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CONTRACTORS: A EUROPEAN PERSPECTIVE

Introduction

Contractors (in German *freie Mitarbeiter*, Dutch *zelfstandigen zonder personeel* and French *indépendants*) are a key feature of the European labour market. There are many benefits to a company of using contractors, including accessing services or know-how of a kind that a company does not have, as a means to manage one-off projects or plug a temporary gap in the workforce, or as a more flexible cost-saving measure, in lieu of employees. There are however some drawbacks, notably the lesser degree of control a company will have over its contractors (when compared to its employees). The use of contractors may also turn out to be more costly than expected, particularly if individuals engaged as contractors in fact legally qualify as employees. The proper classification of contractors is therefore very important.

This briefing considers how contractors are defined in the UK, France, Germany and the Netherlands. It highlights the key rights and obligations of contractors and principals, the risks and consequences of reclassification of a contractor as an employee, and some topical developments in each jurisdiction.

I. How are contractors and employees distinguished?

Distinguishing a contractor from an employee is a similar exercise in all four jurisdictions. In each case the determination is fact specific, and involves examining the nature of the relationship between the parties. The wording of any contract between the parties will not take precedence over the factual reality, although it may serve as an indicator of the parties' intent. The effect is that an individual who is classified as a contractor in one of our jurisdictions, would likely also be classified as a contractor in the other jurisdictions.

There are several key criteria which can be used to distinguish between a contractor and an employee:

- the **degree of control over, or subordination to, the other party**; employees are bound by instructions of their employer as to time, place and content of work, whereas contractors are typically free to determine when, where and how they provide any agreed services;
- the **degree of integration into the operation of the principal**, for example whether the individual has an office or other workspace within the principal's operation, a phone number/email-address linked to the principal, or uses the principal's tools or other equipment to perform the agreed services. If that is the case, the individual will commonly qualify as an employee. If however the principal is the client or customer of a business run by the individual, he will likely be a contractor;
- whether the individual has to **perform in person**, which an employee invariably has to do, whereas a contractor may be free to subcontract or engage the help of others;
- the **compensation structure**, i.e. whether hourly or daily rates apply, whether the individual solely gets paid for actual performance and against invoices, adding VAT (indicating contractorship), or whether fixed amounts are paid at regular intervals (pointing towards employment);
- which party bears the **financial risk** of the work performed (in employment this is the employer; in a contractor relationship, the contractor); and
- whether the individual is **free to perform services or work for other clients** (an employee would usually not be, whereas a contractor would).

There are some nuances within the four jurisdictions. For example, in the **UK** another key factor is the presence (or absence) of what is termed mutuality of obligation. This refers to the employer's obligation to provide work, and the employee's obligation to accept it. An absence of this obligation, so that the individual has the option to decline work when it is given, or where the principal has no obligation to provide work, would strongly suggest that the individual is a contractor.

In **France** there is a legal presumption that individuals duly registered as self-employed in the Commercial Register will be contractors, although this presumption can be rebutted if the relationship in fact more closely resembles employment. French courts will also look at whether the individual performs similar tasks to those performed by the principal's employees (in which case the relationship would likely constitute employment).

In the **Netherlands**, another relevant issue would be the provision of benefits, such as sick pay or holiday pay, participation in company outings, or giving a gift box that Dutch employers traditionally give their employees at Christmas, all of which would indicate an employment relationship.

In **Germany**, special rules apply to certain trades such as, e.g. agents for insurance contracts and other commercial transactions (*Handelsvertreter*).

Finally, it is worth noting that there may be further categories of individuals in some jurisdictions. In addition to employment agreements and service agreements (the latter being relevant to contractors), **Dutch** and **German** law recognise a third category: works agreements (respectively: *aanneming van werk* or *Werkverträge*), which are agreements relative to the creation of tangible work (e.g. construction work or car repair), without there being a relationship of employment or subordination. In **Germany** and under **UK** law, an interim category between employees and contractors exists. In the UK these are known as "workers", in Germany as "quasi-employees" (*arbeitnehmerähnlich*). These classifications are not examined in detail in this briefing.

