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I hereby declare that I have read and understood the regulations governing the submission of MPhil dissertations, including those relating to length and plagiarism, as contained in the rules of this University, and that this dissertation conforms to those regulations.

Signed by candidate

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1. Introduction

A question that often arises is whether a particular person is an employee or an independent contractor, and what the obligations of the employer in such circumstances are.

The Fourth Schedule to the Income Tax Act requires any employer who pays any amount by way of remuneration to its employees to deduct pay-as-you-earn (PAYE) in accordance with the tables released by the South African Revenue Services (SARS).

Should it turn out that tax has not been deducted as required; the employer is the one that remains liable and can, in addition to the tax, be liable to pay additional penalties and interest on these outstanding taxes.

The purpose of this paper is to highlight some issues and suggest the criteria to be used in deciding whether a person rendering services is to be regarded as an employee or an independent contractor. This is achieved by examining a hypothetical example often met in practice.

2. The hypothetical scenario¹

A South African company is in the business of manufacturing and erecting gates and fences. The company is a BEE company and one of the aims of the company is to support (use) other BEE businesses.

The erecting of the gates and fences is done by subcontractors. Each of these subcontractors has their own team working for them. The subcontractors are responsible for paying their own employee's salaries. There are no written contracts between the company and these

¹ Base on true facts of a similar case dealt with in SARS.

subcontractors – everything is done in good faith. The subcontractor has the freedom to hire/fire his own employees.

The subcontractors know in advance where they have to go and the job to perform – a planning board is utilized for this purpose. They are regularly updated by the contract manager who sets out the work. The contract manager will book a specific subcontractor for 3 days at a specific site. If the work is done in two days, the subcontractor will still receive fees for three days work (if the job, however, is not completed in the said days, the subcontractor will only be paid for three days work). No remuneration will be paid in the case of unsatisfactory workmanship. The contractor manager does not intervene with the subcontractors' manner of working, therefore no detailed instructions. No training is given to these people (all of them were previously employed in such an industry). The company does not intervene with the subcontractor on who to employ, what tools or equipment to use, what routines, patents, or technology to use.

The subcontractors are paid on Fridays. They have to issue the company with a statement by Wednesday, listing all the work completed up to the previous Thursday (they do not provide the company with invoices – only claim sheets). A fixed daily rate of R 680 is paid and this will only change in a few instances, e.g. were more "fancy gates" (more expertise needed) are installed, but still these rates are fixed by the company and not determined by the subcontractor. The subcontractors are only paid if they work. It, however, seldom happens that there is no work for a specific subcontractor. Payments seem to be made regularly (on a weekly basis).

The company helps the subcontractors to obtain transport by taking out leases for bakkies on their behalf. They claim that they do this because they are a BEE company and know that these specific people have good expertise to do the job as required and they do not want to lose them. The payments are deducted from the subcontractor's earnings. All of these vehicles are in the asset register of the company. The company claims the lease payments on these vehicles.

All of the contractors have loan accounts with the company. No interest is charged on these loan accounts. The following costs are debited to their loan accounts; petrol, drill bits, legal expenses, tools, service of motor vehicles, insurance, safety boots, as well as hire of equipment. The company in one instance even paid the bond installments of one of the subcontractors. This payment is then debited to the specific person's loan account. A lack of self control to administer his own finance was the reason for this support.

The contractors are issued with two overalls per person in his team and one of these is paid by the company and one by the subcontractor. The costs regarding overalls are debited to their loan accounts. The name of the company is printed on the overalls.

Management would prefer it if the subcontractors don't work for the competitor, but there is no contract that prohibits them from doing so. The subcontractors are free to build a multiple concurrent client base and are not bound to work only for the company. However, it does not happen in practice (they do not do work for the competitor due to their loyalty to the company).

The question that arises is whether these contractors are independent or whether they are employees subject to employee's tax. One has to closely look at the definitions of an employee, an employer and remuneration as stated in the Fourth Schedule to the Income Tax Act² ("the Act"); the Interpretation Note No.17 that was issued by SARS on these specific matters; case law as well as Common law to answer this question.

