages for the employers in the event of re-characterization

One of the damages that the employer who employs a worker as an independent contractor must bear, when in fact the provision of services between them is governed by an employment relationship, is to conduct un-prescribed contributions.

In addition, you must pay the Social Security penalties for having evaded the worker registration on the Social Security.

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IV. HOW TO STRUCTURE AN INDEPENDENT CONTRACTOR RELATIONSHIP

a. How to Properly Document the Relationship

To adequately justify the relationship of independent contractors, it would be necessary to conclude an agreement.

The contracts made in implementing autonomous professional activity may be written or oral. Each party may require from the other, at any time, the formalization of the contract written. The contract may be concluded for the execution of a work or series of work or to provide one or more services and the time agreed by the parties.

In addition, a worker who wants to register as an independent contractor must follow a few steps required to perform all independent contractors.

First, they have to register with the Tax on Economic Activities (IAE), as long as it is not exempt, within ten working days before the start of the activity.

The Business Tax or I.A.E. is a tribute to local character, which taxes the exercise of business, professional or artistic exercised or not locally. It is mandatory for every company, business or professional.

Since January 2003, individuals and corporations are exempt from this tax, which have a net turnover of less than 1,000,000€. However, it is still mandatory to register on the tax.

For such processes, they must go to the tax authorities or the city council, and fill in the form 845 (for activities subject to quota municipal), the 846 and 850 (for the activities subject to provincial share) or 846 and 851 (for activities subject to national quota), and select the heading that corresponds to their business.

Once discharged from the IAE, the worker shall have a period of 30 calendar days from the start of the activity to register as self-employed in the administration of the Social Security Treasury.

Secondly, it would be necessary to apply to become a member of the Special Regime of Social Security for Workers Independent contractors (RETA), within 30 calendar days of the start of the activity.

The document to become a member of the Special Regime of Social Security of these workers, as well as general data, must contain those related to his business or occupation, and peculiarities regarding contributions and protective action.

The registration request is presented at the Provincial Administration of the Social Security or at the one which boundaries the establishment or, failing that, where he is domiciled.

The application to become a member of the Social Security, as the contribution, is unique, even if the worker develops several activities leading to their inclusion in the scheme. In these cases, if the employee elects to invoke the coverage of industrial accidents and occupational diseases, coverage for such contingencies is practiced by the activity that is applicable to the highest contribution rate among those included in the current premium rates. To this end, workers must make a statement of its activities to the Social Security Treasury in the application to become a membership.

Thirdly, you will need to register for census and taxation and choose accordingly. Thus, the employee must complete form 036 in which you opt for the relevant tax regime and indicate the activity that is to be performed and the data of the company, in addition to
applying for an identification tax number (TIN). This process will have to be completed in any administration of the tax.

b. Day-to-Day Management of the Relationship

An independent contractor is an individual who routinely, personally, directly, on their own and outside the scope of management and organization of another person, performs a business or a professional activity for profit, whether or not he provides occupation for employees. The independent contractor organizes his work without being subjected to a timetable, so that there is no subordination to the company. Moreover, he can work for one company or for several, but usually works for several. Thus, the independent contractor does not receive instructions about how he has to do his job, in that, he is not subjected to the orders and directives of the company, since he can decide what work he wants to do and what he does not. Finally, he perceives benefits for the service provided through bills, which may or may not be the same amount each month.

V. TRENDS AND SPECIFIC CASES

In this section, we will discuss the same case viewed from two different perspectives in order to distinguish the difference between an independent contractor and an employee.

A Company that sells pets requires the services of a veterinarian to care for their animals:

Scene 1
The Company has a contracted worker who is registered in the General Regime of Social Security, and goes every day to the facility to supervise the status of animals. He has a schedule of 9:00 to 15:00, and in the event that an animal become seriously ill, he has to assist it after hours, charging extra for extra time worked. If he cannot go, the Company does not allow him to send someone else in his place. The Company pays him 1,300€ per month (twelve payments) and he has a one month vacation.

Firstly, we can say that, he obeys the dependency note, considering that the worker is subject to the organization of the company, which determines when the services are provided and establishes the holidays, and also the fact that he goes to the place of work of the Company every day.

Secondly, the worker receives a monthly salary, which is why, in this case, he obeys the requirement of payment.

Thirdly, the job reverts to the Company and the worker only receives an economic payment without assuming economic risk.

Finally, we can say that, there is an employment relationship between the employee and the Company, since all the requirements of a contract are done, so in this case, the contracted worker is an employee.

Scene 2
The Company has a contracted worker who goes to the facilities of the Company once a week, when he decides it, or sometimes when there is a serious case, or if the company asks for him. Besides providing his services to this Company, he works for three companies in a more permanent fashion. From each of these companies, he charges 400€ per month, however, there are months that he also provides services to other companies.

Firstly, the employee organizes the work and decides when go to the Company, according to the needs of the client, which does not obey the dependency requirement.

Secondly, receives compensation for the service rendered, but this is not his only or principal income. Also, this payment is not fixed for himself, but for the realization of a service.

Thirdly, the worker decides whether to accept the work and the volume thereof, being for him all the profits, so in this case, the condition of alienation is not carried out.

Finally, we can say that there is no employment relationship between the employee and the Company, considering that, the features of a contract are not obeyed. This is the reason why, in this case, the contracted worker is not an employee.

VI. CONCLUSION

Sometimes, it is very difficult to make the difference between an independent contractor and an employee, as the employer hires workers registered as self-employers when in fact there is an employment relationship between the worker and the company.

The solution to determine which is which, an independent contractor or an employee, is analyzing the characteristic features of a contract of employment, which are: dependency, alienation, personal nature of the relationship, compensation, and exclusivity and assiduity.

These factors are those that enable the qualification and delivery of services as labor and, consequently, if there is no submission, the contract may be considered civil or commercial, but never as a labor one.