II. Are there any formal legal requirements for agreements with contractors?

Generally, there are no formal requirements for concluding agreements with contractors beyond the rules that apply to contracts generally. However, it is advisable to conclude a contractor agreement in writing, and to state explicitly that it is not intended to be an employment agreement. Further it is recommendable to explicitly require proper invoicing, separately showing VAT, and to clearly state that the individual is free to determine when, where and how he performs the contracted services.

In **France** however, a company wishing to make use of a self-employed contractor, and expecting to pay him compensation of EUR 5,000 or more in total, must ask him to provide a "statement of compliance" (*attestation de vigilance*) at the outset of the contract and every six months thereafter. This document is issued by the social security authorities and evidences that the contractor properly declares his activity. Failure to do so makes the principal jointly liable for any tax and/or social security debts of the contractor arising in the context of their contractual relationship.

In the **Netherlands**, there is the possibility of using the Dutch Tax Authority's model agreement, which may give the parties more certainty about the legal status of their relationship (see section 8 below for more details).

III. How can agreements with contractors be terminated?

In the **UK** and **France**, the process for termination of a contractor's service agreement depends solely on the terms of the contract. The parties can include whatever notice period they choose; there is no minimum statutory notice period applicable.

In contrast, **German law** includes default termination provisions which will apply if no notice periods have been agreed in the contractor's agreement. The default provisions specify that the required length of notice varies (from one day to six weeks), depending on the structure of the agreed compensation payments. If compensation is not measured in relation to time worked, principally, termination can be given with immediate effect at any time. Further, termination may also be given for cause (*aus wichtigem Grund*), with or without immediate effect, if continuation of the service relationship has become unreasonable (*unzumutbar*) for the terminating party (although this is a strict test).

The principle is the same **under Dutch law**. If the contractor's agreement contains no termination provisions, default provisions apply. These vary depending on whether notice is given by the principal or by the contractor, and whether they are acting as professionals or as private individuals. Generally, a principal can terminate the agreement with immediate effect at any time, within the general principles of reasonableness and fairness. The same usually applies to private contractors. However, professional contractors are more restricted; they may only terminate a service agreement

for serious cause (*gewichtige reden*) or, in case of a service agreement that is unlimited in time, if the agreement does not end on completion of the agreed services.

IV. Which rights and obligations does a contractor have vis-à-vis the principal?

A key feature of contractor status in all four jurisdictions is that contractors are generally limited to the rights set out in their contract with the principal. Employee protection laws do not typically apply to contractors (although health and safety laws may well apply). The principal may apply company-specific rules and regulations to contractors via the contract. That said, contractors do benefit from some specific protections in some jurisdictions.

Under **UK law**, a contractor may be protected against discrimination, but only if he is hired to do work *personally* (and may not provide a substitute instead), and if there is a relationship of subordination to the principal, which is not usual in practice. Many other rights such as rest breaks, paid holiday and the national minimum wage, would depend on the contractor establishing that he is in fact a "worker".

Contractors benefit from more rights in the **Netherlands**, including protection as whistleblowers against retaliation by the principal if they report suspected misconduct within the principal's company. Female contractors also have the right to take a minimum of 16 weeks' maternity leave, with a maternity allowance being payable by the Dutch Employee Insurance Agency (*Uitvoeringsinstituut Werknemersverzekeringen*, "**UWV**").

In **Germany**, while contractors only enjoy their contractually agreed rights, quasi-employees (*arbeitnehmerähnliche Personen*), i.e. individuals who, although not employed by the principal, are economically dependent on it, enjoy certain employee protection rights. These are e.g. rights to paid leave or rights under certain collective bargaining agreements.

V. What are the tax and social security rights and obligations of a contractor?

In summary, the general overall rule in **all four jurisdictions** is that contractors are liable for their own tax and social security contributions. No such liability falls on the principal, as it would in an employment relationship. Membership of some social security schemes is mandatory for some contractors, but optional for others (with no benefits being payable if the contractor does not join). State unemployment benefits in particular are not always available to contractors, who may need to arrange their own income insurance. Some of this may however change in the foreseeable future, given the ongoing political debates all four countries.