² No.58 of 1962

3. Definitions as per the Income Tax Act

With reference to the Fourth Schedule to the Act employees' tax needs to be withheld where all three of the following conditions are present:

- there is an employee;
- there is an employer; and
- remuneration is paid

In terms of the Fourth Schedule of the Act "employee" means—

- “(a) any person (other than a company) who receives any remuneration or to whom any remuneration accrues;
- (b) any person who receives any remuneration or to whom any remuneration accrues by reason of any services rendered by that person to or on behalf of a labour broker;
- (c) any labour broker; and
- (d) any person, or class or category of person, whom the Minister of Finance by notice in the *Gazette* declares to be an employee for the purposes of this definition;
- (e) any personal service company;
- (f) any personal service trust; and
- (g) any director of a private company who is not otherwise included in terms of paragraph (a)”

In terms of the fourth Schedule of the Act "employer" means –

“any person (excluding any person not acting as a principal, but including any person acting in a fiduciary capacity or in his capacity as a trustee in an insolvent estate, an executor or an administrator of a benefit fund, pension fund, provident fund, retirement annuity fund or any other fund) who pays or is

liable to pay to any person any amount by way of remuneration, and any person responsible for the payment of any amount by way of remuneration to any person under the provisions of any law or out of public funds (including the funds of any provincial council or any administration or undertaking of the State) or out of funds voted by Parliament or a provincial council”

In terms of the Fourth Schedule of the Act “remuneration” means -

“any amount of income which is paid or is payable to any person by way of any salary, leave pay, wage, overtime pay, bonus, gratuity, commission, fee, emolument, pension, superannuation allowance, retiring allowance or stipend, whether in cash or otherwise and whether or not in respect of services rendered, including—

- (a) any amount referred to in paragraph (a), (c), (cA), (d), (e), (eA) or (f) of the definition of “gross income” in section 1 of this Act;
- (b) any amount required to be included in such person’s gross income under paragraph (i) of that definition;
- (bA) any allowance or advance, which must be included in the taxable income of that person in terms of section 8 (1) (a) (i), other than—
 - (i) an allowance in respect of which paragraph (c) applies; or
 - (ii) an allowance or advance paid or granted to that person in respect of accommodation, meals or other incidental costs while that person is obliged to spend at least one night away from his or her usual place of residence in the Republic;
- (c) 50 per cent of—
 - (i) the amount of any allowance or advance in respect of transport expenses referred to in section 8 (1) (b), other than any such allowance or advance contemplated in section 8 (1) (b) (iii) which is based on the actual distance travelled by the recipient, and which is calculated at a rate per kilometer which does not

- exceed the appropriate rate per kilometer fixed by the Minister of Finance under the said section 8 (1) (b) (iii); and
- (ii) the amount of any allowance referred to in section 8 (1) (d) granted to the holder of a public office contemplated in section 8 (1) (e);
- (d) the market value of any qualifying equity share contemplated in section 8B, determined on the date of disposal, which has been disposed of by that person and where the receipts and accruals from that disposal must be included in that person's income under that section;
- (e) any gain determined in terms of section 8C which is required to be included in the income of that person,

but not including—

- (i)
- (ii) any amount paid or payable in respect of services rendered or to be rendered by any person (other than a person who is not a resident or an employee contemplated in paragraph (b), (c), (d), (e) or (f) of the definition of "employee") in the course of any trade carried on by him independently of the person by whom such amount is paid or payable and of the person to whom such services have been or are to be rendered: Provided that for the purposes of this paragraph a person shall not be deemed to carry on a trade independently as aforesaid—
 - (aa) if he is subject to the control or supervision of any other person as to the manner in which his duties are performed or to be performed or as to his hours of work; or
 - (bb) if the amounts paid or payable for his services consist of or include earnings of any description which are payable at regular daily, weekly, monthly or other intervals;

- (iii) any pension or additional pension under the Aged Persons Act, 1967 (Act No. 81 of 1967), or the Blind Persons Act, 1968 (Act No. 26 of 1968), any disability grant or additional or supplementary allowance under the Disability Grants Act, 1968 (Act No. 27 of 1968), or any grant or contribution under the provisions of section 89 of the Children's Act, 1960 (Act No. 33 of 1960);
- (iv)
- (v)
- (vi) any amount paid or payable to any employee wholly in reimbursement of expenditure actually incurred by such employee in the course of his employment;
- (vii)
- (viii) any annuity under an order of divorce or decree of judicial separation or under any agreement of separation"

A question that arises is what is meant by "control or supervision of **any other person**" as stated by the exclusionary subparagraph (ii)(aa) of the definition of remuneration? The Interpretation Note (17) is very clear that the phrase **any other person** means the employer or the representative employer. Such person will ordinarily be the one who will make payments to the "employee" or the "independent contractor" on a regular or irregular basis. Therefore, I assume that "any other person" will be the person who remunerates the "employee" or "subcontractor". Such person will ordinarily be deemed to be the employer.

