

Employee vs Contractor Know the Difference

Contractors, Employees & Employers: Valuable information that may save you money & avoid potential issues

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1. Employee vs Contractor

There are many differences between contractors and employees that affect the rights and obligations of the business and the worker. **Note: Don't get it wrong as it may cost you, see overleaf Section 2.**

To make the correct decision you must focus on the real nature of the working relationship not just the label the parties have given it. The courts have developed some legal tests to help you tell the difference, which are summarised below. Consider all the points that apply to your case to help you decide. No individual point provides the answer. If you are still unsure after you've read this document you should seek legal advice.

 EMPLOYEE	 CONTRACTOR (A.K.A. Self Employed)	EXAMPLES Self-employed people are sometimes referred to as contractors, but these two terms mean the same thing and for the purposes of this guide the term 'contractor' is used throughout.
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INTENTION TEST

The intention of the parties is relevant, but it does not on its own determine the true nature of the relationship between them. Intention is typically indicated in the written agreement between the parties.

Employment agreement (contract of service)	✓	✗	An employee MUST have an employment agreement (contract of service) in writing.
Contract for services	✗	✓	A contractor has a 'contract for services' with a principal, rather than an employment agreement.
Holiday pay	✓	✗	A contractor does not have to be paid holiday pay, whereas an employee does.
Entitlements for working on public holidays	✓	✗	A contractor does not get paid time and a half for working on a public holiday, or receive a day in lieu (unless agreed). An employee does.

CONTROL VS INDEPENDENCE TEST

The greater the control exercised over the worker's work content, hours and methods, the more likely it is that a person is an employee.

A worker with greater freedom to choose who to work for, where to work, the tools used and so on, is more likely to be a contractor.

Control over work, time, location	✗	✓	An employee usually has little to no control over the work to be done e.g. where, when, what, how e.g. the employer largely directs the work.
Set hours	✓	✗	A contractor generally has more discretion regarding how much time is spent at work compared to an employee who will likely have set times and days to be at work.
Control over their availability	✗	✓	A contractor generally has more control over their own availability to provide services e.g. they may make themselves unavailable on certain days of the week, or for a longer period because they are going on holiday. An employee generally has to request permission from their employer to take a day off, or to go on leave.
Supervision and direction	✓	✗	A contractor has their own "plan" of what work to do each day and which site to work at. He/she is usually a specialist in their field of work, and so does not need to be closely supervised or instructed how to do their job.

INTEGRATION TEST

This test looks at whether the work performed by the employee is integral to the employer's business (and whether they are 'part and parcel' of the organisation). Usually the work performed by a contractor is only an accessory to the business.

A person is more likely to be considered to be an employee of the organisation if the work is:

- The type that is commonly done by employees
- Continuous (Not a one-off project)
- For the benefit of the business rather than for the benefit of the worker

Works with own equipment	✗	✓	For an employee, the employer should provide all tools and equipment to do the work e.g. work van. A contractor generally provides his/her own tools and specialist equipment.
Team integration	✓	✗	A contractor is less likely to be integrated into the team e.g. not invited to company events
Paid by results	✗	✓	An employee usually has a set fee for their work e.g. a salary or wage, whereas a contractor may be paid by results.
Reimbursed for work related expenses e.g. travel, petrol, equipment hire	✓	✗	An employee is more likely to be reimbursed for work related expenses, whereas for a contractor, these form part of the costs of running their business.
Uniform that has the logo of the company working for	✓	✗	An employee is likely to wear the employer's uniform (if it has one) whereas a contractor would supply their own clothes.

FUNDAMENTAL / ECONOMIC REALITY TEST

The test involves examining the total situation of the work relationship to determine its economic reality. A contractor is a person in business on their own account.

Fees	✗	✓	A contractor usually charges a fee for their services, whereas an employee is paid a salary or a wage.
Minimum wage	✓	✗	A contractor can be paid whatever rate is agreed to. An employee must receive at least the minimum wage for all hours worked.
Pays tax directly to IRD	✗	✓	For an employee, the employer pays PAYE tax and ACC on the employee's behalf, and the employee is paid net wages or salary. A contractor generally pays their own tax directly to the IRD. In special situations the company or person the contractor is contracted to may deduct withholding tax (WT) on their behalf.
GST registration	✗	✓	A contractor must register for GST if earning over \$60,000.
ACC bill	✗	✓	A contractor is responsible for paying their own ACC levies.
Profit	✗	✓	A contractor is able to profit from their work. For example, they can often decide how much to charge for their services, and how many jobs to take on.
Have employees do the work	✗	✓	An employee is required to perform their job personally and is not able to engage anyone to replace them at work. A contractor can often get someone else to do the work instead of him/her either by subcontracting the work, or employing their own staff.
Financial risk	✗	✓	A contractor carries financial risk. For example, they may not profit from a job if their costs exceed budget. They may also give guarantees to cover breaches of their obligations. They may carry their own insurance to help protect against these risks.
Mainly working for one entity	✓	✗	A contractor may work for multiple principals at the same time e.g. a builder having contracts to do work for Company 'A', Company 'B' and Company 'C'.
Advertises for work	✗	✓	An employee looks for work e.g. answers a job ad looking for a worker, compared to a contractor who often advertises his/her services.
Invoices	✗	✓	A contractor usually issues invoices setting out their fees or charges in order to get paid. An employee usually gets paid automatically, and receives a pay slip.

2. Why do I need to know the difference between an employee and a contractor?

Here are just a few examples...

Employers: If you hire someone as a contractor when they are actually an employee, you may later be held liable for extra costs including: unpaid PAYE tax, unpaid minimum wages, holidays and leave entitlements. You may also be at risk of receiving penalties from the IRD and/or Employment Relations Authority (that could harm your reputation). Also you may be declined approval to bring in workers from overseas.

Employees: If you are hired as a contractor incorrectly rather than as an employee, then you may miss out on your minimum employment rights and your KiwiSaver employer subsidy (NZ Resident), plus you may end up paying tax and ACC levies that you didn't have to.

What are the main rights and obligations related to employees vs contractors?

An employee is a person employed to do any work for hire or reward under a contract **of** services (commonly called an employment agreement). The hire or reward is almost always a wage or salary.

Employees must get: 1) at least the minimum wage, 2) holiday and leave entitlements and 3) an employment agreement. Employees also have extra rights, like the right to take a personal grievance. Also, the employer must keep employee' records such as an employment agreement and wage-keeping details.

A contractor is a person engaged by a principal (the other party) to perform services under a contract **for** services (commonly called an independent contractor agreement). Contractors are self-employed. He/she earns income by invoicing the principal for their services. A contractor must pay his/her own tax and is responsible to pay ACC levies.

Contractors are not covered by employment laws. They are not eligible for employment entitlements (like paid holidays) unless such rights are agreed as part of their contract. Businesses don't have to hold contractor records.