Tripartite Working Group on Better Protections for Contractors

Report to the Minister for Workplace Relations and Safety

22 December 2021

MINISTRY OF BUSINESS, INNOVATION & EMPLOYMENT
HĪKINA WHAKATUTUKI

NZCTU
Te Kauae Kaimahi

BusinessNZ
GROWING PROSPERITY AND POTENTIAL

Contents

Summary of recommendations

1. The Tripartite Working Group on Better Protections for Contractors (the Group) was asked to recommend a set of policy changes to improve how regulatory protections apply to working arrangements at the intersection of "employment" (employment law) and "contracting" (commercial law).

2. In responding to this brief, the Group has decided that addressing the employee/contractor boundary issue must be considered the priority. Accordingly, this report focuses on delineating a clearer boundary between employment relationships and contractor/principal relationships, both in the legislation itself and by making supportive changes to regulatory systems.

3. The Group's main recommendations (all subject to further policy and legal analysis) are as follows:

Rec 1: Revise the legislative definition of "employee" to include a strong sense of contradistinction to someone who is genuinely in business on his or her own account. This should be the critical question to answer when deciding whether someone is an employee or a contractor.

Rec 2: We recommend that the nine design principles we have agreed to (discussed on pages 15-17) be used as the basis for constructing more detailed, objective and prescriptive legislative requirements for worker classification. The aim should be to create an effective legal duty on "hiring entities" to step through a robust decision-making process when considering worker classification, guided to a large extent by the legislation itself. The hiring entity will be responsible for making this decision correctly.

Rec 3: Note the Group's view that further policy work and consultation should be prioritised as a next step, to understand the impacts, manage the risk of unintended consequences, and consider how business models could transition away from unlawful classification practices in a way that is fair for the people involved.

Rec 4: We recommend a comprehensive package of guidance and support services (consistent across all government channels) be developed to support better classification practices by firms in the first instance, reducing reliance on the dispute resolution system.

Rec 5: We recommend allowing judicial determinations on employment status to cover other workers performing similar work for the same hiring entity under similar contractual terms (even if only one worker seeks a judicial decision). Further work should be completed to assess the value of allowing groups of workers to seek employment status determinations.

Rec 6: In designing regulatory systems to respond to worker misclassification, we recommend exploring options that would allow for regulators to intervene without relying on an individual complainant wanting to pursue the matter. Inquiries or regulator-led studies provide a potentially powerful mechanism for responding to misclassification at the sector level or for business models, and we recommend that this option be pursued.

Rec 7: We recommend that the definition of "employee" be aligned across employment and tax legislation. This should include allowing for appropriate two-way information sharing between Inland Revenue and the employment regulator. The Government should explore ways to better use the tax system as an intervention point to encourage better classification practices by firms (including the option described at paragraphs 89-91 of this report).

4. We propose that as a next step, the Government develop and publicly consult on a policy proposal that is based on our recommendations. At a later stage, consideration should be given to the potential "business to business" interventions identified in the *Better Protections for Contractors* discussion document and by stakeholders.

Background

5. Public consultation on the 'Better Protections for Contractors' discussion document took place in late 2019 and early 2020. This consultation sought feedback on a range of potential options for improving outcomes for two overlapping 'types' of workers:

    - Workers who are misclassified as independent contractors, so miss out on basic employment rights and protections

    - Workers who are in the 'grey zone' between employee and contractor status, who would be unlikely to be employees if their status were considered by courts, but who are vulnerable to poor working conditions.

6. The Tripartite Working Group ("the Group") was established following this consultation, composed of representatives from government, BusinessNZ, the New Zealand Council of Trade Unions, and chaired by Doug Martin.

7. We were asked to recommend a set of policy changes to improve how regulatory protections apply to working arrangements at the intersection of "employment" (employment law) and "contracting" (commercial law). The options in the discussion document were our starting point, but we were free to suggest alternative options to address the issues identified. The underlying objective of our work has been to ensure that appropriate rights are accessible to all individuals who are engaged to perform work for pay, noting that what is "appropriate" will depend on the dynamics of different types of working relationships.

Outline of the Group's work

8. Beginning in late May 2021, the Group has met frequently throughout the second half of 2021. Our initial focus was a "discovery phase" where we heard from a range of stakeholders from industries where contracts for services are commonplace.