Another concern is the meaning of **earnings** as stated by the exclusionary subparagraph (ii)(bb) of the definition of remuneration.

According to the OXFORD Dictionary the meaning of earnings is as follows; "*the money that you earn for the work that you do*". Therefore, earnings will

either be derived from a specific job done by a person i.e. the person is only paid if he/she produces a result (commission agent) or for work done by a person on a regular basis (salary clerk).

4. Definitions as per the Labour Relations Act

In terms of section 213 of the Labour Relations Act³ 'remuneration' means –

“any payment in money or in kind, or both in money and in kind, made or owing to any person in return for that person working for any other person, including the State...”

In terms of same “employee” means –

- “(a) any person, excluding an independent contractor, who works for another person or for the State and who receives, or is entitled to receive, any remuneration; and
- (b) any other person who in any manner assists in carrying on or conducting the business of an employer...”

In *Denel (Pty) Ltd v Gerber*⁴ the appellant argued *in limine* that the respondent was an independent contractor. The Labour Court, however, referred the matter for oral evidence on the point *in limine*, and ruled that the respondent was an employee of the appellant at the time of her alleged dismissal.

³ Act No. 66 of 1995

⁴ (2005) 9 BLLR 849 (LAC)

5. Tools in determining whether a person is an employee as opposed to an independent contractor

Two sets of tools⁵ are available to determine whether a person is an employee as opposed to an independent contractor or vice versa, namely –

- the statutory tests; and
- Common law tests.

The statutory tests are conclusive in nature and in practice are considered first. If these tests apply, a person will be deemed to be an employee and any payments to such person will be treated as remuneration subject to employees' tax. The common law tests are the second tool and only apply if the statutory tests are not applicable in a particular situation. The common law tests do not permit a simple "checklist" approach and there are no hard and fast rules in determining whether or not a person is an independent contractor.

6. The statutory tests

The tests are listed under paragraph (aa) and (bb) of the exclusionary subparagraph (ii) of the definition of 'remuneration' in the Fourth Schedule of the Act.

The tests deem that a person shall not carry on a trade independently if:

⁵ SARS Interpretation Note No.17 at p 2

- the person is subject to the control of the company as to the manner in which worker's duties are or will be performed, or as to the hours of work.
- the person is subject to the supervision of the company as to the manner in which worker's duties are or will be performed, or as to the hours of work
- The amounts paid or payable for the person's services include earnings of any description, which are payable at regular daily, weekly, monthly or other intervals⁶.

If these factors do not exist, there is a belief that the recipient of the remuneration is carrying on an independent trade, therefore the remuneration paid to such person is excluded from the definition of remuneration and not subject to employees tax. However, if any of the above tests apply positively (it is only necessary for one of these tests to be applicable in a particular situation), there is a presumption that the person is not carrying on an independent trade, and therefore fees paid/payable to him are seen as remuneration and subject to employees tax. In such a case it is not necessary to consult the common law dominant impression test for purposes of determining whether an amount is excluded from or included in "remuneration"⁷. If however it is not certain that the individual is deemed not to be an independent contractor in terms of the above definition, further guidance must be obtained from the common law principles, referred to by the SARS as the "dominant impression test".

6.1 Control

For a very long period in South African judicial verdicts, the right of control has been held to be conclusive⁸.

⁶ SARS Interpretation Note No. 17 at p 6

⁷ *ibid* at p 6

⁸ *De Villiers CJ in Colonial Mutual Life Assurance Society v Macdonald* 1931 AD 412

“One thing that appears to me beyond dispute and that is that the relation of master and servant cannot exist where there is total absence of the right of supervising and controlling the workman under the contract; in other words unless the master only has the right to prescribe to the workman what work has to be done, but also the manner in which that work has to be done.”

Over the years the judges began describing the right of control not as decisive, but merely as important⁹. Joubert J.A. came to the following conclusion:

“The right of supervision and control is not the sole indicium but merely one of the indicia, albeit an important one and there may also be other important indicia to be considered depending upon the provisions of the contract in question as a whole.”

This then draws one’s attention to other factors (*“payment regime”* and the *“dominant impression test”*) that have to be taken into account to decide whether a person is an independent contractor or an employee¹⁰.

6.2 Control of Manner

With reference to paragraph 7.1.1 of the Interpretation Note No.17, an employer controls the manner in which work is done either by “detailed instructions”, “by training”, “by requesting that prior approval be sought by”, or “by instituting disciplinary steps in the event of unacceptable performance by the worker”.

