

A-Z Guide

CONTRACTS FOR SERVICES



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Use This Guide to Understand

- The differences between a contract of service and a contract for service.
- The consequences of incorrectly classifying a relationship as a contract for service.
- The tests which are used to correctly classify the working relationship.

Contract for Service

A contract for service is a contract for something that is not a contract of employment. An **employee** is a person employed under a contract **of** service while an **independent contractor** is a person who enters into a contract **for** service.

A contract for service may be a contract between a principal and independent contractor, purchaser and supplier, or a service provider and client. For example, when a householder calls in an electrician to repair a faulty appliance or when a company has a carrier move its goods. It is essentially a commercial relationship, where terms and conditions are usually expressed in a written contract. It is subject to a variety of law, both common (case law) and statute, and many specialised subspecies of it have developed over time.

Features tending to indicate a contract for service are:

- The contractor determines how the service is to be performed.
- The contractor may subcontract the work to another contractor or require one of its employees to perform the work.
- The contractor is able to perform services for more than one business.
- The services the contractor provides are specialised and historically those specialist services have been independent of other businesses.
- Payment is requested by invoice and required at agreed intervals or at the completion of the service.
- The contractor pays its own ACC levy and is responsible for its own income tax liability including GST.

Note: This list is not exhaustive and cannot solely be used to determine the matter.

Contract of Service

A contract of service is an employment contract; it is between an employer and an employee (or an employer and union under the Employment Relations Act 2000). Historically this was a term used to describe the relationship between a master and their servant. The central character of this relationship was a high level of control by the master over what services the servant performed and the manner in which they performed them.

The Employment Relations Act 2000 does not define a contract of service but provides a meaning of employee and states that an employee is a person employed under a contract of service. The meaning of an employee is set out in section 6 of the Employment Relations Act 2000.

This definition includes both a homeworker, such as a cleaner or carer, and a person intending to work. It excludes a person who is working as a volunteer and certain types of people employed for film production work.



Consequences of Incorrectly Classifying the Relationship

It is essential to determine from the outset of a relationship whether the person is being employed as an employee or engaged under a contract for service as an independent contractor. The main issue with the incorrect classification of a relationship is that the provisions of the Employment Relations Act 2000 and those contained in the other Acts that make up the minimum employment code have no application to contracts for service. Incorrectly classifying an employee as a contractor may entitle that person to ask the courts to order you to repay that person any unpaid holiday pay, unpaid public holidays, sick leave and more.

Further, where the Employment Court enjoys an exclusive jurisdiction over matters concerning contracts of service, it has no jurisdiction over matters concerning contracts for service (other than being able to provide mediation to the parties). If a contractor is dismissed in accordance with their contract but is later on held to be an employee, the person may be able to argue that their dismissal was unjustified, and you will be obliged to defend this claim.

How to Determine the Nature of the Relationship

The Employment Relations Authority or the Court has jurisdiction to decide whether a person is an employee. To determine this, the Court must look at the real nature of the relationship between the parties as described in section 6 (2) of the Employment Relations Act 2000. The real nature of the relationship will be determined by looking at all relevant matters that show the intention of the parties. Any statement or agreement entered into will not be treated as being the determinative factor and the Court will look at the overall circumstances of each particular situation.

The Supreme Court in *Bryson v Three Foot Six Limited* 2005 NZSC 34 has confirmed that the historical tests such as the integration and the fundamental test are relevant in the determination of whether a person is an employee or not. The Court stated these tests are relevant matters which can be used to review the real nature of the relationship between the parties.

There is some overlap between them as the fundamental test also includes notions of control and integration. The decision in any particular situation will rest on the facts of the case in question.



The Relevant Tests

Control

The control test examines the level of control a person has over what work is to be done and how it is to be done on a day-to-day basis. The Court looks at how much control employers have over matters such as:

- Hours of work, time of work, location of work
- Materials or stock
- Labour levels
- Marketing, advertising and other costs of sales
- Training
- Performance standards
- Presentation of workers
- Warranties and guarantees
- Rate and timing of payment

Where employers have a high level of control over the work, the relationship is more likely to be that of a contract of service rather than a contract for services.

Integration

The integration test focuses on the level of dependence of the person's activities, and whether they are their own person or whether they are an integral part of the business organisation of an employer. An employment relationship is indicated if employers:

- Provide the work to be performed
- Provide the equipment/materials
- Administer the relationship
- Supervise the work performed
- Bear the costs associated with the finding of and the performing of the work
- Refer to and abides by statutory and regulatory obligations
- Insures and indemnifies the service it provides
- Are identifiable as the service provider and no independent operation is discernable
- Provide uniform for employees

Fundamental or economic reality test

This test looks at who has taken on the risk associated with venturing into business for the desired gains to assess whether or not the person concerned is in business on their own account. Consideration will also be given to whether it is normal to employ independent contractors in the industry.