9. The consultation we undertook was not exhaustive and was intended to supplement the broader consultation already completed by MBIE in 2019 and 2020. It provided the Group with a more nuanced picture of how contracts for services are used in particular industries and business models, including the extent to which they are used. Speaking to stakeholders with close knowledge of industries shaped the Group's sense of the key priorities for regulatory change.

10. At the conclusion of this phase, we settled on an agreed problem definition (set out below at paragraph 28), which we used as the basis for our substantive policy discussions.

Key themes from our stakeholder consultation

11. Some of the themes from our discussions with stakeholders are set out below. In many cases these insights amplify the findings of MBIE's consultation in 2019 and 2020.

Use of contracts for services is entrenched in some industries, such that employment models are barely used

12. The Group heard how in some industries, such as residential construction and in silviculture, contracting has become so entrenched as a business model that employment models are rarely used. The submission by BCITO to MBIE's initial consultation raised the issue of

building apprentices being set up as contractors rather than employees at the very start of their careers when those workers are least equipped to operate as an independent business. Concerns about apprentices being engaged as contractors were echoed by some of the industry representatives the Group met with.

Contractor-based business models can reflect an entrenched power imbalance

13. The Group heard that, where contracting arrangements have become "normalised", individual workers are usually powerless to challenge this practice. Worker representatives stated that, in sectors such as courier delivery and residential construction, the possibility of workers being engaged as employees rather than contractors is not seriously entertained by most businesses. In these cases, there is a systemic power imbalance, rather than merely a power imbalance operating at the level of individual relationships.

Some contractors take on a lot of business risk for which they are not adequately compensated…

14. Many contracting arrangements have the effect of transferring business risks from the hiring entity to the worker. Examples were provided of courier drivers being required to pay to replace goods that were rejected by the recipients. The Group also heard that contractors in the residential construction industry often have contracts that allow work to be withdrawn or cancelled without any compensation.

… and enter into these arrangements without a full picture of the costs and benefits

15. The Group heard that contractors entering into contracting relationships often do so based on financial information provided by the hiring entity. Information provided by the hiring entity can overstate potential earnings and not account fully for expenses and taxes. Many stakeholders the Group spoke to told of workers basing their understanding of potential income and opportunity for business growth on information the hiring entity had provided. Only after entering into the contract did the worker find that their real income was significantly lower, and the long hours required to complete the work provided much less flexibility than initially anticipated at the time of entering into the contract.

16. We note that similar feedback was received by MBIE during its initial consultation. A majority of the contractors who responded to MBIE's survey self-identified as 'vulnerable workers' and nearly three-quarters of respondents stated that they relied on a single firm for most or all of their income. ProDrive, the organisation representing professional drivers in New Zealand, explained that drivers in the courier industry often find themselves 'being sold a dream' based on these unrealistic earnings figures, with many drivers making significant investment in a courier run only to find that they are unable to make a sustainable living.

17. The Group also heard that there were few options open to contractors to seek a legal remedy when they entered into a contract based on partial information and, where they could, it was often unaffordable to pursue legal action.

In many cases, contractors do not have meaningful opportunities to negotiate the terms of their contracts

18. A number of stakeholders the Group met with raised concerns about businesses operating a 'take it or leave it' model that provides no meaningful opportunity for the worker to negotiate the terms of the contract. Some stakeholders gave examples of employees having their employment ended through redundancy, only to be offered the same work as an independent contractor with less favourable terms.

19. Many of the examples the Group heard involved the use of a standard form contract that disproportionately favoured the hiring entity. Examples of these one-sided terms include the ability to terminate the contract without notice or any right to challenge the decision, strict restraints of trade that prevent the worker seeking out additional clients, requirements to maintain vehicles and equipment to a certain standard, the ability for the principal to unilaterally vary the terms of the contract without notice, and requirements to purchase supplies exclusively from the hiring entity.

20. Typically, these contracts also allow the hiring entity to terminate the contract without cause, leaving few avenues for a worker to seek recourse. Even in cases where there may be rights to challenge the hiring entity's conduct or decisions, for some workers the fear of being 'blacklisted' within their industry is a powerful disincentive to pursuing any remedies available.

21. Worker representatives from the transport and courier industries explained how standard-form contracts typically allow for a driver's contracted 'run' to be varied with relatively little notice by the hiring entity, such as by changing the territory in which the worker makes deliveries. Often the contract for service will also contain provisions indemnifying the hiring entity for any damage their actions may cause to the contractor's goodwill in their business.