Finally, encourage people who are in this situation to be hired as freelancers when in practice there is an employment relationship to sue the employer, by taking into account that the document signed by the parties does not matter, for the really important thing is the reality in the qualification of the employment relationship. Therefore, if the relationship between the worker and the company obeys the characteristics of the employment contract, the employment relationship will be judicially qualified as a labor one.
UNITED STATES

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I. Legal Framework Differentiating Employees From Independent Contractors

a. Factors that determine who is an employee and who is an independent contractor

There is no uniform definition of “employee” under the laws of the United States, and no single standard or test exists to determine conclusively whether a worker should properly be classified as an independent contractor or employee. Classification issues may and frequently do arise in the U.S. under an intricate patchwork of federal and state laws and legal principles relating to taxation, employee benefits, employee wages and work hours, collective bargaining, workplace safety and health, employment discrimination and other employment-related matters. As discussed below, courts and government agencies have developed different and often divergent classification standards. The outcome of any classification analysis, therefore, is highly context-dependent.

Navigating the manifold standards and expectations under federal and state laws in the day-to-day implementation of an independent contractor arrangement can be a challenging task and the risk of misclassification is by no means insignificant. Enforcement efforts by government agencies have been stepped up markedly in recent years, while private collective and class-action lawsuits abound. Any independent contractor relationship should be carefully reviewed and managed to avoid the potentially serious consequences of an adverse agency ruling or court judgment.

The Common-Law Test

The United States Supreme Court has held that when a statute does not adequately define “employee,” the term must be interpreted by reference to the common law of agency.1 The common-law test has been applied in a variety of contexts. Such contexts include claims by allegedly misclassified employees seeking participation in employer-provided welfare or retirement benefit plans under the federal Employee Retirement Security Act (“ERISA”);2 claims to determine collective bargaining rights under the National Labor Relations Act (“NLRA”);3 claims to decide whether a company is required to withhold from compensation for state unemployment compensation benefits;4 and various other statutory and common-law claims.5

The central question to be answered under the common-law test is whether the hiring party retains the right to control the manner and means by which the work is to be accomplished. This means that courts must focus their inquiry on whether the hiring party “has the right to control and direct the work, not only as to the result to be accomplished by the work, but also as to the manner and means by which that result is accomplished.”6 When the hiring party retains the right to control the manner and means by which the work is to be accomplished, the worker is considered an employee – even if the hiring party actually never exercises the right.7

Although the extent to which the hiring party actually supervises the “means and manner” of the worker’s performance is a core factor under the common-law misclassification

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5 N.L.R.B. v. Steinberg, 182 F.2d 850, 857 (5th Cir. 1950).
test, it is far from the only one. Among the numerous additional factors courts must weigh as part of their overall analysis are the following:

- the skill required;
- the source of the instrumentalities and tools;
- the place of performance;
- the duration of the relationship between the parties;
- whether the hiring party has the right to assign additional projects to the hired party;
- the extent of the hired party's discretion over when and how long to work;
- the method of payment;
- the hired party's role in hiring and paying assistants;
- whether the work is part of the regular business of the hiring party;
- whether the hiring party is in business;
- the provision of employee benefits; and
- the tax treatment of the hired party.

The common-law test requires a careful balancing of all relevant factors. No one factor controls the outcome. The weight given to each may vary from case to case depending on the particular facts and circumstances. In no case, however, will the terms of any written agreement between the company and the worker by themselves prove dispositive of the outcome.

A recent federal district court decision illustrates the common-law approach. In this decision, the court refused to dismiss a class action lawsuit filed by insurance agents whom the company had classified as independent contractors. The agents claimed that they were employees under the common-law test and therefore entitled to certain employee benefits under ERISA. The court denied the company's motion to dismiss the case, finding that a series of factors could be interpreted to indicate employee status. These factors included the insurance company's requirement that agents sell their company's products exclusively and only use company-owned hardware and software; the company's ability to fire the agents at any time with or without cause; the company's right to determine where agents' offices were located and what their office hours would be; and the company's actual monitoring of agents' daily work and compliance with production and conduct requirements.

The IRS Right to Control Test

Perhaps the most commonly-used test is a variant of the common-law test developed by the U.S. Treasury Department's Internal Revenue Service ("IRS") to determine whether a worker should be deemed an employee for income tax purposes. The IRS has historically applied a lengthy 20-factor test. In recent years, however, the agency restructured its approach and now applies a simplified "Right to Control Test," which groups 11 factors into three broad categories. As with the common-law test, the critical inquiry focuses on the degree to which the business retains the right to control the manner and means by which the work is performed.

The Right to Control Test can be summarized as follows:

(A) Behavioral control. Behavioral control refers to the degree to which the company retains the right to direct and control how the worker performs the task for which the worker is hired. Whether or not the business in fact exercises that right is irrelevant. The focus is simply on whether the company has reserved the right of control to itself. There are two behavioral control factors:

- Does the business provide instructions to the individual regarding (a) when and where to perform work, (b) what tools or equipment should be used, (c) where supplies and services should be purchased, (d) whether and what assistants the worker may hire, (e) whether the work must be performed by a specified individual, and (f) in what order or sequence the work must be completed?
- Does the business provide training to the worker?

Independent contractors normally use their own methods to perform work and require little to no training. Positive answers to the above questions therefore point to the existence of an employment relationship.

(B) Financial control. Financial control factors are intended to capture the degree to which the business has the right to control the business aspects of the job:

- Does the business pay the worker's business expenses? Routine reimbursement of a worker's business expenses can be indicative of an employment relationship.
- Has the worker made a significant investment in the services performed? Typically, independent contractors, but not employees, have invested substantially in the work, for example by maintaining an office or other facilities where services are performed.
- Does the worker make his or her services available to the general public?
- Independent contractors generally remain free to advertise their services and are available to work in the relevant market.
- Is the worker paid a flat fee, or by the hour, week or month? Employees commonly receive a regular wage based on a certain time interval, whereas payment on a flat fee, per-job basis suggests independent contractor status.
- Does the worker have the opportunity to realize a profit or loss from the work? This is ordinarily a hallmark of independent contractor status.