The following would indicate that the “employer” exercised control over the “employee”;

- The employer decides which tools or equipment to use.

⁹ *Smit v Workmen’s Compensation Commissioner* 1979 (1) SA 51 (A)

¹⁰ Andre Neethling *EMPLOYEE V INDEPENDENT CONTRACTOR: WHEN MUST EMPLOYEES TAX BE DEDUCTED* 1995

- The employer decides which raw materials must be used and where it must be obtained.
- The employer decides which labour to employ.
- The employer decides which routines, patents or technologies to use.

One has to look at service contracts to determine if the “employer” has a right to exercise the required degree of control over the activities of the worker. Whether or not the employer actually exercises that right is not important – it is the right to control which matters, not the practical ability, which is relevant (e.g. a businessman cannot practically control or supervise the manner of working of a specialised professional although the right to do so is retained.

Thus, where an employer has the contractual power to control the manner of use of a workers’ productive capacity, either to the manner in which the person performs his/her duties or to the hours that the person must work, the worker is deemed to be an employee and his remuneration is subject to employees’ tax.

6.3 Supervision

The following is typical of an employer/employee relationship-

- The employer controls the work done.
- The employer controls the environment in which the work is done.
- The employer gives detailed instructions on the specific time spent on a specific job – when to begin or stop.
- The employer controls the order or sequence of the work¹¹.

By exercising the above control/supervision over the employee the employer enhances the productive capacity of the worker. This is indicative of an employer/employee relationship¹².

¹¹ SARS Interpretation Note No. 17 at p 12

The degree of supervision would be indicative of an employer/employee relationship. However, supervision is not an essential feature of an employee contract. The degree of control must be measured against the level of supervision which the nature of the work requires. For example, supervision may be largely absent in the case of certain professionals (such as an IT specialist)¹³. An employer may, however, inspect the performance of an independent contractor, but would normally not intervene.

In the hypothetical scenario, the contractor manager/ company does not interfere with the subcontractors' manner of working. No detailed instructions are given (except if a specific client has a specific need). No training is given to these people (all of them were previously employed in such an industry). The company does not intervene with the subcontractor as to who to employ, what tools or equipment to use, what routines, patents, or technology to use. No payment will be made in the case of unsatisfactory workmanship. The company does not control the hours that the subcontractors must work. The subcontractors are paid per result and not per hour.

They are, however, indirectly controlled by the company in the sense that the subcontractors' payments are linked to a fixed timeframe (if the job is not completed in the said days, the subcontractor is only paid for three days work – refer to hypothetical scenario). The employer gives detailed instructions on the specific time spent on a specific job – when to begin or stop.

Analysing all the abovementioned facts one will argue that the subcontractors are independent in the sense that they are not directly subject to the control or supervision of any other person as to the manner in which his duties are performed or to be performed or as to the hours of work¹⁴. One, however, has to look at all other relevant facts, like regular payments and loans made to these contractors, before one can make a decision.

¹² *Liberty Life Association of SA Ltd v Niselow* (1996) 17 ILJ 673 (LAC)

¹³ SARS Interpretation Note No. 17 at p 13

¹⁴ paragraph (ii)(aa) of the definition of "remuneration"

6.4 Payment regime

A worker can be paid with regards to a result or to effort. In the case of effort a person is paid if he works, regardless of the quality of the result or if there is any result. This contract is a *locatio conductio operarum* (an employer/employee contract). In such a case the employer controls the employee's effort to achieve results. However, if the employer is dissatisfied, it generally cannot apply financial sanctions. The employer can, however, increase control through supervision, training or dismissal¹⁵.

In the case of a result a person is only paid if he produces a result. This is a *locatio conductio operis* (the independent contractor agreement). In this case, the employer does not control the independent contractor's effort, but purchases the independent contractor's result. If the work is not done to the required specification, the employer can refuse to pay any amount or he/she can only pay a portion of the contract price¹⁶.

The conductor operis (independent contractor) is not under the supervision or control of the locator operis (employer) – he is relatively free from the employer's orders. Where a contract appears to be a mixture of work and services, it has been held that the dominant characteristics or impression will prevail¹⁷.

