Are Your Independent Contractors Independent?

Complying with Global Employee Classification Rules

Table of Contents

Employees vs. ICs

Companies use independent contractors for their unique skills or short-term projects. Staffing flexibility and fast access to in-demand skills, increasing overall efficiency, productivity and competitiveness in the market make hiring an independent contractor (IC) an attractive option. Employers want to ensure they treat their ICs as contractors, not employees, during their engagement. Labor laws around the globe apply to any worker who qualifies as an employee. Failure to comply could result in fines, penalties and a loss in credibility as an employer.

Businesses hire employees because they have control over how and when work gets done. The ability to supervise and direct employees in day-to-day operations can be crucial for efficiency, quality assurance and cost control. Good employees also can become valuable long-term assets. ICs are useful for short-term, one-off projects or something that requires a specialized skill the company doesn't need for the long term. Companies often develop relationships with ICs and engage them for other projects. ICs cost less than employees because employment and payroll laws don't apply to them.

A person working under a contract for services is not protected by labor law, so companies don't have to comply with laws that apply to employees. **They don't have to worry about:**

- minimum wages or salaries,
- overtime pay,
- leave,
- social security benefits, or
- unemployment insurance.

Hiring ICs rather than employees can be appealing, especially for companies seeking to control costs due to a tepid economy or to facilitate company growth. But it's not hard to step over the line between the two and treat contractors as employees. A company may not be able to point to contract terms to prove a contractor is independent if it has required the contractor to report to a manager. Employers and HR departments need to understand what makes an employee an employee.

SIDEBAR: Some people contract with companies through a professional service corporation they own instead of as an individual. Or they may be more flexible with contract arrangements because they do not want to be employees, often for tax reasons. However, contracting with a worker through their professional service corporation does not guarantee the worker is not an employee.

Labor laws control when a person is an employee, not contract terms. Companies that hire ICs want to make sure those contractors are treated as contractors, not as employees.

Employee Classification for Global Employers

When going global, companies must be clear about the nature of work arrangements they make with ICs. In many countries, labor laws require companies to make sure the people they hire or engage are not misclassified employees. This means a company that uses ICs must respect the independent nature of the work defined by the scope of the services contract and treat ICs as contractors. A company that treats its work relationship with an IC as it would an employee runs the risk of having misclassified the IC.

Another way to view the issue is that companies engaging ICs avoid labor law compliance by making sure that labor law doesn't apply to their ICs. In most countries, the existence of a services contract is not enough to avoid labor law compliance.

Typically, a person working for a company is an employee when the company controls and directs the worker on a day-to-day basis.

If an employer wants to ensure a worker is an IC, the answers to these questions should be "no."

- Does the company have control over daily matters such as process, discipline, or work rules?
- Do you set the work schedule and work hours?
- Do you provide a workplace, supplies and support staff?
- Do you pay for vacation, sick leave or benefits?
- Do you include a non-compete clause in the contract or prevent the worker from providing services to other clients?
- Do you bear the risk of profit or loss for the worker?

A worker may be an IC even if some of the answers are yes, but employers should look at the overall work relationship. Common themes of an employment relationship are:

- the amount of daily control a company takes over how and when the work is performed,
- the ability to restrict the employee from working for others, and
- the structure of compensation.

Fines, Penalties & Costs of Misclassifying an Employee

If an IC challenges its relationship with a company and the IC is found to be an employee, the company most likely will be held liable for employee misclassification. Misclassified employees can cost a company far more than typical employee compliance costs.

Depending on the country, a company may be required to pay:

- fines and penalties,
- back wages if the employee received less than minimum wage,
- back social security contributions for both the employee and the employer, plus interest,
- back income withholding taxes plus interest, and
- penalties for failure to file tax returns and pay taxes.

Most employers don't engage ICs to avoid complying with laws that protect employees or social security rules and contributions. However, if misclassification is found to be intentional or fraudulent, an employer will face hefty fines and penalties, including criminal fines and possibly prison.

Employment Relationships Around the Globe

Uncertainty about whether a worker is an IC usually results in the worker being classified as an employee. Labor law protects workers.

