

ADVISORY: CONTRACTORS vs EMPLOYEES

What this advisory is about

Organisations can engage people in a number of ways, including as contractors, employees, and volunteers. Each form of relationship has different practical and legal considerations (and in some cases requirements). Employment relationships in particular bring with them a range of statutory entitlements and obligations. As a result, contracting can sometimes be seen as an easier or cheaper alternative. However, that only works if the underlying relationship reflects that arrangement. If you contract but in reality are in an employment relationship, issues can arise - particularly where the organisation ends the relationship or difficulties arise. This can negatively impact the organisation and result in legal issues and potential liability. It's therefore important to choose the right relationship to reflect your needs, document that appropriately, and manage the relationship accordingly.

This Advisory looks at the core differences between contractors and employees, and the implications if you use a contractor arrangement incorrectly (ie when the true nature of the relationship is one of employment). We provide a separate checklist that can be used to help determine whether someone might be a contractor or employee. If you want to set someone up as a contractor, we provide a template contractor agreement that outlines key clauses. As a practical aid, you can also use the factors in the checklist to help ensure that the way the relationship operates in practice reflects that of an independent contractor.

Employees and contractors – what's the difference?

Typically employees serve an organisation – another name for an employment agreement is a "contract of service", compared with contractor agreements that are "contracts for services". Employees are an integral part of the organisation and usually perform its core work. The organisation exercises a high degree of control and supervision over what they do and how they work. Employees are entitled to various minimum entitlements (including minimum wages, annual holidays and other types of leave). 'Good faith' obligations exist, and there are fair and reasonable process requirements that apply, including before making decisions to end an employee's employment or affecting them to their disadvantage. Employees can raise personal grievances, and have access to statutory dispute resolution procedures and forums, including mediation and the Employment Relations Authority.

Contractors are usually in business for themselves (whether or not this is through a separate legal entity, ie. their own company). They are typically at arm's length to an organisation and are contracted to provide services that are within their area of expertise. As a result, they tend to operate more independently and have greater control over when and how they work. Generally they can negotiate their terms, and they can influence the extent to which they profit, for example by working more efficiently, or providing services to other entities at the same time. For more information on these differences, see the attached checklist.¹

¹ Also, refer to MBIE's guidance on contractors vs employees: <https://www.employment.govt.nz/starting-employment/who-is-an-employee/difference-between-a-self-employed-contractor-and-an-employee/>

Scenario

An NSO engages Sarah as a contractor to provide financial services for 12 months (to replace the Finance Manager who left). The NSO and Sarah sign a contractor agreement, which says that Sarah will provide the services for 20 hours per week. Sarah provides the services at the NSO's office, for 4 hours a day, 5 days per week at times set by the NSO, using the NSO's equipment. She has to ask permission when she wants to be away from work. Sarah often attends management meetings and training, and socialises with the NSO's staff. Sarah is GST registered and she pays her own tax. While the contract provides for her to give the NSO monthly invoices, in practice the NSO pays her a set fee each month without requiring an invoice. The relationship starts off well, but then the quality of Sarah's work drops, and the NSO raises concerns about that. The contract reaches its expiry date. Sarah is now claiming that she was in fact a part-time employee and that she was unfairly dismissed. She is seeking reinstatement, compensation and various entitlements as an employee.

Is Sarah an independent contractor or an employee?

When answering this question, the Authority or Court would determine "*the real nature of the relationship*". It would take into account all relevant matters including any documentation, the level of control the organisation has, how integrated Sarah is in the organisation's business, and whether she is primarily in business for herself. Customary arrangements in the industry or sector can also be relevant, but in a limited way. The factors are not always black and white, and there is no one factor that tips the balance (even a signed contractor agreement or the fact that the person initially wanted to be a contractor will not be determinative on its own).

In this scenario, helpful questions to ask are:

- To what extent does the NSO control where, when and how Sarah works? Does it supervise and direct Sarah's work (and how closely)?
- What arrangements apply when Sarah takes a break or is unavailable?
- Is Sarah's work an integral part of the NSO's business?
- How does Sarah appear to people outside the NSO? How does the NSO introduce her or refer to her, does she use the NSO's uniform or branding, what does her email sign-off say?
- Where does she work and who provides the equipment?
- Does Sarah have to do the work herself, or can she arrange for someone else to do it?
- Can Sarah work for others?
- What payment, tax and ACC arrangements apply?
- Does Sarah have her own business?
- Who determines the fee?

If Sarah's claim is successful, what could it mean for the NSO?

If Sarah is an employee, the NSO could be liable:

- to pay her any shortfall in what she has earned based on the minimum wage;
- to accrue and pay her annual holidays and other leave entitlements (including sick leave, bereavement leave and public holidays);
- for reinstatement (and to continue to employ her as a permanent employee), lost wages, and compensation for hurt and humiliation (for example on the basis she was unjustifiably dismissed);
- to pay any unpaid tax (eg. PAYE) and Kiwisaver contributions;
- for penalties including under the Holidays Act and to the IRD (note that the IRD applies its own assessment of whether a person is a contractor or an employee for tax purposes, so there may be other tax implications as well).

Sarah's claim is successful. What could the NSO have done differently?

- Before engaging someone and signing an agreement, seek advice. Does the proposed arrangement look like an employment relationship or a contractor relationship? (Consider the attached checklist and template contractor agreement). Is casual, fixed-term, or part-time employment more appropriate?
- Draft the contractor agreement for a fixed term (ie. provide an expiry date), and, where possible, describe the term and the reason for the arrangement ending in that way in the same way you would for a fixed term employment arrangement. This helps manage expectations and potential legal exposure if the person challenges the situation and is found to be an employee.
- If you're looking to engage someone as a contractor, consider the various factors in this advisory, the checklist and template agreement. Can you make any adjustments so that the relationship operates as much like a 'typical' contractor relationship as possible? For example, can you limit the level of control you have over the person and the work? Can the person manage how, when, and where they do the work, use their own equipment, work for other organisations? Can you limit the extent to which they are integrated within your organisation, and manage how they are represented to others outside your organisation? What level of access to your systems, equipment and resources do they need (if any)? To what extent do they need to form part of your training, meetings and social events for other staff?
- Treat the relationship as a commercial relationship. For instance, negotiate the fee, pay the person on receipt of an invoice that they generate, and talk about the work in terms of service delivery.
- Contract with corporate entities where possible (eg. Sarah's company), not with individuals.
- Before the agreement expires - if you are looking to terminate the agreement or if the person raises concerns – seek advice. This may impact on the process you follow. For instance, if there is a risk the person could be an employee, you might take more of a consultative, employment-type approach to issues, share relevant information etc. Doing so will not make the relationship an employment one if it isn't, but will provide some protection from a claim if it is.

Summary

Contractor arrangements are an appropriate way to engage someone, and should be used when they suit the parties and reflect the true nature of the relationship. However, they should not be used to mask what is otherwise an employment relationship, for example to avoid minimum employment obligations. That could create legal liability and potential financial exposure, particularly where the relationship ends badly and the person challenges the termination.

Assess your situation, and if needed, seek advice when entering into contractor agreements. If you currently engage contractors, but you are concerned that they may be an employee in reality, there are some practical steps you can take now. Consider making some changes based on ideas from the checklist or this advisory so that the arrangement operates more like a contractor relationship in practice. If that is not achievable, you could explore changing the arrangements (and agreement) from a set point to better reflect the relationship, or look at ending the relationship amicably. Alternatively, you could take extra care in the future if issues arise, the agreement expires or if you look to end the relationship. The Sport NZ Legal Helpdesk can provide specific advice for your situation.

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