In the case of *GEORGE ELCOMBE (PVT) LTD v COMMISSIONER OF TAXES*¹⁸ it was held:

“Held, further, that on the facts established, the contracts for the performance of specific jobs had all the ingredients of contracts made by independent contractors and as such could be classified as contracts locatio conductio operas and not within the charge levied under the Act;”

¹⁵ SARS Interpretation Note No. 17 at p 9

¹⁶ *ibid* at p 9

¹⁷ *Ongevallekommissaris v AVBOB* 1976 (4) sa 446 (AD)

¹⁸ 35 SATC 257, 1973 (4) sa 407 (RAD)

In Interpretation Note 17, paragraph 7.1.2 SARS say:

“Payment at regular intervals (whether at a fixed rate per time interval or at a fixed rate per hour) which fluctuates depending on the hours actually worked, but without material reference to output or result for that interval, indicates that there is an acquisition of a worker’s effort (productive capacity), as opposed to a result of effort (productive capacity deployed). Payments by time-periods (i.e. payment for a result but with the reward merely calculated by time-periods worked) or payment for a service (in the sense of a result) must be distinguished from payment for time (payment for the worker’s effort over time, often measured in hours worked). If the employer is, for example, entitled to a worker’s services for all normal business or working hours, the employer has effectively acquired exclusive use of the productive capacity of the worker, which is indicative of an employee status.”

In the scenario the subcontractors are paid on Fridays. They have to issue the company with a statement by Wednesday, with all the work completed up to the previous Thursday. The subcontractors are only paid if they work. It, however, seldom happens that there is no work for a specific subcontractor. Payments seem to be made regularly (on a weekly basis).

One must take cognisance that regular payments in the building industry are the normal practice and would not necessarily render a subcontractor an employee.

In the current scenario the subcontractor is paid for a result. This is therefore a *locatio conductio operis* (an independent contractor agreement). If the job is not done in the required time, only a portion of the contract price is paid. Therefore, although the subcontractors receive regular payments (as envisaged by the exclusionary subparagraph (ii)(bb) of the definition of “remuneration”), they receive irregular amounts. Where the subcontractor does not work for a day, week or month they do not earn anything from the

company for that period. Quite clearly the legislature could not have intended such a method of payment to render the subcontractor an employee.

Paragraph (ii)(bb) of the definition of “remuneration” does not apply. Therefore, in this specific scenario, further guidance must be obtained from the common law principles, referred to by the SARS as the “*dominant impression test*”, as the subcontractor is not deemed an independent contractor in terms of the definition of “remuneration”.

7. The Common Law Dominant Impression Test

If the individual is deemed not to be an independent contractor in terms of the definition of “remuneration”, further guidance must be obtained from the common law principles, referred to by the SARS as the “*dominant impression test*”¹⁹. The SARS has issued a ‘*dominant impression grid*’ which it uses to determine the relationship between the employer and worker. This “grid” sets out twenty or more common interrelated indicators in tabular form and is not meant to be exhaustive. All these indicators must be taken into account to gain an overall impression of the actual employer/worker relationship. No one indicator is decisive²⁰.

These indicators have been classified into three categories, namely –

- Near conclusive indicators of the acquisition of productive capacity (i.e. of employee status or non-independent contractor status).
- Persuasive indicators of the acquisition of productive capacity (i.e. of employee status or non-independent contractor status).
- Indicators resonant of (i.e. creating an immediate or superficial impression of) an employee relationship or an independent contractor relationship.

¹⁹ Huxham, Haupt, Notes on South African Income Tax, 2005 at p.516

²⁰ SARS Interpretation Note No. 17 at p 7

7.1 Near conclusive indicators

These indicators are considered to be deciding factors in determining the relationship between the employer and the worker. The indicators are the following;

7.1.1 Person who must render the service

An independent contractor is normally free to hire, fire, pay or supervise his own workers (e.g. worker is free to choose who works for him). This is indicative of an independent relationship.

The following will be indicative of an employer/employee relationship:

- The employer has a contractual right to insist on the personal service of a specific worker.
- The employer has a contractual right to object where a certain worker is substituted by another one²¹.

In the scenario the person has the freedom to hire/fire his own employees and there is no requirement that the individual must render the services as a subcontractor.

7.1.2. Nature of obligation to work

The following will be indicative of an employer/employee relationship:

- There is an obligation on the worker/person to be present at all time, regardless of whether work is available.

The following will be indicative of an independent relationship:

²¹ SARS Interpretation Note No. 17 at p 10

- There is no indication that the worker be present anywhere at any time. The person does not comply with the employer's instructions about the nature and hours of work - the obligation to work is delineated by result and not time²²

In the scenario the contractor is not obliged by the hours he works. The contractor is driven by result and time. He is paid per result and not per hour.

7.1.3 Employer (client) base

The following will be indicative of an employer/employee relationship:

- The person is contractually bound to one employer (i.e the person works full time for the employer). The person is restricted in developing a client base and typically has no client base.