Almost every country has crafted unique factors under their labor laws for classifying people as employees, but those laws don't have a simple test that draws a clear line between employee and IC. Correct classification of a worker as an employee requires an analysis of the working relationship. Most countries have factors to consider in that analysis that often come from their judicial law.

Legal classification of a worker in a dispute can be complex. However, companies can avoid disputes by learning the basics behind the factors. If ICs perform their work independently within the scope defined by the contract, they should remain ICs.

Cutting Through the Confusion

Contracting for work as an independent worker predates modern labor laws and influenced what labor laws and their protections for workers look like today. But, despite decades of labor protections, confusion around the difference between an employee and an IC continues.

French law gives freelancers the choice of labor law protection by permitting companies to organize as a société de portage salarial (wage company) to employ freelancers and work as an intermediary for freelancers when they contract their services. But most countries leave managing an independent contract services arrangement to the company and the contractor.

Companies should be confident that engaging ICs rather than hiring employees will meet their business objectives. The work needed should be clearly definable, and the worker providing the services should have the necessary skills and experience to complete the work within the contract deadline. If cost is the issue, companies can look at other alternatives for hiring employees.

Below is a deeper look at the differences between ICs and employees in some of the world's major employment markets.

United States

The U.S. Federal Labor Standards Act (FSLA) defines an employer as “any person acting directly or indirectly in the interest of an employer in relation to an employee,” and an employee as “any individual employed by an employer.” The term “independent contractor” is not defined.

A Department of Labor regulation contains an economic dependence, or economic reality test that gives guidance on when an employee/employer relationship exists. A person is an employee if they economically depend on the employer for work. A person is not an employee if, as a matter of economic reality, they are in business for themselves.

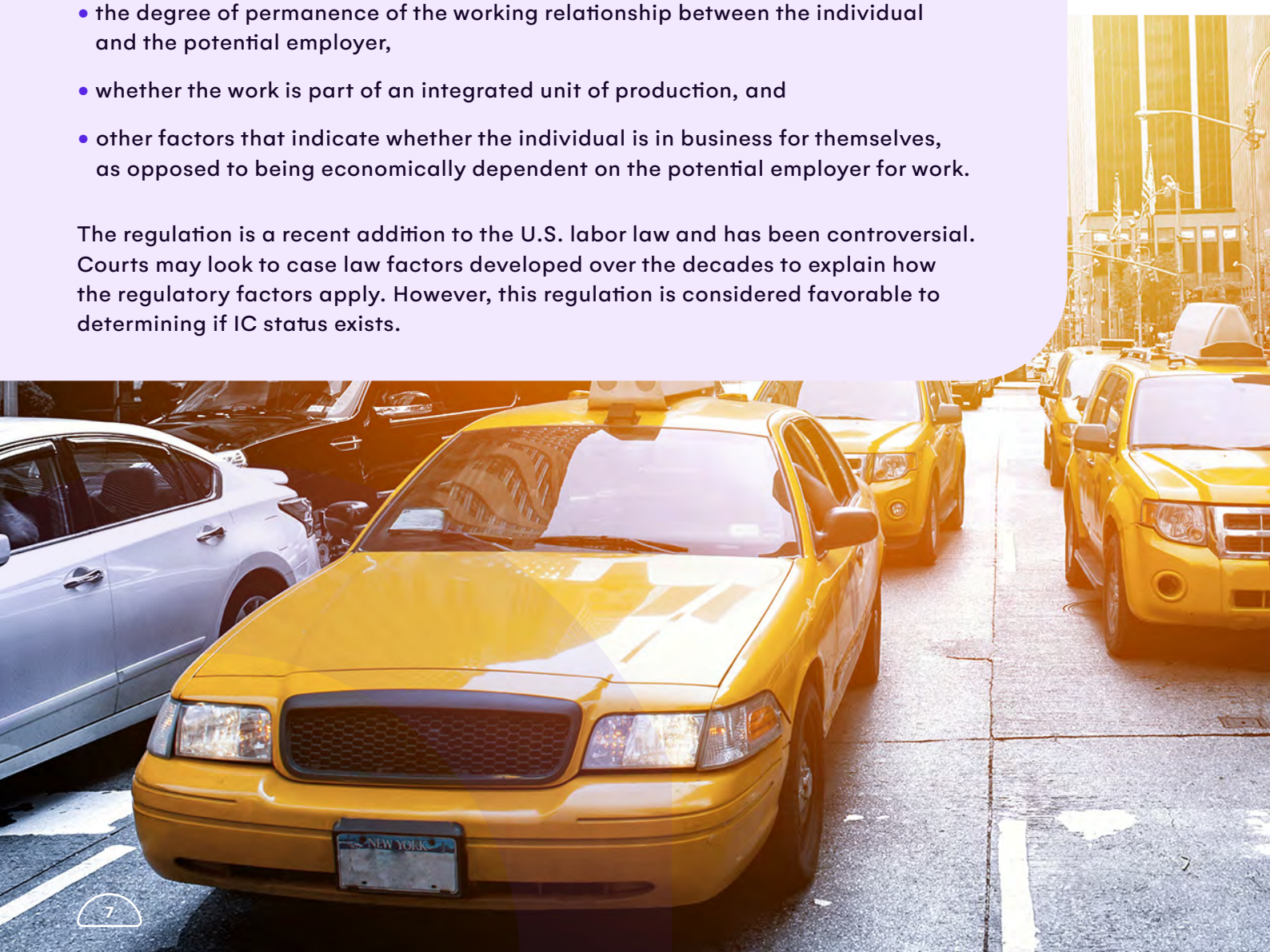
The regulation describes six factors to determine the economic reality of an IC’s situation, but assigns two as having the strongest weight:

