



The hidden risks of using independent contractors

Aka the need to ensure you are using a compliant provider

Introduction

The Labour Relations Act (Act 66 of 1995) defines an 'employee' as "any person, excluding an independent contractor who works for another person or for the State". It is clear from this definition that independent contractors have been specifically distinguished from employees.

Shortly after the introduction of the Labour Relations Act in 1996, and seemingly in light of this distinction, many businesses sought to avoid the complications of formal employment relationships by opting for independent contractor-type arrangements.

In many cases these 'independent contracts' contained declarations to the effect that the "agreement did not constitute an employment relationship", or acknowledgements by the 'contractor' that he or she had "no claims in law for unfair dismissal or on the basis of the protections afforded by the Basic Conditions of Employment Act".

Case law

This problem was highlighted in *Building Bargaining Council (Southern and Eastern Cape) v Melmons Cabinets CC*, in which the Labour Court described an arrangement where an employer had required its employee to sign a contract calling himself an 'independent contractor' as a cruel hoax. The court found that the worker concerned was in fact an employee, despite the contract referring to him as an independent contractor.

In *Motor Industry Bargaining Council v Mac-Rite Panel Beaters and Spray Painters (Pty) Ltd*, the court referred to one such contract as "not only a subterfuge but a bizarre one designed to strip workers of the protections to which they are entitled". The court observed that "it is the actual relationship between the parties that is of decisive importance rather than the label that is attached to it".

Shortly after the courts adopted this proactive approach in piercing through many of these so-called 'independent contractor' arrangements, the legislature sought to amend both the Basic Conditions of Employment Act and the Labour Relations Act by inserting presumptions dealing with the definition of an 'employee'.⁽¹⁾ The introduction of these presumptions was designed to discourage the wholesale resort to such artificial arrangements. Section 200(a) of the Labour Relations Act states that "until the contrary is proved and regardless of the form of the contract", a person is presumed to be an employee if any one or more of "a number of factors" are present. These factors concern "the manner in which the person works, his hours of work, whether he is subject to the control and direction of the employer, whether the person forms part of the organisation of the work provider". Armed with these amendments, the Labour Court demonstrated an increased willingness to interrogate such relationships – as was apparent in *Denel (Pty) Ltd v Gerber*.

In *Denel* the court emphasised the need to have regard "to the realities of the situation when deciding on the existence or otherwise of an employment relationship". The Labour Appeal Court went so far as to look through the use of an intermediary (ie, a close corporation) that had been "contracted with to provide services", and found that in reality an employment relationship did exist between Denel and Gerber.

Further risks

But these are not the only dangers to employers that resort to such artificial arrangements. Unfortunately a number of businesses have unfortunately tended to use independent contractors or labour brokers primarily to avoid:



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- the challenges that are presented by formal employment relationships; and
- the risks associated with:
 - unfair dismissals;
 - unfair retrenchments;
 - overtime pay; and
 - many of the other rights that South Africa's progressive employment statutes have accorded to employees.

However, there are a number of significant risks that employers tend to ignore (or which they are unaware of) in using independent contractors.

Occupational injury or disease:

The Compensation for Occupational Injuries and Diseases Act provides a statutory insurance to employers and effectively precludes employees from suing their employers for recovery of any damages that they may suffer as a result of occupational injury or disease that results in disability or death.

What is the position, however, if an independent contractor develops an occupational illness or suffers an injury while working on the premises of a work provider?

In such an instance, there is no bar in law to this 'independent contractor' instituting action against the work provider for any damages or losses that result from occupational injury or disease, or for that matter to the dependants of a deceased 'contractor' instituting such a damages claim.

The potential for this type of litigation becomes even more apparent in light of the Occupational Health and Safety Act, which seeks to impose several responsibilities upon owners and users of machinery and equipment – seemingly in an effort to promote occupational health and safety in the workplace. Unlike other labour legislation, this Act is not simply confined to situations where an employment relationship is present. It also imposes health and safety obligations on work providers in respect of self-employed persons and persons engaged in the manufacture, production or sale of machinery or substances used in the workplace.

Employers are required not to ensure the health and safety only of their own employees, but of all persons who may be directly affected by their activities.

Even though in a number of instances these contract arrangements are concluded between work providers and 'independent contractors' where the latter have registered their employees under the Compensation for Occupational Injuries and Diseases Act, there is still a significant threat of work providers being sued for occupational injuries or disease.

The registration of employees of 'independent contractors' does not preclude those employees from suing the work provider for general damages. 'General damages' usually involve claims for pain and suffering, loss of amenities of life and disfigurement; and are to be distinguished from 'special damages', which involve the direct cost of hospital expenses, doctors' expenses and loss of income from employment. In many instances the quantum of general damages will be by far the largest portion of an injured person's claim. Work providers are not covered by the Act against any claims for such general damages. Moreover, even though employees of independent contractors may recover some special damages through the act (if they are registered by their independent contractor employer), they are still legally entitled to recoup any unrecovered special damages directly from the work provider.

The position is the same with regard to labour brokered persons who are injured or who die on a work provider's site as a result of an occupational injury or disease.



Income tax

The Income Tax Act (Act 58 of 1962) presents another often overlooked risk of utilising independent contractors or labour brokered personnel. Schedule 4 of the act defines an 'employee' as including any labour broker and any personal service provider, whose terms are also defined in Schedule 4.

This inclusion places a withholding obligation on a work provider or client utilising such service providers. As such, they will generally be held liable to the South African Revenue Service for failing to withhold pay-as-you-earn tax on remuneration paid to the labour brokers and personal service providers.

Personal service providers generally involve small entities that provide employment-type services to clients or work providers at their premises. A 'personal service provider' is defined as including a company or trust where the service is provided via a person who is a 'connected person' in relation to such company or trust, and:

- such person would be regarded as an employee of such client if the service were rendered by that person directly to the client, other than on behalf of such company or trust;
- where those duties must be performed mainly at the premises of the client, such person or such company or trust would be subject to the control or supervision of the client as to the manner in which the duties were performed or were to be performed; or
- more than 80% of the income of such company or trust during the year of assessment, from services rendered, consists of or is likely to consist of amounts received directly or indirectly from any one client of such company or trust.

A company will be deemed not to be a personal service provider throughout the year of assessment, if it employs three or more full-time employees.

A further implication of classification as an 'employee' is that labour brokers and personal service providers will be entitled to only a limited income tax deduction. They will not be entitled to claim as income tax deductions many of the normal expenses regarded as expenditure (other than the remuneration of the employees they use), which are incurred in the production of income and which would otherwise be deductible.

Comment

The indicated risks inherent in the use of independent contractors, labour brokers and personal service providers should be carefully weighed up by work providers against any possible advantages, so as to ensure that informed decisions are made as to the prudence of their use.

Where independent contractors, labour brokers or personal service providers are used, work providers would be well advised to include in their contracts appropriate indemnities, mandatory clauses and insurance obligations to mitigate against the risks and possible liability that attach to their use.

To provide further piece of mind it is suggested that you place your labour broker (TES) through our labour compliance process that we provide in conjunction with Grant Thornton. This process evaluates the labour compliance across a spectrum of labour legislation as well as the financial assessment by Grant Thornton.

For more information, please feel free to contact our Grant Wilkinson or Johnny Goldberg.

Extracted and adapted from an article by [Irvin Lawrence](#) at ENS- Edward Nathan Sonnenbergs