The following will be indicative of an independent relationship:

- The person has a right to build a multiple and concurrent client base.
- The worker is not economical dependent on one employer. It is, however, possible in certain industries (like the building industry) to only work for one employer over a period of time. For example, a subcontractor working on a specific building site. In such a case it may seem that the person is economically dependent on one client and therefore not an independent contractor. This is in essence true, but one must take cognisance of the fact that not one indicator is decisive in determining the status of a person²³.

In the scenario the contractor is in a sense dependent on the company as they do not do any work for anyone else. They have, however, the freedom to build a client base. Therefore the contractors are independent of the company

²² SARS Interpretation Note No. 17 at p 10

²³ SARS Interpretation Note No. 17 at p 11

as they have the freedom to build a client base, even if they do not build such a client basis.

7.1.4 Risk, Profit and Loss

The following will be indicative of an employer/employee relationship:

- The remuneration paid/payable to the person is not dependent on the sales/profit of the company (except for a commission agent).
- The person is not directly exposed to market risks.
- The person is paid a fixed salary regardless of defective workmanship.
- The person does not bear risks of increases in raw materials prices.
- The person does not make any business decisions (unless mandated to do so by the employer on behalf of the employer)

The following will be indicative of an independent relationship:

- The remuneration is dependent on the sales/profit of the company.
- The person is directly exposed to market risks.
- The person typically agrees on a set fee or price for a specific job and bears the risk of any losses if performance costs exceed that said price/fee.
- The person bears the risk of increases in raw material prices²⁴.

In the scenario the subcontractors agree on a set fee for a specific job. If the job takes longer, they only received the agreed fixed fee and extra time or work to be done is for the contractors' expense. They are also responsible for bad workmanship and will carry any financial losses because of that.

Therefore, the subcontractors are seen as independent.

²⁴ SARS Interpretation Note No. 17 at p 12

7.2 Persuasive indications of the acquisition of productive capacity

7.2.1. Reports

The existence of a reporting regime can be persuasive in favour of an employee/employer relationship. That is if the reporting is meant to give the employer feedback to enable him to control the manner in which the work is done. A reporting regime that amounts to control of the manner in which work is done, is sufficient to satisfy the “control” requirement in exclusionary subparagraph (ii)(aa) of the definition of “remuneration”²⁵.

In the scenario the contractors’ do not report to the employer, therefore indicative of an independent relationship.

7.2.2 Training

Training can serve as a technique of supervision/control;

- If it is intended to promote uniformity of production techniques and procedures; or
- If the purpose is to promote an exclusive production technique or form of service provision (e.g. client etiquette).

Training people to utilise the same techniques and procedures is an effective manner to control or supervise employees.

Training, therefore in most cases is indicative of an employer/employee relationship, except to where “product training” is given to for example a broker house. The typical independent contractor invests in his own training and normally is free to choose his/her own production techniques.

²⁵ SARS Interpretation Note No. 17 at p 14

In the scenario no training is given to the subcontractors, therefore indicative of an independent relationship.

7.3 Indicators resonant of (i.e. creating an immediate or superficial impression of) an employee relationship or an independent contractor relationship.

The existence of a term containing such an indicator, or of an aspect of the employer/ worker relationship embodying such an indicator, ordinarily would be regarded as relevant one way or the other, and must be considered in forming a dominant impression.

The following factors would be indicative of an independent relationship (not all the factors need to exist, but most of them should):

- The person utilises his own tools, production or office materials, business stationery, etc.
- The person operates his own office and is only temporarily present at the employer's usual work premises.
- The person can sustain his activities at other places than at the client's premises.
- The person is not dependent on the employer for its economic survival.
- The person does not have a job description or a position in the employer's hierarchy or organogram.
- The person's contract is normally terminated on achievement of a result or production of an item.
- The person has in most cases made a significant investment in his business.
- The person normally incurs typical business expenses (advertising, entertaining, bookkeeping, wages and travel) and builds these into his/her fee or contract price.

- The person makes provision for his/her own insurance and retirement.

In the scenario the subcontractors' meet most of the listed requirements to be seen as independent contractors.

8. The subcontractors have loan accounts with the company

The question that arises is why would an employer give a loan to an independent subcontractor? Why would the company help them? Is it maybe because of the BEE status of the company and its policy to support (use) other BEE businesses? I understand that a condition to getting contracts on a preferential basis as a result of your BEE status, is that you also need to show that you actively support (use) other BEE businesses. Maybe the subcontractors were unable to raise working capital and therefore the company assisted them in taking out leases in the company's name and allowing the subcontractors to pay it back? Maybe the reason for the other loan accounts was to make it possible for these people to start their own independent business. One has to ask the question if it is such an unusual deed to help small black subcontractors to start their own businesses²⁶.

