Proskauer

International HR Best Practices Tip of the Month

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This Month's Challenge

The proper classification of workers as employees or independent contractors has significant financial implications around the world, but each jurisdiction uses its own criteria to define these terms.

Best Practice Tip of the Month

Be alert to the possible consequences whenever—and wherever—you engage individual workers as independent contractors. The wrong classification could lead to expensive retroactive liability.

Employee/Independent Contractor Classification Concern Crosses Borders

How a worker is classified can have important ramifications for companies in any country. In almost all jurisdictions, a company has more (and more costly) obligations to an employee than to an independent contractor. A determination that a worker was misclassified as an independent contractor generally means that the company will be liable for the payment to the employee of the employment benefits that were not paid, and payment to the government of the unpaid employment taxes, Social Security taxes and the like. In addition, various legal rights and obligations (for example, employment discrimination protections) will flow from the determination that a worker is an employee rather than an independent contractor.

In the U.S., the determination can be made by various federal, state and local agencies and courts, which may apply different (though usually similar) standards and criteria. The same situation applies abroad. Typically, the company’s designation of the relationship, and even an agreement between the parties specifying that the relationship is not one of employer/employee, are just factors to be considered but are not binding.

While different jurisdictions use different standards for determining the nature of the relationship, in most countries, the determination boils down to one factor: control. For instance, in France, an employment contract is one that contracts for: (1)?the performance of an activity; (2)?in return for remuneration; and (3)?which requires the existence of a superior-subordinate relationship between the parties. If the worker is found to be an employee, the employer must contribute to nationally mandated pension and social security funds, as well as provide the worker with all the same benefits as any other employee. Moreover, a French worker who has been classified as an independent contractor may apply for reclassification of his/her employment status at any time. If the French agency that is assigned the classification task finds that that there is a superior-subordinate relationship, the worker is entitled to back-pay and damages for benefits not received.

The existence of a superior-subordinate relationship, while dispositive in many jurisdictions, is not necessarily the determining factor in all. Sweden, for instance, utilizes a ten-part test, with each factor being weighed equally, including whether: (1)?there exists a personal duty to perform work according to the contract; (2)?there is actual personal performance of work; (3)?there are no predetermined work tasks; (4)?there is a lasting relationship between the parties; (5)?the worker is being prevented from performing similar work of any significance for someone else; (6)?the worker is being subject to the orders and control of the principal/employer concerning the content, time and place of work; (7)?the worker uses machinery, tools and raw materials provided by the principal/employer; (8)?the worker is compensated for his expenses; (9)?the remuneration is paid, at least in part, as a guaranteed salary; and (10) the economic and social situation of the worker is equal to that of an ordinary employee. If the nature of the relationship is in question, the issue is decided by a Labor Court. A worker who successfully convinces a court that he was actually an employee would be entitled to vacation, holiday and severance pay, and the employer would be required to contribute to the worker’s social security fund for the period during which the employee was misclassified.

Canada uses a four-part test, with similar consequences if an employer/employee relationship is found. In determining whether a worker is an independent contractor, Canadian law asks: (1)?Is there control? (2)?Does the worker furnish his own tools? If so, what is the cost of buying and maintaining those tools? (3)?Does the worker have a chance of profit/risk of loss? (4)?Are the activities of the worker integrated with those of the payor? As in most other jurisdictions, the consequences of the relationship being classified as an employment relationship are that the worker must be included in Canada's mandatory pension and social security programs. Again, the employer would be liable for all back-taxes, for benefits over the entire period of misclassification, and in some cases, equitable remedies that are at the discretion of the judge.

Regardless of the jurisdiction in which a company is operating, an employer wishing to use independent contractors must be vigilant in ensuring that the relationship does not begin to resemble an employer-employee relationship. Even if the contract clearly establishes that both parties view the agreement as one of an independent contractor, courts in the jurisdictions discussed above, and many others, may find, after-the-fact, that the facts and circumstances surrounding interactions between the parties establish an employment relationship. The costs of misclassification (in the form of vacation and holiday pay, payroll taxes, and benefits), especially when this misclassification occurred for numerous workers, can be tremendous. Maintaining an independent contractor relationship requires constant scrutiny, not just a solid contract.

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