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Independent Contractor vs. Employee

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Introduction

The distinction between independent contractors and employers has long been a contentious issue in employment law and the subject of much litigation. The focus of the first part of this paper is the development of judicial tests traditionally used to determine the status of a worker. This will include a review of notable judicial authorities on the matter, along with a consideration of the ongoing relevance of these tests following legislative developments on the independent contractor/employee distinction in more recent times.

The second part of this paper will explore the practical implications associated with the distinction, including a consideration of the advantages and disadvantages associated with each status. This section will include a brief discussion of the potential financial and legal implications for a business where a worker, initially thought to be an independent contractor ('contractor'), is found to an employee.

Historical Legal Background

The statutory definition of *"employee" is* a relatively recent phenomenon. Historically, the distinction between whether a worker was an employee or a contractor was first developed by the Courts in the context of vicarious liability cases, when determining when an employer was liable to a third party for the torts of its employees (*Quarman v Burnett, 1840*). The distinction between employees and contractors has become more significant over time as the statutory protection afforded to employees has developed, and other factors such as tax, copyright and intellectual property implications "came to be" affected by the distinction of whether a worker is an employee or a contractor.

In the early decision of *Marshall v Whittaker's Building Supply Co,* Windeyer J provided an insightful explanation: "the distinction between an employee and independent contractor is rooted fundamentally in the difference between a person who serves his employer in his, the employer's business, and a person who carries on a trade or business of his own" (p.217).

Given the absence of express statutory guidance, over the years the Courts have developed and employed a number of tests to distinguish between whether a worker was an employee or a contractor. Examples of these common law tests include the Control Test, the Integration/Organisation Test, the Fundamental/Economic Reality Test, and the Mixed Test. It is important to note that no one test has ever been considered entirely determinative and they have often been used in combination when assessing the nature of a particular relationship. The variety of tests indicates that the employee/contractor distinction is by no means easy to draw. Furthermore, the fact that they have remained in regular use, even after the advent of a statutory definition of

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"employee", confirms the complexity of this aspect of employment law and is indicative of Parliament's intention that they should continue to play a role in determining whether a worker is in fact an employee or contractor.

The Control Test

Historically, the most influential of the various tests developed by the Courts was the Control Test. Under the Control Test, the court enquired as to whether the alleged employer had significant control over the individual. A contractor tended to have the freedom to provide the relevant services in the manner he/she saw fit. Where control was found to have been exercised by the alleged employer, this was found to indicate an employment relationship.

The Control Test was first recognised in New Zealand in 1904 in a case known as *Inspector of Factories v McIntosh* where the test was framed in the following way:

> The test usually applied is whether the employer retained control of the work and the men were bound to obey him….in the case of a contract the contractor is at liberty to do the work in his own way, free from the control of the other parties (p.265).

What mattered was the "ultimate control" over the employee (*Inspector of Awards v Michael Parnemann Limited 1998*). In other words, the Control Test did not require the alleged employer to exercise continuing detailed control over the work being done. Rather, instead of asking whether control was actually exercised, the test asked whether the alleged employer had the right to control the alleged employee.

Many commentators pointed out the deficiencies of the Control Test (see Drake, 1968; Mills, 1979; Merritt, 1982). It is particularly difficult, for instance, to see how a managing director of a one-person company can be said to be under the company's control. Yet, in the Privy Council case of *Lee v Lee's Air Farming Limited*, Mr. Lee, who was the governing company director, and held all but one of its 3,000 shares, was held to be an employee of the company. It was held that the right to control existed, even though it would have been for Mr Lee, in his capacity as agent for the company, to decide what orders to give himself. Looking at the matter from a different viewpoint, a high level of independence on the part of the individual is inconsistent with a high level of control by an employer or principal.

This test has been applied in more recent times; in *Challenge Realty Limited v Commissioner of Inland Revenue* where the Court of Appeal found that the employer's ultimate ability to control its employees pointed to the existence of an employment relationship. A few years later when the Control Test came back before the Court of Appeal in *TNT Express Worldwide (New Zealand) Limited v Cunningham,* the Court of Appeal held that while control remained a relevant factor in determining whether a worker was an employee, it was not the decisive factor; it is only one of several factors to consider when determining whether a worker was a an employee or contractor.