A further question that comes to mind is, is the reason for these loans not to make these people dependent on the company? One has to look at the true purpose/intention of the loans as well as all the other surrounding facts and circumstances. The fact that the subcontractors were not obliged (no contract that prohibits them) to work only for the company should also be in the favour of independence.

One also has to take cognisance of the fact that each one of these contractors carries on independent businesses, which are not subject to the

²⁶ An opinion of a taxpayer in a similar situation.

control or supervision of the company, neither as to the manner in which the work is done nor as to the hours of work²⁷ The payments made to these subcontractors were also not made to them in their personal capacities, but to them as businesses, and they in turn have to pay their employees. They also have to utilise some of these payments to pay for their tools and other operating costs²⁸.

The court would apply its mind to all the facts and not only just to the issue surrounding the loans. Looking at all the factors I arrive at a dominant impression that the subcontractors are indeed independent contractors, although some indicators in the dominant impression grid indicate that they are probably employees of the company.

9. The deduction of employees' tax from non –residents

As previously stated employees' tax needs to be withheld where there is an employee, an employer and remuneration is paid – all these conditions must be present. The exclusionary paragraph (ii) of the definition of "remuneration" states, however, that remuneration does not include amounts paid/payable to independent contractors, except in the case where these subcontractors' are not ordinarily resident in the Republic. Therefore, employees' tax needs to be deducted from independent contractors who are not ordinarily resident in the Republic. These amounts paid/payable to such an independent contractor must be, however, for services rendered by the person in the Republic.

"gross income", in relation to any year or period of assessment, means –

"(ii) in the case of any person other than a resident, the total amount, in cash or otherwise, received by or accrued to or in favour of such person from a

²⁷ An opinion of a taxpayer in similar situation.

²⁸ refer to *ITC 1695* (63 satc 133)

source within or deemed to be within the Republic, during such year or period of assessment, excluding receipts or accruals of a capital nature." (emphasis added)

There is no definition in the Act of the term 'source'. Guidance must therefore come from the courts. There have been numerous cases dealing with the interpretation of the term.

With regard to employment and services rendered the Special Court for Hearing Income Tax Appeals has consistently held that the source is where the services are rendered and not where paid or where contract concluded²⁹. Therefore the services must be rendered by the independent contractors in the Republic.

In *CIR v Kuttel*³⁰ it was made clear that:

"the natural and ordinary meaning of 'ordinarily resident' was 'that a person must be habitually and normally resident here, apart from temporary or occasional absence of long or short duration'."

In *Cohen v CIR*³¹ the following meaning was given to the words "ordinary residence":

"his ordinary residence would be the country to which he would naturally and as a matter of course return from his wanderings; as contrasted with other lands it might be called his usual or principle residence and would be described more aptly than other countries as his real home".

This income paid to such a person must be for services rendered by the subcontractor in the Republic.

²⁹ *CIR v Lever Brothers, Millin v CIR, CIR v Epstein and COT(SR) v Shein; COT (SR) v Nell*

³⁰ 54 SATC 298, 1992(3) SA 242(A)

³¹ 1946 AD 174, 13 SATC 362

10. The concept of “independent contractor” at Common Law

The concept “independent trader” has very much the same meaning with regards to the Fourth Schedule of the Act and the Common Law. The main difference between the two terms is that the definition of “remuneration”, through exclusionary sub-paragraphs (ii)(aa) and (bb), mentions two of many possible indicators as a strict test to deem common law independent traders not to be independent for tax purposes.

South African law traditionally refers to the independent contract as a contract of *locatio conductio operis*. Roman labour law used the term *locatio conductio* to include three types of transactions, namely –

- *locatio conductio rei*, which is the letting and hiring of things;
- *locatio conductio operum*, which is the letting and hiring of services (the employer/employee contract; or
- *locatio conductio operis*, which is the letting and hiring of work (independent contractor contract)³²

The court³³ made the following distinction between the *locatio conductio operum* (contract of service) and the *locatio conductio operis* (contract of work);

“1 *The object of the contract of service is the rendering of personal services by the employee (locator operarum) to the employer (conductor operarum). The services or the labour as such is the object of the contract. The object of the contract of work is the performance of a certain specified work or the production of a certain specified result.*

³² SARS Interpretation Note No. 17 at p 23

³³ *Smit v Workmen's Compensation Commissioner* 1979 (1) SA 51 (A) (Also see *SABC v McKenzie* (1999) 1 BLLR 1 (LAC))

It is the product or the result of the labour which is the object of the contract.