Contracting has become less sustainable for workers in some industries

22. The Group was told how the transport and courier industry was once a sustainable industry for contractors when their work was primarily business deliveries. The rise of consumer deliveries to residential areas with lower density has resulted in lower margins and in some cases an unsustainable business model. Some operators and franchisors provide top-up payments to contractors and franchisees to supplement income which suggests that the contractor model is financially unsustainable for the contractor or franchisee on its own.

23. We heard that, within the cleaning industry, the use of contractors and franchises has caused a 'race to the bottom', with businesses using these business models able to undercut those that use an employment model.

Despite these concerns, many workers express a preference to remain as contractors

24. The Group heard from ProDrive that many workers in the courier and delivery sector appreciate the flexibility and independence that contract work provides, and do not feel that being classed as employees is an appropriate solution to the issues that they face.

25. In line with this preference, ProDrive advocated for additional protections for "dependent contractors". Suggested interventions included legislative protections allowing contractors a right to review their contract every year, the right to recover reasonable costs from the hiring entity, and improved access to justice.

26. These sentiments were also reflected in the results of the initial consultation. In the survey conducted, 66 per cent of the respondents enjoyed the independence that being a contractor afforded them, with 53 per cent stating that becoming their own boss was one of their main reasons for becoming a contractor.

Platform work and the 'gig economy' is a growing business model

27. The Group heard from some stakeholders that workers enjoy the flexibility of being able to do platform work at times that suit them. However, when speaking to workers using these

platforms the Group was told that the flexibility offered was in effect illusory, because earnings are dependent on receiving bonus payments for making themselves available at certain times.

Problem definition

28. The core problem the Working Group has identified is that, in some segments of the New Zealand labour market, **contractor arrangements are being used in ways that undermine the Government's core labour market objectives** – which are to ensure decent work, and promote high quality, highly productive jobs, with better pay and conditions.[1] These contracting arrangements can see:

    - remuneration that would be likely to breach the minimum wage and other employment standards if the relationship was recast as one of employment
    - the contractor being burdened with risks and compliance costs that they are ill-equipped to bear (including risks associated with delays, mistakes, sickness, and damaged equipment and goods; risks related to insecurity of income; and the risk of contract termination without procedural fairness or redress)
    - the contractor having to work long hours because of contractual expectations and/or financial necessity, with no guaranteed breaks, and very limited ability to take annual leave or sick leave (such leave is generally at the contractors' expense)
    - the principal having a high degree of control over the contractors' time and working arrangements, raising the possibility that, in some industries, standard "industry practice" for the engagement of workers could amount to serial misclassification (i.e. the relationships appear more akin to employment than business-to-business relationships)
    - contractors being expected to manage their own health and safety risks, while at the same time having contractual incentives to underinvest in good health and safety gear and practices
    - adversarial working relationships, including examples of bullying, where the contractor needs to repeatedly assert their rights to receive payments and other terms that are guaranteed in their contracts.

29. These features can all have harmful effects on the wellbeing of the people performing the work. In particular, the Working Group has heard of instances where such contracting arrangements are associated with poor health and safety outcomes, in terms of workplace accidents and the psycho-social harm resulting from work-related stress.

30. Where contracting arrangements load costs and risks on to people who are not well equipped to manage them, this raises questions of efficiency, as well as the more obvious issues of equity or social justice. Asking these workers to individually bear compliance costs such as the accounting fees associated with tax and ACC payments means that the total

[1] Where industries operate substantially outside the employment model, this also risks undermining specific interventions that are designed to promote those Government labour market objectives, such as collective bargaining, pay equity settlements, and Fair Pay Agreements.

compliance burden is many times greater than it would be if these services were performed centrally (by the principal firm).

31. Similarly, the "long hours, low pay" (below minimum wage) dynamic that is prevalent in some contractor-dominated industries suggests that labour markets, in their current guise, are not directing labour to its most productive use. The "low pay" model externalises some of the costs of providing services onto society generally (e.g. in the form of income assistance and health spending).

32. Several factors combine to create the conditions where contracting arrangements can be used in this way (and to these ends). Chief among these is the **power imbalance between principal and contractor**. This exists at the "point of entry" to a working relationship, as a systematic feature of the offer and acceptance of work in some industries. It arises in part because current regulatory settings do not meaningfully constrain businesses' ability to offer employment-like work as contracts for services (particularly where it is an established industry practice to do so).