(C) Type of relationship. As the nature of the relationship between the business and the worker can provide further evidence of control, the IRS also examines the following additional factors:

- Does the work have an opportunity to participate in certain employee welfare and pension benefits, such as health insurance, a pension plan, vacation pay, or sick pay? Benefits typically are provided only to employees.
- How permanent is the relationship? An independent contractor relationship is ordinarily of limited duration and defined by the length of the specific project for which the contractor is hired. Hiring a worker on an indefinite basis indicates intent to create an employer-employee relationship.
- Are the worker's services a key aspect of the company's regular business? If so, an employment relationship is more likely to exist.
- Do the terms of a written contract between the business and the worker show that the parties intended to create an independent contractor relationship? This factor is normally the least important, because courts must examine first and foremost the parties' actual practice.

The Economic Realities Test

Neither the common-law test nor its IRS variant governs where federal wage-and-hour laws are concerned. In the United States, federal minimum wage and overtime pay...
standards are established by the Fair Labor Standards Act ("FLSA"). Recognizing that the FLSA was enacted to remedy low wages and long working hours, the United States Supreme Court has long held that the common-law distinctions between employees and independent contractors do not apply when determining FLSA coverage. Instead, courts must decide whether a worker has been properly classified as a matter of "economic reality." The key question to be answered under the Economic Realities Test is this: Is the worker economically dependent on the hiring party, or is the worker truly in business for him- or herself? If economic dependence is found, the worker will be classified as an employee, even if the employer does not exercise full control of the means and manner of the worker’s performance.

Resolution of this question requires a balancing of the following factors in light of the totality of the circumstances:

- the degree of control the business exerts over the worker;
- the worker’s opportunity for profit or loss;
- the worker’s investment in the business;
- the permanence of the working relationship;
- the degree of skill required to perform the work; and
- whether the services are an integral part of the company’s business.

Various additional factors may also be considered as part of the economic realities test, such as whether the business has the power to hire and fire employees, supervises and controls employee work schedules or conditions of employment, determines the rate and method of payment, and maintains employment records. No one factor is determinative. All must be carefully weighed and take account of the factual circumstances of each particular case.

The ABC Tests

Many U.S. states have wage-and-hour laws that provide additional or greater protections beyond those set out in the FLSA. These states employ any one of a number of different tests to determine whether misclassification issues exist. The "ABC Test" represents one of the more commonly used alternatives not only to determine exempt status under state wage-and-hour laws but also to evaluate whether a worker should be deemed an employee for state unemployment tax purposes.

Although applications of the ABC Test are not uniform, it generally places the burden of establishing independent contractor status squarely on the hiring party. In its broadest form, the ABC Test provides that a worker should be considered an employee unless the business can establish that:

- the worker has been, and will continue to be, free from control or direction over the performance of the work under both the terms of the contract and in fact;
- the services are either provided outside the usual course of the business or performed outside of all the places of business of the enterprise; and
- the worker is customarily engaged in an independently established trade, occupation, profession, or business.

In most, but not all, states, all three conditions must be met. As a result, meeting independent contractor requirements can be particularly onerous where the ABC Test applies.

As the above reflects, courts and legislatures in the United States have woven a complex tapestry of legal standards for determining independent contractor status. Further complicating the analysis, employee status may also need to be determined under laws governing workers’ compensation insurance for individuals who suffer work-related injuries or illness; laws protecting whistleblowers or prohibiting discrimination in employment; and various other employment-related statutes. Depending on the statute, state agencies and courts may use variants of the common-law, IRS, economic-realities and ABC tests discussed above.

Not surprisingly, application of the many different tests for determining employment status can lead to diverging results. An individual may, for example, be classified as an independent contractor for state or federal income tax purposes, yet is deemed an employee for purposes of workers’ compensation law and be qualified for such benefits. Businesses should remain mindful of the fact that each situation must be evaluated on its own merits.

b. Differences in tax treatment

There are significant tax advantages for businesses when workers are classified as independent contractors. U.S. employers must pay one-half of an employee’s required social welfare taxes for government-provided Social Security retirement and medical benefits (known as "Medicare"). Typically, these equal approximately 7.65 percent of an employee’s wages. Independent contractors, by contrast, must pay the full amount without any contribution from the hiring business. Employers must also withhold state and federal employee income taxes from an employee’s paycheck, whereas independent contractors pay these taxes on their own in the form of a self-employment tax. Finally, the amount of an employer’s contributions to federal and state unemployment insurance funds depends on the size of the employer’s workforce, but does not take into account independent contractors.

From the perspective of the individual as well, substantial financial benefits can be reaped from holding independent contractor status. Independent contractors need only make quarterly tax contributions and can thus realize benefits from the greater control the absence of mandatory withholdings from each paycheck can afford. Social welfare benefits, in turn, need to be paid only once a year and one-half of the contribution can be deducted from the individual’s income tax. Moreover, unlike employees, independent contractors are able to deduct a wide range of direct and indirect business-related expenses from their taxable income. The increased flexibility and potential for greater actual earnings therefore render independent contractor status an attractive option for many workers.

That said, the adverse tax consequences flowing from misclassification of employees as independent contractors can be a matter of significant concern, particularly when large groups of similarly-situated workers are found to be similarly misclassified. Recent years have seen an increasing focus on aggressive enforcement actions on the part of not only the Department of the Treasury, but also other federal and state agencies. As a result of new information-sharing agreements between agencies, a finding by the IRS that a business has misclassified employees may now lead to audits and further enforcement proceedings by the Department of Labor (which enforces the FLSA), as well as potential
investigations by state tax and workers’ compensation agencies. And as further discussed below, workers claiming to be misclassified may also pursue costly class action litigation, with the attendant risk of potentially very large liability verdicts. A misclassification finding therefore can place the very survival of a business at risk. This underscores the need for careful assessment before entering into any independent contractor arrangement.

c. Differences in benefit entitlement

Workers’ Compensation

Most state laws require U.S. employers to provide their employees with workers’ compensation insurance, which provides compensation for wage loss, medical treatment and death benefits in the event of a work-related injury or illness. No requirement exists to provide workers’ compensation coverage for independent contractors hired to perform services for the business. Since workers’ compensation coverage can be costly, many businesses find it financially advantageous to hire independent contractors, where appropriate, in order to lower premiums.