The Integration/Organisation test

The Integration Test was a move away from the Control Test as the primary means of determining whether an individual was an independent contractor or an employee. It was first "applied" in the case of *Stevenson Jordan & Harrison v MacDonald & Evans* by Lord Denning, who explained*:*

> One feature which seems to run through the instances is that, under a contract of service, a man is employed as part of a business, and his work done is an integral part of the business;

> whereas under a contract for services, his work, although done for business, is not integrated into it but is only accessory to it.

This Integration Test has enjoyed academic support as being consistent with the "economic reality" of employment relationships in the late 20th century and, as emphasising the economist's distinction between one who sells his or her labour power to the enterprise of another and one who operates his or her own enterprise (Wedderburn, 1986). The Court of Appeal adopted the integration test in *Challenge Realty Limited v CIR* where it said:

> The issue that must be settled in today's case is whether the worker is genuinely in business on his own account or whether he is "part and parcel of" – or "integrated into" the enterprise of the person or organisation for whom work is performed (p. 118).

In *Telecom South Limited v Post Office Union,* the Court of Appeal again referred to the Integration Test. The Court held that a clause in a contract providing for payment of salary on a monthly contract fee, which was transparently a tax device, was held to be outweighed by the fact that, among other things, the individual concerned was "fully integrated into the company's organisation".

The problem with the Integration Test is that, while it appears to be deceptively simple and logical, it is rather difficult to apply in practice. In particular, it does not reveal what degree of integration into the employer's business is required (*Ready Mixed Concrete (South East) Limited v Minister of Pensions and National Insurance, 1968*). How, then, does one determine what constitutes an integral part of the business of the organisation? Furthermore, there are some genuine independent contractors, such as IT specialists, whose work is often integral to the business of an organisation. In such cases, the Integration Test is of little assistance in determining whether an individual is an employee or not.

The Fundamental/Economic Reality Test

A further test adopted by many judges is based upon the concept of economic dependence. The test examines the practical realities of the economic relationship between the parties rather than scrutinising in detail the terms on which the individual is formally engaged. In *Re Porter*, Gray J said: "the level of economic dependence of one party upon another, and the manner in which that economic dependence may be exploited, will always be relevant factors in the determination whether a particular contract is one of employment" (p. 184-185)

The test has also been described as the "Fundamental Test" (see Goddard CJ in *TNT Express World (NZ Limited v Cunningham*) and the "Business Test". Essentially, the Economic Reality Test is a mirror image of the Integration Test. Whereas the integration test asks whether a person is part of the organisation, the economic reality test asks whether that person is truly independent of it (Anderson, 1995). The Court asks whether the individual has risked his/her own capital, and whether the individual has had an opportunity to profit from the work depending upon how he/she arranges the work in question. In *Market Investigation Limited v Minister of Social Security*, Cooke J gave the test an authoritative formulation:

> 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.

A similar analysis occurred in NZ *Dairy Workers Union v Southern Fresh Milk Co Limited,* a decision referred to by Goddard CJ in the *TNT* case. Goddard CJ explained:

> The ownership of a truck was one of two factors which persuaded me in NZ Dairy Workers Union ... that the driver who owned it was "capital" rather than "labour"; the other factor was that he was permitted to back-load his truck with products of persons other than the dairy company to which he was mainly contracted. This reinforced the claim that he was in business on his own, and not on the dairy company's account.

More simply put, where a worker supplies their own tools, has a chance of a profit or a risk of loss, the economic reality will likely be that they are running their own business.

The Mixed/Multiple Test

The Courts have also opted for an approach that combines a number of the tests together. This approach is often referred to as the Mixed or Multiple Test. In *McMillan Holdings Limited v Auckland Clerical Workers Union,* Blair J observed:

> The correct approach is to look broadly at the whole transaction and apply the various tests which the Courts have from time to time suggested should be used in deciding the category in which the particular workers should be (p.531).