- the nature and degree of control over the work, and
- the person's opportunity for profit or loss.

The other factors to weigh include:

- the amount of skill required for the work,
- the degree of permanence of the working relationship between the individual and the potential employer,
- whether the work is part of an integrated unit of production, and
- other factors that indicate whether the individual is in business for themselves, as opposed to being economically dependent on the potential employer for work.

The regulation is a recent addition to the U.S. labor law and has been controversial. Courts may look to case law factors developed over the decades to explain how the regulatory factors apply. However, this regulation is considered favorable to determining if IC status exists.



United Kingdom

The UK Employment Rights Act 1996 (ERA) defines an “employee” as someone who works under a “contract of employment,” also known as a contract of service. ICs are called “workers” and work on a personal or independent basis. As with other countries, the statutory definitions do not provide guidance on the difference between an employer/employee relationship and a contracting relationship.

Case law, called judicial law in the UK, provides four basic tests to help companies determine whether a person is an employee:

- **Mutuality of obligation.** Does the person have a statutory right to a minimum amount of pay, or are they required to work a minimum number of hours? Can the person refuse work when offered? Does the relationship end when a project ends?
- **Personal service.** Can the company substitute another person for the job at any time? The UK does not have “at-will” employment.
- **Control over the work.** Does the company have sufficient control over the person for the relationship to constitute employment?
- **Terms of the contract.** Is the contract more consistent with a contract establishing an employer/employee relationship?

In the UK, employers are required to actively determine whether the people they contract with should be properly classified as employees. The liability costs are steep if employers mis-classify workers as ICs.

Canada

In Canada, a worker is an employee when an employer/employee relationship exists.

Canadian case law uses a two-factor test to determine whether a person is an employee or an IC:

- **Subjective intention.** What was the intent of the parties based on both the written contract and conduct?
- **Objective reality.** Are the facts of the relationship consistent with the parties' stated intentions?

To determine whether a worker is in business for themselves or is part of the company's business, the company must weigh conditions around the working arrangement.

Spain

Under the Spanish Workers' Statute (Estatuto de los Trabajadores), a contract of employment is one under which a worker regularly provides services to the organization and direction of a company or other employer in exchange for wages for a period of time. In fact, an employment relationship comes with a "statutory assumption" status in Spain. The Workers' Statute establishes that an employment relationship exists every time work is performed under someone else's direction, organization and account for compensation.

As a result, a contract may require a worker to provide a specific service or do a precise activity personally and voluntarily, but these factors alone do not prove that the IC is not an employee.