Health Insurance

In 2010, the United States Congress passed the Affordable Care Act (“ACA”), colloquially known as “Obamacare,” which for the first time in the country’s history makes health insurance protection mandatory for most Americans. Beginning on January 1, 2015, employers with 50 or more full-time employees must offer health insurance coverage to their full-time employees. Under the ACA, a “full-time” employee is one who works 30 hours or more per week or 130 hours or more per month. No mandate exists for businesses to provide similar coverage to part-time employees or independent contractors. Persons falling into these categories will instead be required to obtain individual coverage in the marketplace or incur a tax penalty.

Leave Benefits

The federal Family and Medical Leave Act of 1993 (“FMLA”), which covers companies with at least 50 employees, allows eligible employees to take up to 12 weeks of unpaid leave in a 12-month period for certain family and medical reasons. These include the birth, adoption or placement for foster care of a child and incapacity due to an employee’s or family member’s serious health condition. In addition, employees may take leave for certain purposes in the event a family member is called to active duty or sustains injury or illness as a result of military service. The FMLA applies only to employees and affords no benefits to independent contractors. Various states have statutes that provide leave benefits greater than, or in addition to, the FMLA. As with the FMLA, most of these state-level statutory benefits are restricted to individuals classified as employees.

Other Employee Benefits

Generally, U.S. employers are not legally mandated to provide other types of benefits to employees. Thus, except where state law provides otherwise, businesses need not offer vacation, sick leave, disability or retirement benefits to their employees, and when employers do provide such benefits, independent contractors are typically excluded. Some states offer state-funded benefits, such as disability payments, to employees. Independent contractors’ eligibility for such benefits would depend on the particular state law at issue.

The contractor/employee distinction is particularly important for employee benefit plans covered by ERISA, which can lose their tax-favored status if they cover independent contractors. Independent contractors generally are precluded from participating in a company’s tax-qualified retirement plans, because such plans can only cover employees. It would be permissible for an independent contractor to participate in a company’s health plans, assuming the insurance policy allows it, but if the company were to make premium payments on behalf of the independent contractor, the payments would be includable in the contractor’s gross income. Employees, by contrast, may exclude such payments from gross income.

Unemployment Compensation

Generally, a company is liable for making unemployment insurance withholdings from the compensation paid to employees (including temporary employees), but not from compensation paid to independent contractors. If a worker classified as an independent contractor subsequently makes a claim for unemployment compensation benefits, the relevant state agency will likely re-examine this classification, and the employer may be held liable if the agency determines that the individual was misclassified and contributions should have been paid.

d. Differences in protection from termination

With the exception of the State of Montana, employment in the United States is deemed to be “at will” absent a written contract to the contrary. This means both employer and employee are free to terminate the employment relationship at any time, with or without notice, and for any or no reason. This basic common-law principle, however, is limited by an intricate framework of state and federal statutory and common-law rights providing employees – but not independent contractors – with protection against termination decisions that arise from an unlawful motive. Unlawful motives include discrimination based on an employee’s race, color, national origin, religion, age, gender, disability and other legally protected statuses, as well as retaliation against a worker for complaining of discrimination, for blowing the whistle on alleged illegal activity, for exercising legal rights to certain employee benefits, and for a myriad of other legally protected activities.

By contrast, the duration and termination of an independent contractor arrangement is generally regulated by contract. An independent contractor relationship is, by its very definition, one that is limited in duration and that ends upon completion of the project for which the contractor was hired. The parties may by agreement specify conditions on which the agreement may be terminated at an earlier time.

e. Local limitations on use of independent contractors

There are no laws that limit the use of independent contractors to specific purposes or circumstances. Rather, the primary state limitation is the risk of misclassification. Increasingly, states are passing laws that create a presumption of employee status for individuals performing services in certain industries, such as construction, where misclassification has historically been the most prevalent. These statutes squarely place the burden on the employer to provide evidence that a worker is sufficiently independent to qualify as
In addition, the FMLA prohibits employers from interfering with employees’ use of statutorily-guaranteed leave and from retaliating against employees who avail themselves of such leave. ERISA, in turn, makes it unlawful to discriminate against any employee for exercising any right under an employee benefit plan. These federal statutes are limited to employees and do not cover independent contractors. Note, however, that in some states, state and local employment discrimination laws have been interpreted to cover certain independent contractors. Thus, it is critically important to be cognizant of the applicable jurisdiction.

Numerous statutes also afford various types of whistleblower protections—among them the Sarbanes-Oxley Act of 2002, which protects employees of publicly-traded corporations who report alleged shareholder fraud or violations of federal securities laws. In most (but not all) cases, whistleblower protections may be unavailable to independent contractors. Federal and state occupational safety and health laws likewise in most cases apply only to employees.

Vicarious Liability

The United States recognizes the common-law doctrine of respondeat superior, under which an employer can be held liable for the negligent acts of its employees if the acts were committed in the scope of employment and in furtherance of the employer’s business. By contrast, under the common law of most states, the hiring party has—with limited exceptions—no responsibility for the negligence of an independent contractor. Liability can arise if a third party is physically harmed by an act or omission of the contractor pursuant to orders or directions negligently given by the hiring party, or because the hiring party failed to exercise reasonable care to retain a competent and careful contractor. The risk of liability can be lowered significantly by hiring independent contractors rather than employees where permissible under applicable law.

g. Leased or seconded employees

One way to avoid the legal pitfalls of misclassification is to enter into an agreement with a third-party employee leasing or workplace management firm. Such an agreement typically provides that the staffing firm, not the business, is responsible for hiring, placing and terminating workers; ensuring appropriate tax payments are made and tax reporting is performed; providing workers’ compensation insurance coverage; and offering employee benefits, if available, directly to employees. Where an outside vendor has been engaged, the company’s responsibilities can be limited significantly, reducing the possibility that an employer-employee relationship will be found to exist.