In taking a Mixed/Multiple test approach, the Court would consider a number of factors
(i) The right to engage and terminate;
(ii) The power to delegate the performance of work;
(iii) The payment of wages and other remuneration;
(iv) Whether the person owns and maintains their own equipment;
(v) The intention of the parties;
(vi) The "label" that the parties have attached to their relationship.

(*Challenge Realty v CIR, 1990).*

Employment Contracts Act 1991

The word "employee" was first defined in the New Zealand employment law context in the interpretation section of the Employment Contracts Act 1991, which provided the following definition:

Employee –
(a) means any person of any age employed by an employer to do any work for hire and reward;
(b) includes-
(i) A homeworker; or
(i) A person intending to work:

A significant early decision under the Employment Contracts Act 1991 was the judgment of the Court of Appeal in *TNT Express Worldwide (New Zealand) Ltd v Cunningham*. In that case, TNT Couriers engaged Mr Cunningham as an owner/driver in the company's courier division. He transported small packages from the premises of customers to designated destinations. The owner/driver contract contained a provision which stated that Mr Cunningham a contractor and not an employee.

The contract bound Mr Cunningham to work exclusively for TNT. It required him to wear TNT's uniform, have his vehicle painted in TNT's colours, work set hours and provide personal service. On the other hand, Mr Cunningham was to provide the vehicle, the transport licence and insurance and be remunerated principally on a per trip basis. He was responsible for GST and ACC payments and it was over to him to employ relief drivers.

The contract contained termination provisions whereby TNT was entitled to terminate for cause, or either party was able to end the relationship on four weeks' written notice. TNT terminated the contract on 6 August 1991. Mr Cunningham claimed that the termination was unjustified and procedurally unfair and commenced a personal grievance claim under the Employment Contracts Act 1991 claiming he was an employee.

The Employment Court found that Mr Cunningham was an employee, relying upon both the Control Test and the Fundamental Test (*Cunningham v TNT Express Worldwide (NZ) Limited, 1992*), Mr Cunningham had been subject to a considerable degree of control and was considered to be fundamental to the company's business.

Interestingly, the Employment Court's decision was subsequently overturned by the Court of Appeal, which approached the case as one of interpretation of contract. The Court held that, where the terms of the contract were reduced to writing, the intention of the parties about the nature of the relationship was to be arrived at from a consideration of the contents of the written document read in the light of all the surrounding circumstances at the time of its execution. The Court held that "the parties' intention was to be discerned from the contents of the written contract, construed in accordance with ordinary principles. The parties label was not decisive" (ibid: 695).

Although acknowledging that TNT exercised tight control over its couriers, the Court of Appeal regarded the degree of control as more a reflection of the need for business efficiency in the courier industry rather than affecting the fundamental nature of the contractual relationship. In short, the Court of Appeal ruled that the exercise of control and other features of the dealings between the parties may only be illustrative of the terms of the contract rather than determinative of its nature. Justice Robertson observed that "in my view he [the Chief Judge] focused too much on the admittedly important aspect of control to the exclusion of the clear words of the written contractual arrangement" (ibid: 718).

Employment Relations Act 2000

The judgment of the Court of Appeal in *Cunningham* was viewed by some commentators as enabling employers to impose independent contractor relationships on workers when, in reality, the workers were working in situations that were identical to an employment relationship. To counter this, the Employment Relations Act (ERA) 2000 provided the Courts with an extended definition of the word "employee". Section 6 of the ERA provides:

(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
    (i) a person intending to work; but
  (b) 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.

(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 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.

[… **Emphasis added**]

Although the definition of employee remained almost the same as it had been under the Employment Contracts Act, under s6(2) and (3) of the ERA, the Court is now required to determine the "the real nature of the relationship" between the parties. In determining the "real nature" the Court is required to consider all relevant matters, including any matters that indicate the intention of the persons but is not to treat, as a determining matter, any statement by the persons that describes the nature of their relationship, such as the words of a contract. Such an approach was seen as a move away from the emphasis on the primacy of the written contract over other indicators of the relationship.

When the Employment Court considered the new s6 test for the first time in *Koia v Carlyon Holdings Ltd* (2001), the Court reiterated the commonly held view that the Court of Appeal's decision in Cunningham was evidence that, under the ECA: "the clearly expressed contractual intentions of the parties prevailed over all other considerations" (ibid: 25).