33. An overarching systemic issue is that the distinction between employment relationships and contractor/principal relationships is applied primarily by the judiciary, on a fact-specific, case-by-case basis. As a result, **there is no generalisable employee/contractor "boundary" that is applied consistently by businesses, workers, and government institutions**. Some businesses using contracting arrangements may opt for this model to deliberately out-source cost and risk. Others may be unclear about what is "appropriate" due to the lack of clarity on this question provided by legislation, case law and official channels.

34. A related issue is that, in some sectors, businesses appear to opt for contracting arrangements as their default position, without considering alternative possibilities – including that:

    - a contracting model may not be in the best interests of the business
    - an employment model could meet the business's needs while at the same time providing better outcomes for its workforce and being more consistent with the intent of employment regulation.

35. Once engaged as a contractor, the "business to business" framing of the work relationship means that there are no significant regulatory boundaries, or institutional support, that might mitigate the weaker party's disadvantage.[2] (A short-hand reference for this could be that **the power imbalance is not mitigated by regulatory limits**.) Unlike other types of relationships where some contract terms are implied by statute (e.g. an employment relationship, or even the transactional relationship between businesses and consumers) the only real constraints on the conduct of a business to business relationship are those set out in the contract itself. There is also a lack of external assistance or any accessible pathway for

[2] There are two possible exceptions to this, although in the Group's judgement neither of these options is likely to offer substantial support as they are currently designed. The first is the option for the contractor to assert that they are in fact an employee and therefore entitled to employment protections (this has proven not to be a viable pathway in practice). The second exception is the recent extension of "unfair contract terms" and "unconscionable conduct" protections into the realm of some business-to-business relationships (this has not yet been fully implemented or tested).

contractors to enforce whatever rights they have under the contract, particularly given the contractor's lack of recourse in the event of contract termination.

36. In the context of the arrangements the Working Group has heard about, the contract in question is typically a standard form drafted by the principal, featuring terms that are more favourable to the principal, and offered on a "take it or leave it" basis. **Specific terms included in these contracts can <u>amplify</u> the power imbalance that existed at the outset.** These include requirements that make it difficult for the contractor to exit the relationship (e.g. needing to own specific capital assets; "non-compete" clauses), and terms that confer unilateral variation rights upon the principal.

37. While the one-sided nature of some contracts can be understood as a consequence of the prevailing power imbalance, it is also worth highlighting the **strong information asymmetries** that contractors face, both at the "offer and acceptance" stage, and during the engagement.

- The disclosure information that contractors must rely on before entering into the contract may give inadequate information about key inputs, earnings, and risks, such as:
    - Anticipated earnings after expenses (including tax, ACC costs, vehicle depreciation, finance costs, fuel, and compliance costs such as accountancy fees)
    - A comparison of anticipated post-expenses earnings, expressed as an hourly rate, and what would be the minimum legally required to be paid to an employee for the same time. This information is fundamental to allow an informed time-use choice by the prospective contractor
    - Anticipated time required to be worked (i.e. labour input required in order to generate average earnings), including time and effort required to manage business assets and meet compliance costs.
- The contractor often will continue to have information gaps while performing the contract (e.g. they are unlikely to have access to data that would enable them to review whether, in an economic cost/benefit sense, the working arrangement is proving worthwhile overall). In a practical sense, the utility of performing such a regular review would also be limited, given the difficulties the contractor would face to change the terms of their contract, or to exit their contract.
- The principal, by contrast, will have comprehensive data about historical outcomes for contractors. In many instances, the principal also is likely to have readier access to analysis and professional advice.

The Group's overall approach to responding to these problems

38. Our problem definition above contains statements about both outcomes and causation. The latter two parts (paragraphs 32-34 and 35-37, respectively) represent the most promising intervention points for a Government policy response, as these point to root causes rather than symptoms:

- **Responding directly to paragraphs 32-34, the Government could take steps to make the employee/contractor distinction clearer and more enforceable**, with a stronger 'channelling' effect on labour market relationships. Potential interventions in this

category include legislative changes to re-draw the distinction between employment relationships and contractor/principal relationships, as well as systemic changes to give the legal distinction more prominence in the broader contracting environment.

- **Responding directly to paragraphs 35-37, the Government could seek to mitigate the power imbalances that exist within certain contractor/principal (business-to-business) relationships, without seeking to characterise those relationships as employment relationships**. Potential interventions in this category range from pre-contract disclosure requirements and targeted industry codes (which could mitigate the identified information asymmetries), through to higher-impact interventions such as removing barriers to collective bargaining by groups of contractors or providing other statutory rights to "dependent contractors" (as raised in the 2019 MBIE discussion document).

