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Payroll Practitioners
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Developing and Supporting
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How to determine who is a Contractor and Employee?



Who is an employee?

A problem for payroll is when a person is employed by the organisation and yet when payroll looks at the work they do, how they are being paid and the paperwork that has been provided, they don't seem to be an employee but are in fact a contractor.

The distinction between the two comes down to common law terms:

- **contract of service** (this is when the employee agrees to serve an employer and they get remunerated for their labour; they must have a signed employment agreement under the ERA).
- **contract for service** (this is when a contractor agrees to provide a service but is not an employee and does not have an employment agreement under the ERA).



Five Tests to determine the difference

The difficulty has always been how to distinguish between the characteristics of these two relationships.

The Courts have established a number of tests to use to determine what the true relationship is in any one case.

Employers should note that tax cases use the principles established in respect of employment law.

Employers must look at each instance in its own right, and the decision in any particular case will always be a question of fact.

We will look at five common tests to determine if an contractor is a employee and vice versa.



Control Test

This measures the employer's right to control the individual's method of doing the work.

This includes for example:

- Who has the right to make choices about hours of work,
- Where their place of work is,
- If they have to wear a uniform, or code of dress in the workplace
- Can work be delegated to subordinate staff?

Result: The more control of a person by an employer the more they look like an employee.



Organisation of Integration Test

This test is about how integrated the person is with the business.

This includes for example:

- Is the work integral to the employer's business?
- Is it of a type that other employees do?

The more the person is integrated within the business the more they look like an employee.



Independence Test

This test is about how independent the person is.

This includes for example:

- How independently does the individual work?
- Does this person supply their own equipment?
- Can they choose to work from home?
- Can they work for other people?
- Do they maintain their own accounting system?
- Do they invest or risk their own money in the activity?
- Do they submit invoices in respect of the work performed?

The less independent the person is the more they look like an employee.



Intention Test

This test is about what was agreed verbally and in writing when the parties entered into the relationship.

This includes for example:

- What was the intention of the parties as to their relationship?
- Why is this individual being treated as a self-employed person?
- What has the relationship of the two parties been in the past?
- Is there enough evidence on which to base an assumption that these parties believed they were independent contractors?

Depending on what was verbally stated or in writing will potentially define the relationship between the parties. The more vague the terms are the less certainty in using this to define the relationship.



Economic Reality Test

This test is about where the person gets their money from.

This includes for example:

- Does the person only get their money from one business?
- Does the person work for many different organisations?
- Is this a normal situation within the organisation?

If a person gets all their money from one source that is typical of being an employee.