Subsequently, however, in *Curlew v Harvey Norman* (2002) another of the early authorities where the Employment Court applied the new ERA definition of employee, Judge Colgan (as he then was) disagreed that the Court of Appeal in *TNT* had relied purely on the words of the contract. Rather, he noted that the judgments in Cunningham:

> … all, to a greater or lesser degree, rely in deciding the case upon a consideration of all the relevant factors of which such an expressed term was one evidencing the intention of the parties at the time the contract was entered into (ibid: 25).

On this basis, it appears that the Court of Appeal's judgment in *Cunningham* was misinterpreted in *Curlew v Harvey Norman* and that, even before the enactment of the ERA, consideration was, nonetheless, given to other relevant matters by way of the various tests developed over the years. Judge Colgan in *Curlew* also considered that these traditional tests, including the Control and Integration Tests, remained relevant in determining the real nature of the relationship under s6 of the ERA.

Bryson v Three Foot Six

The leading authority on "the s6 definition" is the judgment of the Supreme Court in *Bryson v Three Foot Six* [2005] NZSC 34. Mr Bryson had been a model-maker hired to work on miniatures for the *Lord of the Rings* films. While not given an employment agreement when he started work, he was later provided with a written contract for all crew, which refers throughout to 'Contractor'

and 'Independent Contractor'. He worked fixed hours. He was subsequently made redundant and alleged unjustified dismissal.

The Employment Court considered that Mr. Bryson had been an employee (*Bryson v Three Foot Six, 2003*). It noted that the label given to the relationship was not to be treated as decisive. The Court had recourse to a wide range of matters, such as the control exerted over Mr Bryson and the extent of his integration into the business. For example, he could not accept other work engagements and had fixed hours of work, taxes were deducted at source; payment for statutory holidays was at double time or a day in lieu; the company provided him with protective equipment; all items created were to be the sole and exclusive property of the company, Three Foot Six.

Mr. Bryson had also worked closely with other members of the miniatures team and, as such, was thoroughly integrated. At the beginning of his engagement, he had received six weeks of training so it could not be said that he had contracted his skills from the outset. The Court also noted that Mr. Bryson's contract with the company read like a contract of service and rejected submissions that such terms and conditions were nothing more than common industry practice. The Employment Court determined that the real nature of Mr. Bryson's relationship with the company was that of employee and employer. Judge Shaw made the point that the decision was one made based on Bryson's particular circumstances.

The Court of Appeal overturned the Employment Court's decision. It relied particularly on the fact that he had signed an agreement describing himself as a contractor, and on industry practice, noting that a majority of workers in the film industry are contractors. The Court observed that this practice was common, given that a project could be terminated at any time, giving rise to constant fluctuations in labour requirements. The Court of Appeal was concerned that finding Mr. Bryson to be an employee would have an adverse impact on the New Zealand film industry by increasing costs and creating uncertainty. In finding that Mr. Bryson was a contractor, it observed:

> In light of industry practice there is no basis for holding Mr Bryson's relationship with the appellant was other than what was provided for in the contract he signed. It also follows that the Judge was wrong in treating industry context as confined solely to what the intentions of the parties were. It is directly relevant to the "real nature of the relationship" between the parties (*Three Foot Six Limited v Bryson, 2004: 11*).

The Court of Appeal's decision was, subsequently, appealed to the Supreme Court which found that that the Employment Court had duly considered industry practice. On that basis, Three Foot Six's appeal to the Court of Appeal was not based on any error of law. The Court of Appeal did not, therefore, have jurisdiction to hear the appeal and the Employment Court's decision was restored (*Bryson v Three Foot Six, 2005*).

The Supreme Court made a number of other observations. In particular, their Honours had reference to the terms and conditions of the crew deal memo which contained much that indicated a contract of service. They also noted that Mr. Bryson's engagement was effectively full time, with predictable hours. He was also fully integrated into Three Foot Six's business. The Supreme Court noted that evidence of industry practice did not seem to describe relationships similar to that between Mr. Bryson and Three Foot Six, and that prevailing industry practice ought not to obscure a consideration of the contract as it had operated in reality.