There exists considerable variability in this area. Some staffing companies hire the workers as their own independent contractors and thus assume the risk of misclassification. Others perform the full panoply of functions traditionally associated with an employment relationship, such as withholding of income taxes, payment of Medicare and Social Security contributions, payment of workers’ compensation and unemployment insurance premiums, provision of employee welfare and retirement savings benefits, performance management, and implementation of employee discipline, transfer and promotion decisions. Since companies must be well-informed about the ramifications of each arrangement, entering into an agreement with a reputable and knowledgeable provider is of critical importance.
Using a staffing company is not a cure-all. Under various employment statutes, the client of a staffing agency is potentially considered a "joint employer" for purposes of liability, such as those prohibiting discrimination and harassment. In that case, an employer leasing arrangement will afford only limited liability protection. Additionally, some state laws regulating staff leasing companies may expressly require the staffing company and its client to agree that both will assume joint employer responsibility in specific aspects of the worker's employment.

For example, regulations implementing the FMLA provide that "[w]here two or more businesses exercise some control over the work or working conditions of the employee," or where the work performed "simultaneously benefits two or more employers," a joint employment relationship may exist. A company will likely be considered a joint employer of employees supplied by a staffing agency and be subject to many of the requirements of the FMLA, if the company and the agency: (1) share control over the worker; (2) share the worker's services; or (3) act in each other's interest with regard to the worker. Indeed, some courts have found that a joint employment relationship exists for FMLA purposes anytime a staffing agency places employees with a client employer:

Where employee rights to welfare and retirement benefits governed by ERISA are concerned, the specific language of the benefit plan may control whether workers are entitled to participate in a client company's plans. Several recent court decisions hold that when workers appear to be employees under the common-law test and the language of the plan does not expressly exclude individuals on the payroll of third-party contractors, the workers may be entitled to participate in the client company's ERISA benefit plans.

h. Regulations of the different categories of contracts

There is no regulatory scheme that governs employment contracts or independent contractor agreements. The parties are free to contract as they see fit, subject only to the provisions of the various employment laws discussed in the preceding sections. Many employers do not have written contracts, but are employed on an "at-will" basis. The details of an at-will employment relationship are often described in policies and procedures promulgated by the employer for all employees. Contractual disputes arising from independent contractor agreements are commonly resolved through litigation. Employment laws are enforced through agency actions such as audits, investigations and legal proceedings, as well as through private litigation initiated by employees claiming to be aggrieved.

II. BUSINESS PRESENCE ISSUES

a. How the use of one or more independent contractors creates a permanent establishment in country and the ramifications

A foreign entity with a permanent establishment in the United States may be subject to U.S. federal taxation. As a general rule, foreign corporations are subject to federal income tax on income that is effectively connected with a U.S. trade or business. Such income may, however, be subject to exemption if a tax treaty so provides. A common tax treaty exemption limits federal income taxation to amounts attributable to a permanent establishment maintained by the foreign company in the United States. Such an exemption exists, for example, under the tax treaty between the United States and Canada.

Under the terms of this and other treaties containing such an exemption, a permanent establishment exists if the foreign company maintains in the United States either (1) a "fixed place of business" or (2) employees or "dependent agents" who have, and habitually exercise, authority to conclude contracts on behalf of the foreign company. By contrast, no permanent establishment is created if business is carried out through a broker, general commission agent, or other independent agent acting in the ordinary course of their business.

Court decisions interpreting these provisions are sparse. However, consistent with the language of the applicable treaty, courts customarily distinguish between an independent agent or contractor, retained to perform a specific project without authority to contract on behalf of the foreign principal, and a dependent agent who has such authority. In other words, independent agents or contractors who operate in the normal course of their own business and merely represent the products or services of the foreign resident generally do not create a permanent establishment of the foreign resident. On the other hand, when an agent is both legally and economically dependent on the foreign company, the presence of the agent is likely to give rise to a permanent establishment.

b. How the employment of one or more individuals creates a permanent establishment in country and the ramifications

As discussed in the preceding section, tax treaties between the United States and many other countries provide an exemption from U.S. federal taxation for income derived by a foreign corporation from a U.S. trade or business if the foreign corporation lacks a permanent establishment in the United States. Treaties differ in their definition of "permanent establishment," and the factors indicating the existence of a permanent establishment vary. Very commonly, however, the presence in the United States of a fixed place of business of the foreign entity or of employees of the foreign entity who habitually exercise the authority to bind the foreign company contractually will reflect the existence of a permanent establishment.

It is important to recognize that the federal government has no authority to enter into tax treaties with other countries that affect individual states. Each state has its own laws and criteria that determine when and under what circumstances a foreign company is considered to be transacting business in the state and thereby potentially subject to state taxation and regulation. It is commonly agreed that when a company exploits the state's marketplace — for example by employing individuals in the state to sell its products, produce its goods or perform services on its behalf to customers — state taxation and regulation is likely to be invoked.

III. RE-CATEGORIZATION OF INDEPENDENT CONTRACTORS AS EMPLOYEES

a. Laws and Guiding Principles

As discussed in Section I of this chapter, classification of independent contractors and
employees is subject to an intricate framework of statutory and common-law approaches. A fundamental principle, however, is that courts must undertake a comprehensive examination of all relevant facts. No single factor is dispositive. Instead, careful balancing of all relevant factors is required to reach a determination based on the specific situation at hand.