Factors that determine the distinction between an employee and IC are:

- dependence of the worker,
- conditions for terminating the relationship,
- personal nature of the relationship,
- payment, and
- the exclusive nature of the relationship.

When classifying a worker, companies should also look at:

- the extent to which the company assumes the costs, risks and individual economic results of the worker's services; and
- the extent to which the worker depends on or is subordinated to the company, such as being within its disciplinary and organizational circle.

For workers, Spain's labor laws are especially protective. In recent years, a Spanish court held that drivers providing delivery services for online delivery services platforms are employees, not ICs. The legislature promptly enacted legislation turning the court's holding into statutory law.

India

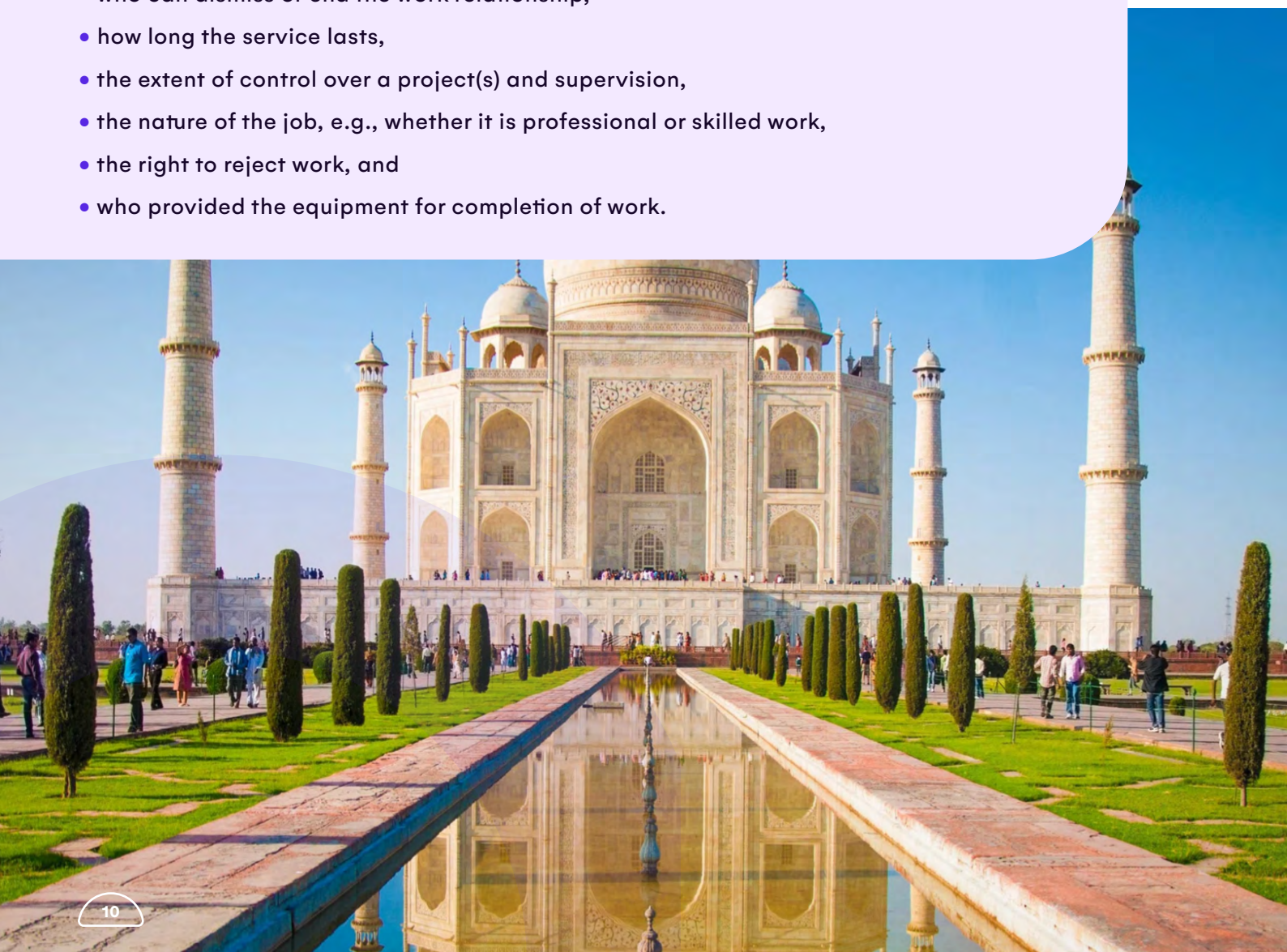
In India, an employer/employee relationship is a “contract of service,” not a “contract for service.” It is a relationship of master and servant that involves obeying orders in the work to be performed, and its mode and manner of performance.