The Supreme Court ruled that while a Court is required to consider the words of the contract, these must be examined against the backdrop of the way the relationship operated in practice. On this basis, it was open to Judge Shaw in the Employment Court to conclude that the written contract was

not determinative because it did not give any reliable indication of the real nature of the relationship. Their Honours provided a helpful list of "all relevant matters" for the purposes of s6. These were said to include:

(a) the written and oral terms of the contract given that they often contain indications of the common intention of the parties
(b) any divergence from those terms and conditions in practice
(c) the way in which the parties have actually behaved in implementing their contract
(d) features of control and integration and a consideration of whether or not the person has been working on his or her own account.
(e) Industry or sector practice, while not determinative of the question, is nevertheless a relevant factor.
(f) Common intention as to the nature of the relationship, if ascertainable, is a relevant factor.
(g) Taxation arrangements, both generally and in particular are a relevant consideration however care must be taken to consider whether these may be made as a consequence of the labelling of the person as an independent contractor (*Bryson v Three Foot Six, 2005:* 32).

The law following *Bryson*

At the time the Supreme Court's decision in *Bryson*, there was a great fear that it would open the "flood gates" to successful claims of status as an employee (Cullen Law, 2010). However, authorities decided since *Bryson* have shown that this is not the case.

A little over a year after the Bryson decision, the Employment Court considered the employee/contractor distinction in the case of *Clark v Northland Hunt Incorporated.* Mr. Clark was engaged by Northland Hunt as a huntsman and signed a series of contracts for services. He was engaged to maintain the Northland Hunt's pack of hounds. He had considerable autonomy in maintaining and breeding hounds, and provided his own equipment. Mr. Clark was also registered for GST and invoiced Northland Hunt for his services.

In applying the Control Tests the Court noted that Northland Hunt had very little control over how Mr Clark used the property, maintained the pack of hounds and maintained other equipment. The Court was also not convinced that Mr Clark was integrated within Northland Hunt as an employee (ibid).

Finally, the Court was heavily persuaded by the Fundamental Test. The Court considered that Mr. Clark structured his engagement with Northland Hunt as a separate business and took advantage of minimising tax liabilities accordingly. As a result the Court held that Mr Clark was not an employee but an independent contractor.

A further recent significant authority on this issue is the decision of the Employment Court in *The Chief of Defence Force v Ross-Taylor.* In Assessing Dr. Ross-Taylor's status, the Employment Court had recourse to the "relevant matters" expounded by the Supreme Court in Bryson.

The Court found that Dr. Ross-Taylor was an experienced medical practitioner, who was familiar with running her own practice, and that she fully understood the nature of the contracts that she had signed on four separate occasions.

The Court was satisfied that the contracting arrangements had clear advantages for both parties and that it was their intention that Dr. Ross-Taylor would be an independent contractor. It was also relevant that, during the currency of the final contracting agreement, Dr Ross-Taylor had specifically addressed the issue of becoming an employee with the General Manager of the New Zealand Defence Force (NZDF), but had not progressed matters any further. The Court noted that it was not until the events that led to the termination of the agreement that Dr. Ross-Taylor claimed for the first time that the real nature of the relationship was one of employment and referred to the following warning in *Massey v Crown Life Insurance*: 581

> In the administration of justice the union of fairness, common sense and the law is a highly desirable objective. If the law allows a man to claim that he is a self-employed person in order to obtain tax advantages for himself and then allows him to deny that he is a self-employed person so that he can claim compensation, then in my judgment the union between fairness, common sense and the law is strained almost to breaking point... (ibid: 581).

The Employment Court reviewed the arrangements entered into by Dr. Ross-Taylor and the NZDF and noted that:

> 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 terminated, the real nature of their relationship was completely different. That is what the Authority found in this case on the basis of the skilful legal submission made on behalf of the defendant. I too had the benefit of these submissions (para. 30).

The Court noted that, while the intention of the parties is not determinative of the real nature of the relationship between the parties, it would be considered as part of "all relevant matters" as required by section 6 of the ERA.