That said, there are common themes that run through each of the various tests. Although an independent contractor agreement should be detailed and carefully documented, the written agreement between the parties never controls the outcome. Certainly, the parties’ intent matters. However, it is the actual implementation and the realities of the parties’ performance that determines how courts will characterize the relationship. For purposes of the common-law and Right to Control tests, the focal point of the analysis will be the company’s ability to control and direct the manner and sequence of the worker’s performance. Under the Economic Realities test, the analysis turns on the degree of the worker’s dependence on the company. At bottom, the fundamental question under any test is whether the facts demonstrate that the worker is truly in business for him- or herself. If so, an independent contractor relationship exists.

b. The Legal Consequences of a Re-Characterization

When independent contractors are reclassified as employees, employers may be subject to payment of back income tax withholdings and Social Security and Medicare tax contributions, as well as for penalties for misclassification. Employers also risk potential claims by employees for unpaid hourly and overtime compensation, and past workers’ compensation and employee benefits liabilities. In addition, government agencies may conduct audits and investigations and impose additional obligations, combined with penalties and interest for noncompliance. Moreover, only employees, and not independent contractors, have the right to form unions. Reclassification thus entails the risk of greater unionizing activities and potential collective bargaining obligations if such activities are successful.

In some situations, reclassification of independent contractors as employees may increase the number of employees and render an employer subject to other laws that were previously inapplicable, because the employer did not meet the threshold. For example, the FMLA covers only employers with at least 50 employees, while most federal employment discrimination laws cover only those employers who have at least 15 or 20 employees, depending on the statute. Employers with 100 or more employees must additionally file annual EEO-1 reports with the United States Equal Employment Opportunity Commission. Other reporting requirements similarly come into play once a particular employee size threshold is crossed. Employers thus must take careful account of the implications once coverage under a particular statute is triggered.

c. Judicial Remedies Available to Persons Seeking ‘Employee’ Status

If a worker believes he or she has been incorrectly classified as an independent contractor, the worker can request a determination of worker status for purposes of federal employment taxes and income tax withholdings from the IRS. In the event of a determination that the worker was misclassified, the business is sent a letter notifying it of its obligation to pay employment taxes and to adjust any previously filed employment tax returns accordingly. Workers may also file complaints for unpaid wages with the U.S. Department of Labor, which enforces the FLSA. An individual complaint will result in an administrative investigation, but may also trigger a broader audit of independent contractor classification practices for similarly-situated workers. When the agency finds that misclassification has occurred, enforcement actions may result seeking relief not only on behalf of the complaining individual, but also for other misclassified workers throughout the organization.

 Apart from seeking relief through administrative agency determinations and enforcement actions, workers seeking employee status may also file civil lawsuits. At the state level, an increasing number of state legislatures are enacting misclassification statutes, many of which grant workers the right to file a private suit for misclassification, with varying remedies. Some laws are limited to particular industries, such as constructions. Others have broad applicability. For example, Massachusetts’ misclassification statute applies broadly to a wide range of industries and places the burden on the employer to prove each element of a more stringent version of the ABC Test discussed in prior sections.35 In addition to the penalties imposed by other laws, the Massachusetts statute authorizes the Attorney General to impose substantial civil and criminal penalties, and in certain circumstances, to debar violators from public works contracts.

Regardless of whether a state law affords the right to file an action for misclassification, workers may also bring lawsuits under many employment laws, claiming they were improperly classified and treated as independent contractors. For example, the FLSA permits individuals to file “collective actions” — actions filed by a plaintiff as the representative of a class of others similarly situated who elect to participate — in order to seek unpaid wages and overtime compensation based on their alleged independent-contractor misclassification. Under ERISA, persons may file both individual and class-action lawsuits to contest eligibility determinations denying them benefits as a result of having been designated as independent contractors. Civil lawsuits for discrimination, retaliation or interference with benefits can also be filed under various non-discrimination statutes such as Title VII, ADEA and ADA, under the FMLA and other various state and federal whistleblower statutes, as well as under various common-law theories protecting employees, based on the assertion that the contractor should have been classified as an employee protected by the statute.

Class and collective actions asserting misclassification under the FLSA, ERISA, and related laws represent a significant source of potential liability for employers. In some cases, especially where the alleged misclassification has affected broad job categories with numerous incumbents, the potential class size, and with it the potential liability exposure — not to mention the costs of defense — can be truly enormous. One recent case, for example, combined over 42 class action lawsuits filed in 28 states on behalf of thousands of delivery drivers for FedEx Ground, who alleged they had been misclassified as independent contractors and sought reimbursement of business expenses as well as payment of back wages and overtime.46 At the end of 2010, a federal district judge ruled in favor of FedEx Ground under the laws of 20 of the 28 states. That ruling remains on appeal. In the meantime, individual state class actions against FedEx continue to progress, often with divergent and inconsistent results, depending on the applicable state law.

d. Legal or administrative penalties or damages for the employers in the event of re-characterization

The remedies and penalties flowing from independent contractor misclassification in the United States vary depending on the particular statute implicated in a given legal proceeding. A synopsis of penalties and damages based on federal law appears below. It is important to recognize, however, that the availability of collective and class action mechanisms under many statutes can expose employers to liability verdicts of potentially massive proportions.

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35See Mass. Gen. Law Ch. 149, § 1488.
Tax Considerations

The federal Internal Revenue Code (‘‘IRS Code’’) imposes significant potential liability on businesses that fail to withhold and pay employment taxes as a result of employee misclassification. In addition to payment of back taxes and accrued interest,45 if an employee is found to have been misclassified in an IRS audit, a company found to be in violation of federal tax law could be held liable for substantial penalties based on the company’s failure to withhold and collect federal income tax, FICA, and FUTA taxes (accruing monthly up to 25% of the net amount due); for failure to file timely and accurate tax returns (also accruing monthly up to 25%); as well potentially for civil fraud.46 A knowing violation of the statute might also result in criminal prosecution.47

The good news for employers is that in some cases, assuming the misclassification was not willful, liability can be avoided under the safe harbor provision established by section 530 of the Revenue Act of 1978.48 This provision allows an employer to continue to treat a worker as an independent contractor even if the worker would have been treated as an employee under the Right to Control test, if three conditions are met: (i) the employer has filed all required returns reporting payments to the worker as an independent contractor; (ii) the employer has not treated the worker or any similarly situated worker as an employee; and (iii) the employer had a “reasonable basis” to have treated the worker as an independent contractor. A “reasonable basis” can include reliance on prior case law, a past IRS audit, industry practice, as well as other reasonable considerations. If all of these requirements are satisfied, the employer’s liability for payment of employment taxes, interest and penalties may be terminated even though the worker is properly classified as an employee.

