

Contractor vs Employee

A commentary by Tony McKone, Director McKone Consultancy, 14 October 2016

So, your business is growing and you want to take on more people to help you meet that increase in demand. That's great.

But what arrangement do you need to ensure that you are complying with NZ's employment law?

If you know your increase in demand is permanent, then you should be looking for permanent employees. This, however, means that you are taking on a long-term commitment where you and your future employee(s) have duties of good faith toward each other.

If you are contemplating taking on employees, then you need to be aware that you will have some duties towards those employees that are implied by common law.

These are:

- To pay remuneration – and that must be not less than the current minimum wage.
- To provide work – this means it is your responsibility to ensure there is work for the employee for so long as the employee is available for work.
- To provide a safe workplace – this is also extended into the Health and Safety at Work Act 2015.
- To take responsibility for the employee's actions – provided these are carried out on the employer's instruction and the employee believes those instructions to be lawful
- To treat employees with respect – this is backed up by the "good faith" obligations under the Employment Relations Act 2000.

The alternative to employees is to take on contractors to carry out work on your behalf. But how do you tell the difference between the two?

Employees are covered by an employment agreement, that is established under the Employment Relations Act 2000 and sets out the terms and conditions that the parties agree will form the basis of the employment relationship. An employee has the protection mechanisms of the Employment Relations Act 2000 available to them. A contractor does not.

An employee is also entitled to paid annual leave, paid sick leave, and paid bereavement leave. Where the employment relationship breaks down, an employee may raise a personal grievance or dispute through the employment institutes (mediation, the Authority or the Employment Court). As their employer, you are responsible for deducting and paying PAYE, ACC, KiwiSaver contributions.

A contractor does not have paid holidays, sick leave or bereavement leave. They are paid for the hours they work. They are also responsible for their own taxes, including GST where registered, ACC. Superannuation, and any other insurances that may be required. They do not have the right to raise a personal grievance or dispute in the employment institutions.

Despite what documentation that you might use to set up the employee or contractor relationships, that relationship can still be tested in the Employment Court or Employment Relations Authority.

There are three tests that generally apply to determine the real nature of the relationship. These are the Control, Integration and Fundamental tests.

The control test looks at the extent which the person has control over what work they do and how it is done.

The integration test looks at whether the person is part and parcel of the organisation. If they are integral to and integrated with your business, then that person is likely to be an employee not a contractor.

The fundamental test looks at whether the person is in business on their own account. If so, then they are probably a contractor. If not, then they are almost certainly an employee.

The questions that may be considered under this test include:

- Does the person provide their own equipment?
- Did they hire their own helpers?
- What degree of financial risk do they take?
- What degree of responsibility for investment and management do they have?
- Do they have the opportunity to profit from how they manage the performance of the task?

Some of my thoughts on employees' vs contractors

- An employee, while equally being an asset for the business, also creates a permanent financial liability. Amongst other things, you have to account for wages, ACC, annual leave, PAYE, and employer KiwiSaver contributions. If you are planning on taking on staff, you need to ensure you have budgeted for these costs and that you can sustain both the level of work to justify their employment and also the financial resources to be able to pay them regularly.
- You have to find and provide work to keep them gainfully employed.
- You need to have systems in place to keep good records of your employment agreements, leave records, pay records etc.
- You need to continually build the skills and knowledge of your employees if you want to grow and expand.
- You can build long term loyalty and stability through employees.
- Having employees allows you to not only build their skills and competence, but also grow your company's capability and capacity to deliver more work.
- A contractor is a short-term cost that can help you deliver a one-off outcome for a client.
- A contractor means you do not have to invest in training or developing in-house skills if they are not needed long term – this can be a pro and con to having a contractor.
- You need to be mindful of not becoming too dependent on contractors. Whilst having a contractor in place may be a sound short term option, long term this could be a weakness as you won't necessarily build your own in-house capability.
- A contractor may cost you more in the short term than an employee. You should ensure that when you use a contractor, you are getting a good return for that investment.
- A fixed term employee (temporary employee) with the right skills, knowledge and experience, may be just as good an option as a contractor – and won't cost you as much.
- In determining whether you have or need an employee or a contractor, the intent of what you are looking to do will be an overriding factor in determining whether a person is an employee or a contractor.