In terms of the Control Test, the Court considered that Dr. Ross-Taylor was not under any close control of the Navy Hospital as to the performance or hours of her work. Her performance was not supervised and she was accountable only to the Medical Council of New Zealand and to her patients. She was able to decline work and free to work the hours that she chose.

The Court looked at the extent to which Dr Ross-Taylor was integrated into the Navy Hospital and found that, while her services were essential to the proper running of the Hospital, she was not integral to the NZDF's organisation of the Navy Hospital.

Finally, the Court considered the extent to which Dr Ross-Taylor was in business on her own account (the Fundamental or Economic Reality Test). The Court referred to the fact that Dr. Ross-Taylor was registered for GST and issued invoices under her letterhead. She engaged her own accountant and had claimed various tax deductions on the basis that she was self-employed. The Court considered that even though Dr. Ross-Taylor was working exclusively for the Navy Hospital, by the time arrangements came to an end, she was clearly working on her own account.

The Court concluded that the common law tests did not undermine the express intention of the parties, as evidenced by the contractual arrangements negotiated by them on four occasions. Accordingly, Dr Ross-Taylor was a contractor and was not entitled to any remedies following the termination of the contracting arrangement by the NZDF.

This decision disproves fears stemming from the Supreme Court's decision in *Bryson* that contractual labels would be disregarded at the expense of other factors. Instead, the assessment is clearly a balanced consideration of all relevant matters.

Practical implications of the choice

Before choosing whether to engage a worker as an employer or a contractor, an employer should weigh up the various advantages and disadvantages of each relationship. The difference between the two relationships can have important practical and legal implications.

Employees are offered significant protection under the law. Such protections are not afforded to contractors. The importance of the distinction is highlighted in the case of *Telecom South v Post Office Union* when Richardson J (as he then was) observed "the contract of employment cannot be equated with an ordinary commercial contract. It is a special relationship under which workers and employers have mutual obligations of confidence, trust and fair dealing" (p.772).

It is that "special relationship" which gives rise to the whole body of legislation and jurisprudence called employment law. That body of law is not only found in the ERA but also in what is colloquially known as the "minimum code". The "minimum code" is, in fact, made up of a number of statues, all of which provide an umbrella of protection to employees. By way of summary, employees' rights include:

(i) employment protections under the ERA, including access to personal grievance and dispute procedures;
(ii) The right to protection of employment while taking parental leave;
(iii) The right to paid statutory holidays and annual leave;
(iv) The right to sick or bereavement leave;
(v) The right to minimum wage protection;
(vi) The right to protections as listed under the Human Rights Act 1993.

The availability of the above minimum requirements is the reason it has become so essential to be able to identify when an employment relationship exists, as compared to an independent contractor relationship and the reason this issue has been so widely litigated.

Independent contractor agreements are particularly attractive to businesses where there is a need to cover a temporary increase in workflow or where a specific short term project arises. An independent contractor agreement may also be appropriate where a business wishes to retain ongoing part time consultancy services. The obvious advantage when engaging a worker as a contractor is that an independent contractor agreement can be terminated on notice when the contractor's services are no longer required. This offers a business greater flexibility to increase or downsize its labour force than would otherwise be possible with an employment relationship.

If a business identifies a significant and ongoing need for additional labour, and desires the exclusive service of a particular worker or workers, an offer of employment may be desirable. Such an arrangement will allow a business to exert greater control over the worker. The disadvantage in engaging a worker as an employee is that the worker will have access to the full range of statutory employment protections, including personal grievance provisions. An employer which attempts to terminate an employment relationship in the absence of misconduct, poor performance or a genuine redundancy situation may find her/himself facing a claim of unjustified dismissal.

When engaged as an employee, a worker will also be entitled to accrue sick leave, bereavement leave, and annual holidays along with any other leave entitlements provided under the relevant employment agreement, such as paid public holidays. These entitlements can constitute significant contingent liabilities, and the ongoing cost should be considered before an offer of employment is made.

Tax implications

There are also tax obligations to be considered. Classification as an employee rather than an independent contractor radically alters the tax obligations of both the employer and the employee.

