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Independent Contractor or Employee: How Some Countries Differ

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In this series of blog posts, we have examined the use of independent-contractor relationships by multinational organizations. In our last three posts, we identified issues for global entities that are considering using independent contractors when expanding their operations overseas, including international legal implications of an independent-contractor relationship (part I); a checklist of considerations before choosing an independent-contractor engagement (part II); and tips for drafting effective independent-contractor agreements (part III). In this, our fourth and final blog post in this series, we provide a short survey of particular considerations in several major and secondary market countries where independent-contractor vehicles are frequently used.

Below are a few illustrations of noteworthy jurisdiction-specific issues in independent-contractor relationships. These are by no means exhaustive of the listed jurisdictions' laws on the subject—the

bottom line is that any company should understand the local laws in advance of entering into an independent-contractor engagement.

Australia
– The Fair Work Act of 2009 levies penalties for "sham" contracting and provides some protections against discrimination for contractors. The definition of "employee" is also broader for certain statutes such as superannuation retirement benefits. Where a contractor does not have an Australian Business Number (ABN), the company may also need to comply with certain withholding requirements. Depending on the relevant province or territory, other laws may also apply.

Brazil
– In Brazil, the core functions of a business—such as nursing in a hospital—cannot be subcontracted and must be performed by employees. Additionally, independent contractors should be used in Brazil on a project basis only—indefinite relationships are presumptively employment relationships. Companies using independent contractors are strongly recommended to require contractors to set up their own commercial entity—but absent this, should obtain the contractor's registration as an autonomous worker or individual taxpayer from the INSS (*Instituto Nacional doSeguro Social*) as well as the municipality. Payments should be documented by professional services receipts, and it is important that payments be tied to services rendered. A service tax will apply to these payments.

Canada
– In Canada, factors leading to the conclusion that an independent contractor is really an employee include the following: the contractor receives training from the company; the contractor works with tools or equipment from the company; the contractor performs work central to the company's business; the company supervises the contractor's work; and the company (as opposed to the contractor) reaps the profit or suffers the loss in connection with the work. Contractors who are deemed employees are entitled to the protections of their province's labor laws—which differ from province to province, but generally include the right to some amount of notice before termination of employment. In many provinces, if an employee's written contract does not limit the notice period, that employee is entitled to common-law notice, which is usually above and beyond the statutory notice and can be a month per year of service of more. Finally, many Canadian courts recognize an intermediate category of "dependent contractors," who—even though not employees—are financially dependent on one particular principal company. Courts have held that these "dependent contractors" are entitled to reasonable notice of termination.

Chile
– In Chile, a company is ultimately responsible for ensuring compliance with labor and social security obligations in connection with its contractors' and subcontractors' employees. Companies that wish to shift this burden to the contractors must still regularly request government-issued certificates from their contractors to ensure compliance. Without a certificate, the companies must themselves withhold

appropriate amounts from the contractors' service fees—or will be held primarily liable for the compliance. Companies must also maintain an up-to-date list of contractors and subcontractors. In addition, workplace-safety compliance is required in connection with any workers on premises including contractors—and contractors count towards the thresholds for instituting a committee on health and safety (25 workers); and a workplace risk department (100 workers). Consequences for misclassifying an employee as a contractor include labor court fines for "simulation," or labor board penalties for fraud in hiring.

China

– Under China's Labor Contract Law, an employment relationship exists regardless of the form of the parties' agreement if the individual is subject to the company's internal rules and regulations, if his or her services are a critical part of the company's business, and if the company has a right to control the person's work. Article 82 of the law also provides that each employee is required to enter into written employment contracts with his or her employer, and employers that violate this provision must pay double the salary to the employee. Companies should thus make sure that any independent contractor: (1) contracts with the company through his or her own corporate entity; and (2) has a written employment contract with that corporate entity.

France

– Companies should require independent contractors to be registered on the Commercial and Companies Registry, the Commercial Agents Register, or another professional register, as this reduces the risk that the individual is considered an employee. However, if the reality of the situation reflects an employment relationship—that is, if the contractor provides services under conditions that render him or her in a subordinate relationship to the company—then this registration will not be regarded as sufficient to avoid the recharacterization of the relationship as employer-employee. The French labor code requires companies to ensure that the independent contractor has filed all the requested declarations, made payments of social security charges and contributions, and filed the mandatory tax returns with the tax administration, and also that, should the contractor employ staff, that he or she complies with all employment obligations in connection with these staff.

Germany

– In differentiating between independent contractors and employees in Germany, courts look at the parties' agreement and whether, in reality, the contractor can freely determine how, when, and where to perform its services. On the other hand, courts do not consider it particularly relevant whether the contractor is a registered business or whether the contractor is required to submit invoices (though the contract should designate any payments as "fees" rather than salary or remuneration). If an independent contractor is misclassified, reinstatement to an employment relationship is a realistic possibility, as is criminal liability for fraud resulting from failure to make social security contributions or civil liability of individual managers.

India

– Independent-contractor agreements, like other documents, must undergo a formal stamping process in order to be admissible as evidence in court in India. Additionally—and depending on the nature of the services the contractor is rendering in India—the company may be responsible for withholding taxes on service fees paid to contractors. Companies may prefer to shift this burden to the contractors to report and pay taxes, but nonetheless may face liability for failing to withhold. Ideally, the term of services under international independent-contractor agreements should be limited to a period of less than 240 days to reduce labor law issues in case of misclassification. The company should also ensure that the contractor is not under the control and supervision of the company and has not been authorized to negotiate or conclude contracts on the company's behalf.