With respect to pension contributions, the situation is somewhat different: In the **Netherlands**, all individuals living there (i.e. including any who are contractors) are compulsory members of the national insurance which provides for pension insurance and benefits for surviving dependants. In **France**, contractors have to become part of a pension regime, and in **Germany**, certain groups of contractors are mandatory members of the statutory pension system. **In the UK**, this only goes for workers who are treated as employees for tax purposes.

VI. What are the consequences if it is discovered that an individual was wrongfully classified as a contractor?

One of the main risks associated with engaging contractors is that they will allege (or be found) to in fact be employees. This has serious consequences for the principal, across all four jurisdictions. The individual will benefit from employee protection laws, including greater termination protection, and his reclassification as an employee may trigger participation rights of the works council. Collective employee participation rights may be triggered if certain employee number thresholds are exceeded.

The principal (now the employer) will be liable for tax, social security and (potentially) pension contributions (although in the **UK**, this is only if the reclassification is effective for tax as well as employment law purposes, and in **France**, this is only the case if the reclassification was initiated by the social security or labour authorities). The employer may also face historic liabilities, going

back up to six years in arrears, or even further in the event of intentional wrongful classification (up to 20 years in the **UK**, and up to 30 years in **Germany**). Fines, interest and late payment penalties may apply. There will usually be limited (if any) scope for recovering any portion of the unpaid tax and social security contributions from the contractor. There may also be criminal liabilities on the directors and board members of the employing company for failure to pay employee tax and social security contributions.

In **France**, wrongfully classifying an employee as a contractor may qualify as clandestine work (*travail dissimulé*), for which the legal representatives of the company can be sanctioned with up to three years of imprisonment and fines of up to EUR 45,000. Further, a wide array of ancillary sanctions may be levied against the employer, including temporary or permanent closure of the operation, and an obligation to reimburse state aids.

VII. How is wrongful classification usually discovered?

Wrongful classification of employees as contractors typically comes to light in similar scenarios in **all four jurisdictions**, namely:

- audits, inspections or investigations by social security and/or tax authorities;
- transaction-related due diligence processes; and
- a dispute between the contractor and the principal, for example on termination of the agreement.

In all four countries, employment status is a hot topic receiving significant political and media attention. In the Netherlands, Germany and France this is largely in the context of the elections that have just been completed or are upcoming, in Germany further due to a recent change in the relevant law. In the UK, the media attention has resulted in an upsurge of challenges to classification being made, particularly by trade unions or pressure groups.

VIII. How can wrongful classification be avoided?

In most jurisdictions (**except France**), there is some form of process allowing individuals (or companies) to obtain the determination of the competent authority on the correct classification. In the **UK**, Her Majesty's Revenue and Customs (HMRC) provide an online tool to check an individual's employment tax status. HMRC will stand by the result given, unless a compliance check finds that the information provided is not accurate. This result would not however be determinative of an individual's status for employment law purposes. This can only be achieved by applying to a court or tribunal for a determination.

In the **Netherlands**, the parties to a contractorship may use the Dutch Tax Authority's model agreements for services, or submit their own agreement to the Tax Authority for assessment of whether or not the agreement can be regarded an employment agreement. However, the ruling of the Tax Authority can be overridden if the factual situation is different from the contractual arrangement and the relationship in fact qualifies as employment. Further, as in the UK, classification by the Tax Authority is not binding on civil courts, which may decide otherwise if the relationship - in fact - fulfills the elements of an employment relationship.

In **Germany**, principals who are unsure of an individual's status may apply to the Federal Statutory Pension Insurance Administration (*Deutsche Rentenversicherung Bund - DRV*) for status determination (*Statusverfahren*).

The limitations of these processes means that the best starting point in all cases is to look at the facts realistically, using the criteria described in section 1 to determine whether a contractor effectively qualifies as an employee. In difficult or unclear cases, legal advice should be sought, particularly if the arrangement affects a number of people.