Courts in India have developed a two-factor control and integration test to determine whether a person can be classified as an employee or IC. The control test looks at whether a master/servant relationship exists. In a master/servant relationship, the company not only directs the nature of work carried out by the worker but also controls how the work will be done. The nature and extent of such control vary in different businesses. The integration test looks at whether a person is fully integrated into the employer’s concern or remains independent of it.

In applying either test, courts will examine all relevant facts and circumstances, including the terms and conditions of the agreement with the worker.

Other factors a company should consider when hiring and contracting with workers are:

- who appoints authority,
- who is the pay master,
- who can dismiss or end the work relationship,
- how long the service lasts,
- the extent of control over a project(s) and supervision,
- the nature of the job, e.g., whether it is professional or skilled work,
- the right to reject work, and
- who provided the equipment for completion of work.



Poland

An employment relationship exists under the Polish Labor Code when:

- the relationship is for the benefit of an employer,
- the employee is under the employer's supervision,
- work is done in a place and at times fixed by the employer, and
- work will be performed based on a contract of employment.

The Code lists basic elements of an employment relationship, but the definition is further refined by case law.

Factors the courts consider when determining if an employment relationship exists include:

- the voluntary character of performing work,
- the personal performance of work in a continuous manner,
- the person's subordination to the employer,
- how work is performed, and
- how the company pays the person for work.

In Poland, two types of contracts are often used for hiring ICs—a contract of mandate and a contract for a specified task.

A contract of mandate is commonly used for ICs. Under a contract of mandate, an IC is not subordinated to the company and may perform only the work set out in the contract. An IC and a company may also enter into a contract for a specified task. For example, a company may hire a person to create a software program or write a song.

Labeling a work contract a contract of mandate or a contract for a specific task will not make an employee an IC. Companies need to be cognizant of the nature of the relationship they are creating with a worker and whether that relationship would be one of employment under the Code.

In Poland, companies must notify the Social Insurance Institution (ZUS) of each contract for the performance of a specific task within seven days after the contract has ended.

Singapore

In Singapore, an employee covered by the Employment Act is hired under a contract of service, while an IC is hired under a contract for service. Courts may re-characterize a "contract for service" into a "contract of service," should sufficient factors indicate that the relationship is factually that of an employer and employee. The courts look at the substance of the relationship rather than relying on its form.

Singapore's Ministry of Manpower has compiled factors useful for employers in determining whether an employment relationship exists:

