

Guide to Determining Whether you are Employed or Self Employed

Guide No.4 in the Tax Guide Series

About This Guide

This Guide has been prepared to help determine whether you are an employee or a self-employed person.

1. Why is it necessary to differentiate between employment and self-employment?

The income of any individual who receives payment for services will always be liable to income tax. However, the person's status as an employee or a self-employed person will affect the way in which the income tax is paid.

Employees do not have many income tax obligations as income tax is deducted under the PAYE system by their employer. Most employees will not need to file an income tax return and will find that their income tax obligations are quite simple. However, self-employed people pay their own income tax and have quite a number of income tax obligations. Understanding and complying with income tax obligations for a self-employed person is far more difficult than it is for an employee.

Because of the simplicity of the PAYE system, the Income Tax Office will routinely examine the circumstances of self-employed workers who only provide their personal services to determine whether income tax can be taken out of their pay under the PAYE system.

2. How do I know whether I am an employee or self-employed?

In most cases, it will be obvious whether you are employed or self-employed. For example, if you work for a business person in a factory or shop and undertake duties prescribed by the owner of the business, you are an employee.

However, in some cases, the distinction may not be quite as clear. For example, you may work for a number of different people and may not be required to attend for work every day. In some situations it might also be possible for two individuals engaged to carry out similar work to be treated differently. One may be an employee and the other may be self-employed because of the nature of their individual contract and terms of engagement.

Because there are many different ways that people can work, the income tax law does not define employment or self-employment but relies on the general meaning under common law and the decisions of various Courts of Appeal.

3. What is the difference between employment and self-employment?

Whether a person is engaged in employment or self-employment will depend upon the nature of the relationship between the person who does the work and the person who hires them. In this guide, these two people are referred to as the worker and the hirer.

An employment relationship as ordinarily understood would be one where a worker

provides services under the direction of a hirer for a nominated fee. This relationship is quite often referred to as a master/servant relationship and could be either under a written contract of employment or an oral agreement. It might also be for a period as short as one day, for an indefinite period, or a nominated period. The term master/servant relationship is used because it is indicative of someone working under the direction of another person. An employment situation will exist when the terms of the engagement are such that there is likely to be a master/servant (employee/employer) relationship.

4. What are the indicators of an employment relationship?

The indicators of an employment relationship are discussed under the headings of:

- Agreement of service.
- Control over the work and the worker.
- Output.
- Basis of payment.
- Exposure to financial risk.
- The existence of a contract.
- Integration with other employees.
- Provision of equipment.

5. Agreements of service

As noted earlier in this guide, employees are normally regarded as being engaged under an agreement of service because they provide their own personal services as required by the hirer. However, self-employed people are normally engaged under an agreement for service because there is normally a requirement for a specified outcome or product. Both forms of agreement are quite different as the first one relates primarily to labour and the latter relates primarily to the delivery of an outcome or product.

An agreement of service exists if the following two conditions are fulfilled:

- (i) The worker agrees to provide labour and skill in performing services in exchange for wages or other remuneration; and
- (ii) The worker agrees that in performing these services, he or she will be subject to the control of the hirer in sufficient degree to make the hirer the master.

6. Control over the work and the worker.

In an employment relationship, the employer has the right to control what the worker does, where it is to be done, when it is to be done and how it is to be done. Even where a hirer does not exercise the right to control, the mere fact that there is a right to do so distinguishes employment from self-employment.

In a self-employment relationship, the hirer expects an outcome within a specified period so there is some degree of control but there is no control over where, when or how it is done. This work can also be delegated in some cases.

7. Output

Contracts of service (employment) are generally for the provisions of labour and services rather than a defined output. A person who is engaged to provide a specified output would generally not be regarded as an employee where the arrangement is one for a service.

A common example would be a person engaged to prepare the annual financial accounts of a business. This arrangement would not be regarded as employment because the engagement is to supply a specified output – the annual accounts. Alternatively, the business may have regular financial and accounting staff who get paid for their services. Part of the job requirement might be the preparation of annual financial accounts but they are nonetheless employees because they are paid for their services.

8. Basis of payment

Employees are generally paid a fixed wage or salary by the day, week or month. In addition they often qualify for additional payments or benefits such as overtime, long service bonus, annual leave, sick leave or housing.

On the other hand, self-employed people are generally paid a fixed sum for a particular job.

9. Exposure to financial risk

Employees do not usually risk their own money or capital in carrying out their work.

A strong indication of self-employment may be the financial risk which a worker faces when undertaking a job. Individuals who risk their own money by buying assets, meeting their running costs, paying for overheads and materials are likely to be self-employed. In some instances, a self-employed person might also carry insurance against financial loss but it would be unlikely for an employee to do so.

In general terms, the more there is financial risk, the stronger the indication towards self-employment.

10. The existence of a contract.

A contract is an agreement between two or more parties which is intended to be legally binding. It can be written, oral, implied or a combination of these.

A contract can be either a contract of service (an employment contract) or a contract for services (a self-employment contract). The contract will be an employment contract where a contract provides for:

- (i) hours of work;
- (ii) work location;
- (iii) remuneration based on the duration of services (rather than output);
- (iv) entitlement to benefits such as leave, pension, housing, transport; and
- (v) reimbursement of expenses.

Where there is a written contract that contains all the terms of the agreement, the Income Tax Office will often decide employment status based on the written contract. However, the actual terms of an agreement are ultimately a question of fact and a contract will only

be relevant where actual tasks carried out under the engagement are consistent with the terms of the contract.

11. Integration with other employees.

A person cannot opt out of an employment relationship simply by entering into a contract of self-employment. If the tasks and activities carried out by a worker and terms and conditions of the engagement are similar to other employees it is most likely that the worker will also be regarded as an employee.

12. Provision of equipment

Employees may provide their own small tools of trade but self-employed persons will provide all the necessary equipment. If the hirer provides any of the equipment necessary to carry out the work, this will point towards the existence of an employment.

13. Other factors indicating self-employment.

Additional factors that would indicate a person is engaged in self-employment include:

- (i) the worker provides similar services to many hirers;
- (ii) there is a mutual intention not to create employment;
- (iii) the worker has a business-like approach to obtaining and organising the engagements;
- (iv) the worker incurs expenditure in this area of a type not normally associated with employment (for example provision of office accommodation, office equipment, etc.);
- (v) The worker can delegate his work to someone else if he is unable to do it.

14. Contracts primarily for the provision of services

The income tax law specifically includes a contract for services within the meaning of employment if at least 90% of the payment under the contract is for labour. Thus, a person would still be regarded as an employee even though they provide some materials and equipment for the job. The test is whether the cost of the materials and any specific charge for equipment is greater than 10% of the total contract fee.