Contractors generally handle their own tax payments, deducting business expenses, registering for GST and paying their own ACC contributions. Employees, on the other hand, have tax deducted by the employer (PAYE) and are not eligible to be GST registered or deduct expenses against their employment income. For these reasons, the use of an independent contractor agreement may be attractive to a business because of the reduced administration costs.

Risks when engaging independent contractors

Engaging an individual as an independent contractor can involve risk. Even if an individual signs an independent contractor agreement, it is always open to that individual to contest their status and claim that his or her relationship with the company is, in reality, that of an employer/employee. It is not unusual for such claims to occur when the engagement ends, particularly if it is at the business' initiative.

There can be serious legal and financial consequences for a business if a worker, once thought to be a contractor, is later found to be an employee. If a worker is found to be an employee, they may successfully bring an action for unjustified dismissal, leaving the employer liable for payments of holiday pay, lost wages and compensation for hurt and humiliation. There is even the potential for the former "contractor" to be reinstated to their former position within the business.

Employment obligations aside, where parties have proceeded on the basis that an independent contractor relationship exists, a Court decision or other settlement to the contrary would lead to a reassessment of both the employee's and the employer's tax liabilities and payments to date. The IRD may even choose to prosecute the employer for failing to deduct PAYE tax and other levies.

The risks associated with engaging independent contractors have not gone unnoticed by businesses, and the issue remains topical. During the course of negotiations last year regarding the production of the *Hobbit* series of films, Warner Bros. indicated that the "uncertainty" of New Zealand employment law was affecting their decision on whether to commit to filming in this country. In particular, they were concerned about the potential uncertainty surrounding the legal definition of "employee" following the decision of the Supreme Court in *Bryson v Three Foot Six Limited.*

To allay Warner Bros.' concerns and secure the production of the *Hobbit* film in New Zealand, Parliament swiftly enacted the Employment Relations (Film Production Work) Amendment Act

2010 under urgency. The Amendment Act came into force on 30 October 2010 and provides that all workers involved in film production are considered to be independent contractors, unless they have written employment agreements that expressly provide they are employees.

Conclusion

Businesses are advised to take particular care when choosing to engage a worker as independent contractor. It is particularly important to ensure consistency between the wording of the particular contract and the way the contract operates in practice over time. Where other factors point to the existence of an employment relationship, these may override express wording describing the worker as a "contractor".

Those who use independent contractor agreements need to be aware that the real nature of the relationship can change over time, so what starts off as an independent contractor arrangement may change during the operation of the contract into, what is in effect, an employment relationship.

In order to reduce the risk of this happening, companies should carefully monitor the manner in which the contractor relationship is conducted, to ensure factors that are indicative of an employment relationship do not unwittingly occur with the passage of time. For example, a business should take care to ensure that a contractor does not become too integrated into the business and retains a degree of independence in the way the contractor operates. Although a determination of the "real nature of the relationship" will always be a heavily fact-specific question, the following general questions, distilled from the common law tests, may be useful to a business wishing to ensure that an independent contractor is not or does not, over time, become an employee:

- What degree of control does the business assert over the contractor? It should not be similar to how an employer would control an employee.
- Is the contractor in business on his or her own account?
- Does the contractor only work for the particular business, or does he or she contract with a number of organisations?
- How independent is the contractor? Are the hours fixed or variable?
- Would it look like the contractor is a part of the organisation?
- Does the contractor supply their own equipment or tools?
- Where and when is the work carried out?
- Does the contractor invoice the business or is he or she paid by salary?
- Do payments to the contractor include GST?
- Does the business deduct PAYE and ACC levies or are these the responsibility of the contractor?

Arguably, however, a worker is no more likely to be found to be an employee under the ERA than would have been the case under the ECA. Through the use of the traditional tests, the Courts have long had regard to a range of relevant factors, and the label given to the relationship was never determinative. On this basis, the perception that *Cunningham* was decided solely on the words of the contract appears misplaced. Furthermore, *Bryson* was decided on its specific facts, given that the way the relationship operated in reality was different from the "contractor" label used by the parties. Recent authorities have disproved fears *Bryson* would open the floodgates, leading to a great many workers described as "contractors" being found to be employees. The label given by the parties to the relationship remains a valid consideration, along with all other relevant matters.

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