Considerations will include the:

- Organisation of the work and how it is to be performed
- Exclusivity of relationship
- Dependence on outcomes
- Ownership of Goodwill
- Maintenance of standards
- Maintenance of commercial relationships
- Risk assumed and profit to be gained that is unavailable to employees

Independence

This test examines how independently the individual works and is the opposite of the control test. A contract for service relationship will be indicated if the person:

- Works, or has the ability to work, for other people
- Supplies their own equipment
- Works from home or their own premises
- Investor risk their own money in the activity
- Submit invoices for the work performed
- Profit from the successful running of the business

Intention

The intention test looks at what the parties themselves intended the contract to be. The intention may be determined from the terms of the contract and also by considering the way in which the contract has been performed.

The intention of the parties at the outset and whether there is any discernable change in the way the relationship works in practice over time that alters those original intentions are relevant matters for consideration.

A relationship that has the appearance of not being an employment relationship may nevertheless be one if it shares so many of the characteristics of an employment relationship that it cannot be distinguished from it no matter what the parties may have stated the nature of the relationship between them to be.

Industry practice is also a factor which needs to be considered. Whether other people working in the same industry in similar positions are independent contractors or employees is a factor which can help to determine the intention of the parties.

Application of the Law

It has long been established that an employment contract is an evolving creature and how it is defined by the law at its outset may not be how the law views it at its conclusion.

The current definitions of employee/contracts of service, and the contrast they provide with the definition of contracts for service, are applicable to relationships in practice.

Commercial contracts are usually reflected in writing. The requirement of the Employment Relations Act 2000, that all individual employment agreements entered into after that date must be in writing before they are entered into, and that new employees must be given the opportunity to seek advice on the intended agreement before entering into it, amounts to an additional safeguard against uncertainty over whether a person is an employee or an independent contractor.

Tax

Incorrectly classifying the relationship may have tax implications, it is therefore recommended that you talk with Inland Revenue or your Accountant about your situation.

Best Practice

Maintaining an up to date understanding of the law on this issue and reflecting on your business relationships and practices from time to time with reference to the law cannot be undervalued. The agreed terms of a contract for services should be recorded in writing. If you would like to purchase a template contract for engaging a contractor, you can do so by visiting www.ema.co.nz.

The EMA recognises that keeping up with best practice in all aspects of employment is time intensive. EMA Legal and Employment Relations Consultants are able to assist on this and many other matters when you need it. Contact the EMA AdviceLine and ask to be put in contact with one of our Legal/ Consultants.



Chart of Differences

Below is a chart summarising the main differences between contracts of service (employer/employee) and contracts for services (principal/contractor). Please note that this list is not exhaustive.

	The Contract of Service (Employer/ Employee) A person is employed to work for an employer for hire or reward as part of that employer's business and under the employer's control.	The Contract for Service (Principal/ Contractor) A person agrees to carry out work as an independent contractor, not as part of the employer's business or under the employer's total control. The key here is that it is not an "employment" relationship.
Agreement/ Contract	The parties state their relationship to be a contract of service (employment agreement)	The parties state their relationship to be a contract for service
Control over work	The employer determines "how" the work is to be carried out.	The contractor determines "how" the work shall be carried out.
Carrying out work	The employee must carry out the work personally; he/she may not delegate or subcontract it.	The contractor can or does carry out work for more than one business.
Exclusivity	The employee carries out the work exclusively for the one employer.	The contractor can or does carry out work for more than one business.
Integration	The employee, whether skilled or otherwise is an integrated part of the employer's normal business activity.	The contractor's work is often specialised and is not part of the business's activity.
Payment	Payment is by wages or salary paid on a weekly, fortnightly or monthly basis.	Payment is by lump sum or by accounts presented at intervals.
Pay Rate	The rate of pay is typical for an employee of that type.	The rate of payment reflects charge out rates for contractors.
ACC	The employer pays the ACC levies in respect of the employee for work related accidents.	The contractor pays his/her own ACC levy
Tax	The employer deducts PAYE from the employee's earnings	The contractor has responsibility for his/her own income tax liability.
Tools and Equipment	The employer provides tools and equipment or provides monetary compensation.	The contractor provides tools and equipment necessary.
Hours of work	The employer specifies hours of work.	The contractor has freedom to organise the performance of the contract.

Remember

- Always call AdviceLine on 0800 300 362 to check you have the latest guide.
Never hesitate to ask AdviceLine for help in interpreting and applying this guide to your situation.
- Use our AdviceLine employment advisors as a sounding board to test your views.
- Get EMA Legal or one of our consultants to draft an agreement template that's tailor-made for your business.

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