Control

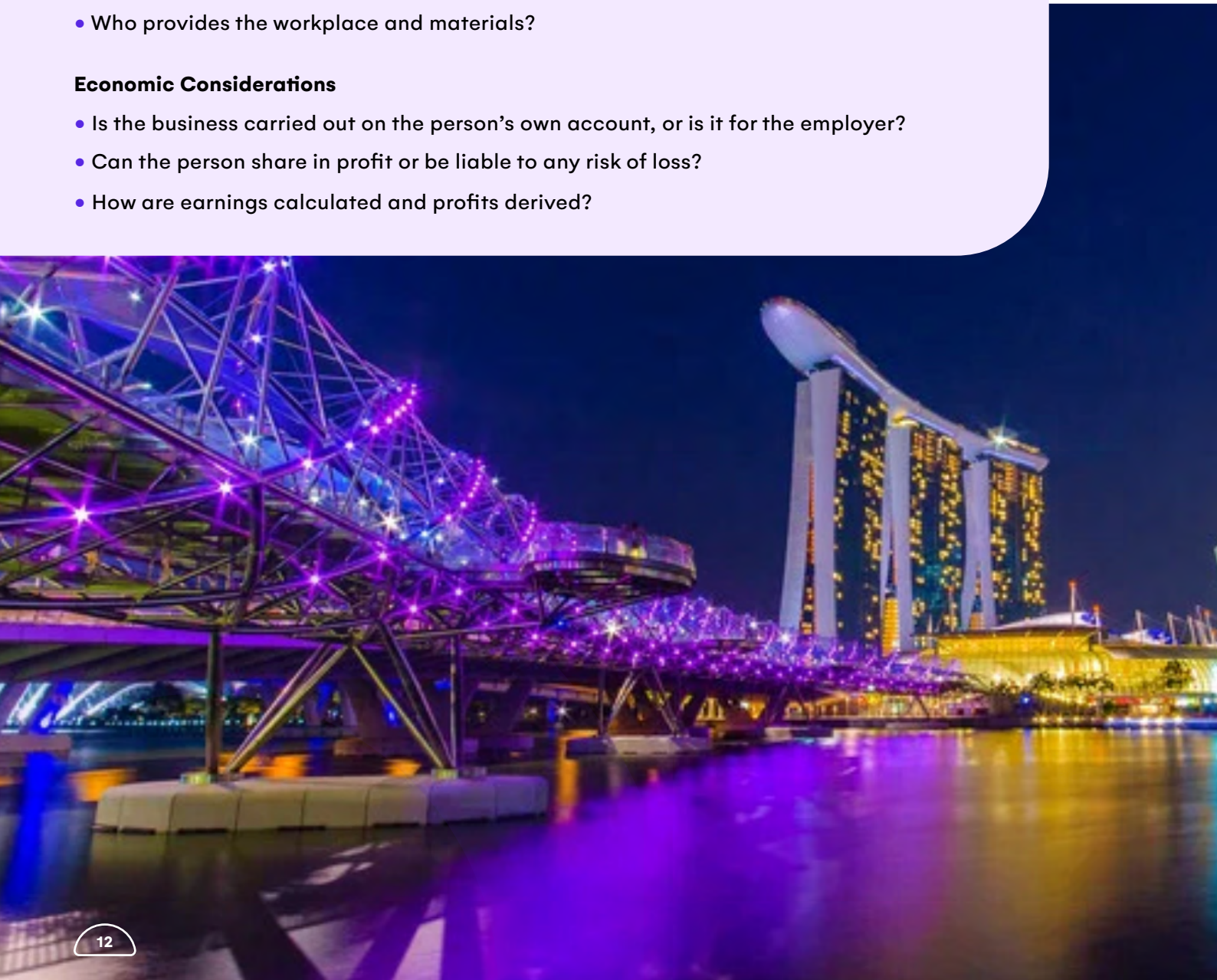
- Who decides on the recruitment and dismissal of employees?
- Who pays for employees' wages and how are they paid?
- Who determines the production process, timing and method of production?
- Who is responsible for the provision of work?

Ownership of Factors of Production

- Who provides the required tools and equipment?
- Who provides the workplace and materials?

Economic Considerations

- Is the business carried out on the person's own account, or is it for the employer?
- Can the person share in profit or be liable to any risk of loss?
- How are earnings calculated and profits derived?



Japan

Under Japan's Labor Standards Act (LSA), an employee is defined as a person who:

- is "employed at a business," and
- receives "wages" from the business.

The Japanese test of whether a person is an employee considers the control a company has over a worker and the dependency of a worker on a principal. The courts consider low income a sign of being a dependent and of an employment relationship.

An IC under Japanese law is a person that works as an independent service provider and is not subject to instruction or supervision by the company.

Factors that administrative authorities and courts consider in determining whether a person is an employee or an IC include:

- the ability to accept or refuse work,
- who decides how the work will be performed and managed,
- whether the company evaluates, supervises, or directly manages the person and their work,
- the discretion to decide working hours and workdays,
- who is responsible for damage in the performance of work,
- whether the worker uses or procures funds needed for the work tasks, and
- who owns the instruments or materials to perform the work.