Wage-and-hour Considerations

Under the FLSA, employees (other than those exempt from the relevant provisions of the FLSA) must be paid no less than a specified minimum wage for each hour worked, as well as an additional premium of one-half the employee’s regular rate for each hour of overtime work. Independent contractor misclassifications can result in liability for unpaid wages and overtime wages, an equal amount as liquidated damages, attorneys’ fees and costs. Also, because the statute permits lawsuits to be brought as collective actions on behalf of similarly-situated others, an employer’s liability exposure can be quite significant if a large group of workers is found to have been improperly classified as independent contractors.

Employer Welfare and Retirement Benefits

Employers who misclassify employees as independent contractors and deem them ineligible for participation in the company’s employee benefit plans can incur significant tax penalties for failing to offer or provide sufficient coverage or make necessary premium payments. In addition, such employers run the risk of individual and class action lawsuits on behalf of all misclassified employees seeking rights to benefits.49 Class action lawsuits may also be filed under the federal Family and Medical Leave Act, which provides employees, but not independent contractors, a right to unpaid leave for certain family and health reasons and protects against termination for having taken such leave.

Workers’ Compensation Insurance

Misclassification of employees as independent contractors for workers’ compensation purposes can result in an award of benefits, as well as assessments of civil penalties and potential criminal liability, depending on the particular state’s workers’ compensation statute.

State Misclassification Statutes

Many state misclassification laws impose civil penalties and restitution requirements, particularly if the employer is found to have knowingly misclassified workers. Such statutes may also grant workers a private right of action.50

IV. HOW TO STRUCTURE AN INDEPENDENT CONTRACTORS RELATIONSHIP

a. How to Properly Document the Relationship

Given the potentially devastating consequences of misclassification, every independent contractor relationship should be carefully and fully documented. Before entering into the relationship, the hiring company should obtain basic information and supporting documentation from the prospective contractor, including:

- the structure of the independent contractor’s business (e.g., sole proprietorship, limited liability company, corporation, partnership, etc.);
- whether the independent contractor has any employees or work under subcontracts;
- whether the independent contractor has performed similar services for other companies;
- whether and where the independent contractor maintains an office (other than the contractor’s home); and
- the type of insurance coverage maintained by the independent contractor; and
- the contractor’s tax identification number.

If the information obtained demonstrates to the hiring party’s satisfaction that the prospective worker meets basic prerequisites to qualify as an independent contractor and that the work to be performed suits the criteria for an independent contractor arrangement, the next step normally is to document the relationship in an independent contractor agreement. That agreement should, at a minimum, specify the following:

- the nature of services to be provided (which should be different from those performed by rank-and-file employees);
- the manner and conditions for payment of compensation (e.g., a fixed sum upon completion of the project or identified milestones);
- that the service provider is an independent contractor and not an employee;
- that the independent contractor will not be eligible to participate in any employee benefits;
- that the independent contractor, and not the company, will be responsible for payment of all applicable taxes and legally required contributions;

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47See Pub. L. No. 95-503, § 530, 92 Stat. 2763, 2885–86, as amended. Although not directly a part of the Internal Revenue Code, the test of section 530 is included in the notes accompanying 26 U.S.C. § 3401(a).
that the independent contractor will provide his or her own workers’ compensation coverage;
what other insurance coverage the independent contractor is required to carry for the duration of the relationship;
that the contractor is free to set his or her own hours of work and to determine in what manner and sequence the work should be completed;
that the independent contractor will supply and use his or her own equipment;
that the contractor will be required to pay his or her own business expenses;
that the independent contractor is free to hire his or her own employees;
the conditions on which the relationship may be terminated and the consequences of early termination, including any notice requirements and potential penalties; and
any desired indemnification (e.g., independent contractor’s agreement to indemnify and defend the company in the event of loss, damage or liability caused by the contractor’s own negligence).

Given the great variability in relevant classification testing, particularly in light of the many different approaches under state law, it is strongly recommended that the agreement be reviewed by counsel in light of applicable standards and actual practice. Careful structuring of the independent contractor agreement is imperative to ensure that the agreement itself does not contain terms suggesting that the business has a right to control the manner and means by which the worker performs the tasks set forth in the contract.

b. Day-to-Day Management of the Relationship

Even the most well-drafted independent contractor agreement is of little value if it does not accurately reflect reality. Companies should make every effort to grant independent contractors the level of independence required to preserve the integrity of an independent contractor classification. Whenever possible, the independent contractor should be a separately incorporated business. Ideally, contractors should be able to set their own hours, have freedom in selecting the site at which work is performed and be free to offer their services to other potential clients. Day-to-day supervision and direction of the contractor’s work in particular should be avoided.

Contractor work assignments should not mirror those given to employees. Rather, employers should carefully and clearly define projects designated for independent contractors, and set specific start and end dates. Any internal evaluation of the performance of independent contractors should focus on the quality and acceptability of the final work product rather than the manner in which it was produced. Under no circumstances should an employer use its employee performance review process to evaluate the work done by an independent contractor. It is also advisable to require independent contractors to provide periodic progress reports and to submit regular invoices as defined targets are met. Moreover, independent contractors should never be paid as part of the company’s regular employee payroll.

Where it is not possible in practice to conform the relationship to the legal requirements, employers may wish to consider alternatives such as re-documenting the relationship to align it with the applicable standards, or retaining a third-party staffing or workforce management company. Although not a panacea, the use of third-party staffing organizations can provide a meaningful buffer to liability under many circumstances and could greatly simplify day-to-day management of the relationship.