IX. Can a current or a former employee become a contractor?

An individual could, in theory, be concurrently employed by and perform services as a contractor for the same company. However, this is usually not advisable as there is a substantial risk that the entire relationship with the individual will classify as employment.

A more usual scenario (particularly in **Germany** and the **Netherlands**, and to a lesser extent in the **UK**) is for a former employee to become a contractor after their employment ends. In **France** this would be very uncommon, and only really conceivable if the former employee has set up his own business and serves a number of different principals. In all four jurisdictions, such changes in status are likely to attract the attention of (and thorough scrutiny by) the relevant authorities. Therefore, special efforts need to be made to ensure that the legal characteristics of a contractor relationship are properly documented and complied with in practice.

X. Topical issues and future developments

The proper classification of contractors is currently a hot political topic in all four jurisdictions, in light of concerns about the potential for abuse of vulnerable individuals, and the need for greater certainty on both sides about the status of their relationship.

In **Germany**, the criteria for determining contractorship were codified with effect from 1st April 2017 (having previously been shaped by court decisions). At the same time, new provisions were enacted to tackle false contracts for work and labour (*Scheinwerkverträge*), also referred to as concealed agency work (*verdeckte Leiharbeit*). These involve the parties concluding a contract for production of a tangible works which is in reality a contract for one party to provide manpower to the other. The new provisions will make it more difficult for businesses to avoid the sanctions for such false contracts, which are to find the concealed agency workers to be employees of the principal, and to impose liability on the principal for compensation, social security payments and wage tax deductions. There is however an exception contained in the new law: where a concealed agency worker explicitly and timely declares in writing that he wants to remain employed by his contractual employer, he will not be deemed to be employed by the principal. It remains to be seen whether either of these recent measures will result in any substantive change to the status of contractors in Germany.

In the **Netherlands**, the Wet Deregulering Beoordeling Arbeidsrelaties ("**DBA Act**") was introduced in May 2016 with a view to avoiding the practical difficulties in determining the status of contractors (see section 8 above). However, so far, the DBA Act has proven counterproductive: companies have been hesitant to hire contractors due to uncertainties with regard to their legal status and the risk

of contractors being regarded as employees from a tax perspective. The enforcement of the DBA Act has therefore been suspended until 1 January 2018, to allow contractors and their clients a transitional period to become acquainted with the use of model agreements. Clients will not be sanctioned if their contractor, in fact, turns out to qualify as an employee, except in cases of obvious malicious intent. The DBA Act has been heavily criticised and may be amended by the new Dutch government, which is still under formation.

In **France**, the forthcoming presidential election and the increased recourse to self-employment in connection with the gig economy has prompted some legal writers and politicians to advocate a revision of the contractor status to bring it closer to employment status, in particular by granting contractors access to unemployment benefits. However, the fate of such proposals is highly dependent on who will be elected President in May 2017.

In the **UK**, there is growing concern that certain sectors of the workforce (beginning with those on zero-hours contracts, and now focusing on those working in the gig economy) are not receiving appropriate protection. The response of the UK government was to commission the Independent Review of Employment Practices in the Modern Economy (the "**Taylor Review**"). Its objective is to identify and then consider the implications of new models of working on the UK economy. The Taylor Review has a broad remit to consider the entire economy, and it is expected to recommend significant changes to the current rules governing employment status and the rights of self-employed contractors, when its findings are published in summer 2017.

Conclusion

The proper categorisation of contractors is a complicated issue, not only because it requires a careful analysis of all the relevant facts, but also because the underlying law is in a state of flux. The stakes are also higher than ever. Financial penalties can be significant, and reputational damage is also a real possibility, given the current political and media spotlight. Businesses need to be aware of the common trend across these four European jurisdictions towards protecting individuals at the expense of business flexibility. Obtaining expert legal advice on your arrangements with your workforce and contractors will be invaluable or may even be a necessity.

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This material is for general information only and is not intended to provide legal advice.

Further information

If you would like to find out more about any of the issues raised in this briefing, or require advice in relation to a specific matter, please contact:

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