Brazil

An employee is defined by the Brazilian Labor Code (CLT) as an individual who renders services to an employer on a permanent basis, under the employer's direction and for a salary. Professional subordination of the employee to the employer is essential in an employment relationship.

An IC relationship is subject to the Brazilian Civil Law. A person hired as an IC would and should be free to determine how and when the work is performed. An IC does not usually perform work that is necessary for the company on a permanent basis.

Brazilian Labor courts have determined factors that indicate subordination in an employment relationship including:

- the lack of self-determination to decide how the work should be done,
- the control of work hours, and
- the obligation to present reports and to observe previous business targets.

Mexico

Federal Labor Law (FLL) in Mexico defines an employment relationship as performing a subordinated personal service in exchange for wages and an employment agreement.

The main characteristic of any employment relationship is subordination, which judicial law has defined as:

- the employer's legal right to control and direct the employee, and
- the employee's corresponding duty to obey the employer.

An employment relationship may exist regardless of how an agreement is characterized by a company and a worker.

Factors the Mexican Supreme Court have found relevant in examining a contract for work include:

- Who controls when and where work will be performed?
- Who provides the tools to perform the work?
- How is the worker treated on a daily basis?

Egypt

Under Egypt's Labor Law, an employee is subordinate to the company they work for. Other factors distinguishing an employee include:

- The company hiring the employee is responsible for an employee's mistakes;
- An employee's work term is not fixed and may not end until the employee reaches the age of retirement; and
- The employer is legally responsible for the employee.

Contract language cannot guarantee a worker is an IC.

Nigeria

The Nigerian Labor Act uses the word "workers" to describe employees, and it defines workers as:

"Any person who has entered into or works under a contract with an employer, whether the contract is for manual labor or clerical work or is expressed or implied, or oral or written, and where it is a contract of service or a contract personally to execute any work or labor."

The Nigerian Supreme Court has set forth several factors to help determine whether a worker is an employee or an IC under the labor law:

- the mode of payment,
- ownership of the equipment, tools or instruments used in providing the services,
- the ability to delegate duty,
- the hours of work,
- the place where the work is carried out, and
- the provision of office accommodation and a secretary.

South Africa

In South Africa, the Labour Relations Act provides a rebuttable presumption that a person performing services for a company, or another person is an employee if one of seven factors is met:

- The company controls or directs the manner in which the person works;
- The company controls or directs the person's hours of work;
- The person is part of the organization;
- The person has worked for the company an average of at least 40 hours per month over the last three months;
- The person is provided with tools of trade or work equipment by the company; or
- The person works or performs services only for the company.

This rebuttable presumption applies only to employees who earn less than a threshold amount determined from time to time by the Minister of Labour. In cases where there is no rebuttable presumption of employment, the seven factors guide a decision as to whether a worker is an employee or an IC.

The South African courts will consider the substance of the relationship between the parties to determine if an employment relationship exists.

Saudi Arabia

Saudi Arabia's Labor Law does not define employee, but guidance can be found in the law's definition of an employment contract. An employment contract is a contract between a worker and a company in which the worker agrees to provide services under the management, control or supervision of the company in exchange for a wage.

The contract may be for:

- a specific or unspecified period of time in exchange for a wage, known as a term contract, or
- the performance of a specified job, known as a project-based contract.

Labor Law recognizes ICs if the status of the IC does not resemble an employment relationship. For example, an employment relationship may be found to exist where the company controls the IC, or the work performed by the IC based on the company's interests while paying the IC regular, fixed payments.

A foreign company that is not officially registered in Saudi Arabia may engage a Saudi national as an IC.

Australia

Australian labor law does not have a fixed legal definition for employee, but judicial case law offers factors under a multi-factor test to help determine whether a worker is an employee or an IC. In addition, Australia has a law that outlines and protects a person's rights and abilities to contract themselves out independently.

When a court determines the nature of a work relationship, it will look at many factors while considering all the facts of the relationship.

Factors that indicate a worker is an employee include:

- work is done under the direction and control of the company,
- fixed hours for work,
- an expectation of ongoing work,
- the company supplies work equipment, and
- The company assumes the risk for the employee's actions.

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