Israel

– Parties to an independent-contractor agreement in Israel frequently include a provision identifying how much of the contractor's service fee should be designated as the "salary" amount for calculating compensation in the event that a competent tribunal deems the contractor an employee. Generally, the total service fee to a contractor amount should be about 25 to 30 percent higher than what is designated as "brut salary"—the extra 25 to 30 percent being an approximation of what an employer would have to pay in social insurance contributions, pension contributions, and severance in an employment relationship. When the designated salary amount is reasonable, these clauses reduce the potential damages in case of a dispute.

Japan

– Two factors are of particular importance in determining whether an independent contractor will be treated as an employee in Japan. First, contractor relationships may not be exclusive or subject to any restrictive covenants. Second, contractors should not be subject to company internal rules or regulations. Also, in Japan, giving day-to-day work instructions by one company (Company A) to an employee of another company (Company B) is called "Worker Supply" and is illegal, usually criminal. Contracting with an incorporated entity as opposed to an individual thus creates the additional risk of "Worker Supply"—in some situations, depending on whether day-to-day direction is anticipated, this concern might tip the scales in favor of contracting directly with an individual.

Korea

– The Supreme Court of Korea has set forth a list of 10 factors that are relevant to whether a contractor is improperly classified, including: (1) whether the company determines the scope of the contractor's duties; (2) whether the contractor is subject to the company's work rules or other employment policies or international regulations; (3) whether the contractor is under the company's direct supervision and control in performing the services; (4) whether the contractor determines the time and place of services and whether he or she may delegate performance; (5) whether the contractor can engage in other careers; (6) whether the contractor pays his or her own expenses; (7) whether the company supplies materials for performing services; (8) whether the contractor is paid a basic salary; (9)

whether the company makes applicable withholdings; and (10) whether the contractor participates in company benefit plans. If deemed an employee, the Labor Standards Act will apply, and the company could be subject to criminal penalties for any resulting violations—such as unlawfully deferring wage payments.

Mexico

– The recently-enacted amendments to the federal labor law imposes significant fines on companies that use alternative legal arrangements (like staffing agencies or contractors) to avoid or reduce its statutory labor obligations or employees' benefits. These penalties are in addition to any employment benefits and entitlements that would have been due to the contractor if he or she was an employee—notably in Mexico, employees are entitled to share in 10 percent of the employer's profits. Unless proven otherwise, services rendered by individuals are deemed to be of an employment nature. For corporate-tax purposes, an independent contractor is likely to be deemed a permanent establishment in Mexico if the independent contractor is acting out of the ordinary course of his or her business, including but not limited to: (i) acting under detailed instructions or general control of the company; and (ii) receiving a remuneration from the company in spite of the results of his or her activities. Companies wishing to use independent contractors despite the risk should have the contractor register with the tax authorities as an independent service provider and make sure to provide signed official pay receipts. In addition, companies wishing to use independent contractors should avoid exclusivity and non-competes as these are strong indicators of an employment relationship or a general control for purposes of being deemed a permanent establishment.

Netherlands

– To be treated as an independent contractor for tax purposes, any individual contractor needs first to obtain an exemption from the Netherlands tax authorities. When applying for the exemption, the contractor must specify certain information including the scope of work to be performed. If the work specified appears to be of an employment nature, the tax authorities will generally decline to grant the exemption. Without the tax exemption, the company must treat the contractor as an employee and withhold taxes accordingly. Otherwise, the company is at risk of being held liable for the required withholdings. The tax inquiry is separate from whether the contractor is misclassified under the labor laws—but a tax exemption is strong evidence that the contractor is properly classified under labor laws. Established self-employed contractors will likely already have obtained an exemption. Even when dealing with contractors who already have an exemption, though, companies should be mindful that the scope of actual work under any given contract needs to conform to what was represented to the authorities when applying for the tax exemption (as an extreme example, a company contracting with someone to perform market research cannot rely on that person's exemption for a window-washing business).

Spain

– Under Law 20/2007, certain contractors are considered "dependent" on a client where: (i) they perform personal services directly for that client on a regular basis; and (ii) at least 75 percent of their

income comes from providing those services for that client. In this situation, the client must adhere to certain protections for its "dependent contractors," which are reminiscent of employee benefits. For instance, dependent contractors are entitled to 18 days of leave per year and are subject to limitations regarding working time. They may also be entitled to damages for termination without cause (as defined in the statute).

United Kingdom

– Like most countries, the United Kingdom looks at the reality of the relationship in determining whether it is one of employment. Moreover many statutes such as the ones establishing the minimum wage, the anti-discrimination laws, and the whistleblower laws protect "workers," which is a broader group than employees. So even if a contractor is not deemed an "employee," he or she might be deemed a "worker." When considering alternatives to contractors, companies must be mindful of the Agency Workers Regulations, which provide that workers from a staffing agency or umbrella company are entitled to the same rights and benefits as the company's regular employees after 12 weeks.

United States

– Employers that misclassify employees as independent contractors are at risk under both federal and state law. Some states have task forces to deter and prevent misclassification—leading to aggressive prosecution, harsher penalties, and in some cases, criminal liability. Many federal and state agencies have information-sharing agreements, which might cause a small tax audit to become a huge labor audit and vice versa. Companies that have utilized a number of contractors in a single category are at risk of a collective action under the Fair Labor Standards Act (FLSA) and/or class actions under state wage-and-hour laws. Moreover, the FLSA and some state statutes provide double damages for willful violations. So, these devices for collective relief can result in massive damage awards.

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