- 2 *According to the contract of service the employee (locator operarum) is at the beck and call of the employer (conductor operarum) to render his personal services at the behest of the latter. By way of contrast the conductor operis stands in a more independent position vis-à-vis the locator operis. The former is not obliged to perform the work himself or produce the result himself (unless otherwise agreed upon). He may accordingly avail himself of the labour or services of other workmen as assistants or employees to perform the work or to assist him in the performance thereof.*
- 3 *Services to be rendered in terms of a contract of service are at the disposal of the employer who may in his own discretion decide whether or not he wants to have them rendered. The conductor operis is bound to perform a certain specified work or produce a certain specified result within the time fixed by the contract of work or within reasonable time where no time has been specified.*
- 4 *The employee is in terms of the contract of service subordinate to the will of the employer. He is obliged to obey the lawful commands, orders or instructions of the employer who has the right of supervising and controlling him by prescribing to him what work he has to do as well as the manner in which it has to be done. The conductor operis, however, is on a footing of equality with the locator operis. The former is bound by his contract of work, not by the orders of the latter. He is not under the supervision or control of the locator operis. Nor is he under any obligation to obey any orders of the locator operis in regard to the manner in which the work is performed. The conductor operis is his own master being in a position of independence vis-à-vis the locator operis. The work has normally to be completed subject to the approval of a third party or the locator operis.*
- 5 *A contract of service is terminated by the death of the employee whereas the death of the parties to a contract of work does not necessarily terminate it.*

- 6 *A contract of service also terminates on expiration of the period of service entered into while a contract of work terminates on completion of the specified work or on production of the specified result.”*

11. The taxation for labour only subcontractors

A ruling issued by SARS, which is effective as from 1 June 2004, requires PAYE (at a rate of 10%) to be deducted from the payment made by the main contractor (employer) to a labour-only-subcontractor³⁴. This ruling has been issued to the building industry only.

A labour-only subcontractor is a subcontractor who provides his services, as well as the services of the people that work for him, to another contractor (employer). He is paid per unit of work delivered and does not provide any materials in the carrying out of his work. An individual who provides his services on his own without a team is deemed to be an independent contractor and must be taxed at a different rate.

The ruling applies only to individuals (operating as a sole trader) and not to legal entities such as close corporations, private companies and trusts. If the subcontractor is a legal entity the taxation rules applicable to labour brokers and personal service companies have to be examined. Remuneration paid to any labour broker who is not in possession of an exemption certificate (IRP 30), is subject to PAYE, at a rate of 35%. Paragraph 2(5) of the Fourth Schedule does not permit the granting of such a certificate, if the labour broker receives more than 80% of its gross income from any one client; or such labour broker provides to any of its clients the services of any other labour broker; or such labour broker is contractually obliged to provide a

³⁴ Rob Cooper *SARS tightens the screws on subcontractors* 27/06/2005

specified employee of such labour broker to render any service to such client³⁵.

It is not necessary to make the 10% PAYE deduction if the labour-only subcontractor is registered with SARS as an employer, and can show tangible proof of such registration. This is intended to serve as an inducement for the labour-only-subcontractor to register with SARS as an employer, which means that he will then be liable for his own PAYE deductions from the wages of his staff. As the income of most such staff fall below the income tax threshold, the labour-only subcontractor would most likely end up deducting no PAYE at all³⁶. So, registration means payment of far less than 10%, and possibly of no PAYE.

Contractors, however, who not make the 10% deduction as from 01 June 2004 will, if audited by SARS and the non-deduction of PAYE is discovered, be liable for PAYE payment at 25% plus interest plus penalties and remember this after having paid the labour-only subcontractor the full amount.

12. Conclusion

Where employees' tax has not been deducted as required; the employer is the one that remains liable and SARS can raise additional penalties up to 200% and interest on these outstanding taxes. It is therefore of the outmost importance that the relationship between the independent contractor and the "employer" must be based around a control free environment and all payments made to such independent contractors should be based on results and not effort.

³⁵ Huxham, Haupt, Notes on South African Income Tax, 2005 at p

³⁶ GAUTENG MASTER BUILDERS ASSOCIATION *PAYE deductions from payments to Labour-only Subcontractors* 2005-06-27 at p 1