V. TRENDS AND SPECIFIC CASES

Recent years have seen vastly stepped-up enforcement efforts on the part of federal and state government agencies seeking to remedy revenue shortfalls in the wake of the economic downturn that began in 2008. All the while, the plaintiff’s bar has increasingly targeted employer use of independent contractors, and the number of class action lawsuits alleging misclassification under federal and state laws has risen steeply. All these developments have placed companies who enter into independent contractor relationships at substantial risk of adverse findings and judgments.

Increased Internal Revenue Service Enforcement and Voluntary Settlement Programs

In 2010, the IRS launched an intensified enforcement program involving widespread audits of businesses to uncover misclassification issues. A year later, the agency announced a new Voluntary Classification Settlement Program ("VCSP"), allowing employers to voluntarily reclassify workers previously treated as independent contractors without incurring tax obligations or penalties for past misclassifications. Under the VCSP, employers receive immunity from IRS misclassification audits in exchange for payment of 10% of the employment tax liability for misclassified workers for one year. Interest and penalties are waived. To be eligible to participate in the VCSP, an employer must, among other matters, have consistently treated the affected workers as nonemployees in the past and have filed the required Forms 1099 for these workers for at least the previous three years.

Participation in the VCSP has been relatively sparse, most likely because the VCSP resolves only an employer’s potential federal tax liability, but not any potential liability arising from misclassification under state tax, employee benefits, wage-and-hour, workers’ compensation and other employment-related laws. Concerned that participation in the program may highlight the existence of potential misclassification issues and invite further audits and lawsuits, many companies have remained wary.

Stepped-up Interagency Cooperation

In September 2011, the United States Department of Labor announced that it had entered into an unprecedented Memorandum of Understanding ("MOU") with the IRS. The MOU provides the foundation for future cooperation and information sharing among the two agencies to facilitate enhanced enforcement of federal tax, wage-and-hour, workplace safety and benefits laws in response to alleged misclassification of employees.

Several states have likewise formed interagency and joint task forces to combat the perceived misclassification problem. The task forces are generally responsible for facilitating the sharing of information and resources among the relevant administrative agencies, developing joint investigative and enforcement strategies, and encouraging the reporting of alleged violations. Agencies in at least 14 states have additionally signed MOUs with the federal Labor Department’s Wage-and-hour Division. At the same time, 34 state agencies now share information concerning misclassification issues with the IRS as part of the IRS Questionable Employment Tax Practices initiative, which aims to identify unlawful employment tax practices.

As a result of this vastly improved communication and collaboration among different federal and state agencies, a single audit by one agency may now result in investigations and enforcement actions at multiple levels under multiple different laws, each with its own potential penalties and other consequences. This means that misclassification of even a single position carries the risk of expansive agency enforcement. As agencies have intensified the publicity of enforcement proceedings, such actions now more easily attract the attention of the plaintiff’s bar, resulting in a greater risk of private lawsuits.

Emergent State Misclassification Legislation

As state agencies are collaborating with the federal government at increasing rates to curb misclassification, a significant number of state legislatures have also entered the
fray by passing legislation. Some of the new laws are specific to certain industries where worker misclassification is perceived to have been particularly rampant. For example, in company functions, to distinguish “freelancers” from employees, however, the IRS determined, following a classification audit, that the freelancers had been misclassified and were actually employees.

This conclusion prompted an ERISA class-action lawsuit by the freelancers, who demanded that Microsoft allow them to participate in a variety of employee benefits, including two of the company’s employer-sponsored ERISA retirement plans. On appeal, the federal Ninth Circuit Court of Appeals noted that the freelancers could not be materially distinguished from Microsoft’s remaining workforce: they often worked on teams with regular employees, they performed the same functions, they shared the same supervisors, and they worked the same hours. Microsoft then conceded that the workers were employees under the common-law test. The company argued, however, that the plan administrator had correctly refused to award benefits under the retirement plans, because the workers had agreed in their independent contractor agreements that they were not entitled to participate.

The court disagreed. The mere fact that the agreements labeled the workers as “independent contractors” was not dispositive, the court held, and the agreements were ultimately based on a mutual mistake and vehement refusal. Accordingly, Microsoft was directed to fund the workers’ retirement benefits retroactively. The case continued through several appeals, but was ultimately settled for close to U.S. $97 million.

The Microsoft decision stands in sharp contrast to the decision by the federal Tenth Circuit Court of Appeals in Capital Cities/ABC, Inc. v. Ratcliff.22 Like the workers in Microsoft, the plaintiffs in Ratcliff had signed independent contractor agreements affirming that they were not entitled to participate in the company’s ERISA benefits plans. The federal Tenth Circuit Court of Appeals found that the agreements had been voluntarily executed and that it was therefore immaterial whether the workers could be deemed employees under common law. Since the workers had sustained no damages, because they had realized greater earnings than he would have had as an employee. The Supreme Court disagreed, observing that the plaintiff had not received the vacation, holiday, or overtime pay paid to employees. If the plaintiff could demonstrate that he was a misclassified employee, the Massachusetts statute would thus entitle him to recover treble damages for any lost wages and other benefits.

The seminal misclassification case under federal tax and benefits laws is Vizcaino v. Microsoft Corporation.13 The case involved a group of workers Microsoft had classified as independent contractors and referred to as “freelancers.” The freelancers were compensated at an hourly rate that was higher than the wage paid to employees performing similar work, were paid through Microsoft’s accounts payable department rather than its payroll department, wore different badges and were not included in company functions. Despite these efforts to distinguish “freelancers” from employees, however, the IRS determined, following a classification audit, that the freelancers had been misclassified and were actually employees.

VI. Conclusion

In a 2006 report on employee misclassification, the U.S. Government Accountability Office highlighted the many inconsistencies in classification standards and aptly observed that “the tests used to determine whether a worker is an independent contractor or an employee are complex, subjective, and differ from law to law.”24 That observation remains true today. Indeed, not only do the tests vary, but so does their interpretation. Outcomes may vary from jurisdiction to jurisdiction and indeed from case to case. Navigating this legal maze can be challenging and treacherous. Any company doing business in the United States should tread with caution when hiring independent contractors and seek legal advice to manage the complexities of the legal landscape.
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