The Group has decided to focus on the employee/contractor boundary in the first instance

39. The issues that the Group has considered cut across many parts of the labour market, and we think that a comprehensive response will, in time, require consideration of both types of intervention set out in paragraph 38. But in our view, addressing the employee/contractor boundary issue must be considered the priority. Our reasons are as follows:

    - Some of the most unevenly balanced working arrangements that the group has heard about, which are currently characterised by the industries concerned as "business to business" relationships, appear to the Group to constitute misclassification. A clearer statutory position on what does and does not constitute employment (vis a vis commercial activity) would in our view go a long way to ensuring that these types of relationship are characterised appropriately as subject to employment law. This would to some extent remove the need for the second category of intervention.

    - Assessing the residual size of the problem – i.e. the extent to which some genuine contractors are in need of greater regulatory protections – will depend on first putting a "stake in the ground" as to the appropriate coverage of employment law.

40. Accordingly, the remainder of this report focuses on delineating a clearer boundary between employment relationships and contractor/principal relationships (both in the legislation itself, and by making changes to regulatory systems to ensure firms' classification decisions reflect this revised definition). As well as being an important issue in its own right, we think that taking a clearer position on this boundary issue will usefully feed into policy development work in other areas, such as the proposed Social Unemployment Insurance Scheme and the Fair Pay Agreements system.

41. Potential changes to the commercial system should be considered in a subsequent phase of policy work. This should assess a range of options, but we do not recommend further consideration be given to creating a third category of worker in between employee and contractor. In our view, the position we have agreed on the employee/contractor boundary removes the need for an intermediate category. Formalising an intermediate category would, in our view, create additional complexity and confusion, and may undermine efforts to instil greater clarity on the fundamental distinction between employment and "business-to-business" relationships.

The Group's consideration of the employee/contractor boundary has been guided by five key objectives

42. While the Group's overall deliberations were guided by objectives stated in the Terms of Reference, we adopted a more granular set of criteria for assessing different approaches to the basic definitional question, "What is an employee?" We agreed that regulation at the employee/contractor boundary should:

- **Set the boundary in an appropriate place**, based on tripartite consensus on the core differences between commercial relationships (which should remain regulated by the commercial system) and the types of work relationship that are better suited to employment or labour-market-specific regulation.

- **Provide certainty and predictability** – a legislative definition should provide as much certainty as possible up front, and be designed in such a way that subsequent decisions (both administrative and judicial) generate precedents that provide greater certainty over time.

- **Provide for clarity and ease of application**:

    - by the parties to working relationships, including at the "entry point" (where contractual relationships are established and the initial act of "classification" takes place)

    - by third parties – especially government agencies and regulators – who have a role in ensuring that working arrangements are appropriately classified.

- **Be flexible and durable** – the basic distinction is flexible enough to be applied to the full range of working arrangements that are currently seen in the labour market, and to novel arrangements that are likely to emerge as firms adopt new technologies and business models.

- **Facilitate access to justice** – by ensuring that classification decisions can be examined in a range of ways, without placing undue reliance on individuals to initiate, fund and pursue legal action.

43. The first of these criteria led us to focus first on stating which types of arrangements *should* be subject to employment law, as a matter of policy (an element that appears to us to be lacking in our current legislation). Currently, the role of providing guidance to the population on what the "real nature of the relationship" is in particular instances has been left to the courts, whose decisions are then reflected in guidance produced by both MBIE and Inland Revenue (among other sources). But a system in which courts consider "all relevant matters" in a highly individualised, case-by-case approach to questions of employment status does not lend itself towards providing greater policy clarity over time.

44. We think that the legislation itself should play a more directive role in delineating where the "real nature" of a working relationship is employment. This will in turn allow for clearer guidance to be provided to businesses and workers on what constitutes lawful classification. To achieve this, we have proposed combining a "high level" statement of policy intent (suitable to be reflected in primary legislation), and a more granular set of "design principles", which could feed into the more detailed legislative schema.

45. In general, we think the legislation should focus on providing clear statements of principle and should not rely on explicitly ringfencing sectors or occupations as employees or contractors (via legislation or regulation). In some cases, however, there may be a complementary role for this approach – e.g. for the avoidance of doubt, to avoid unintended outcomes, or to reinforce the recommendations of an inquiry into classification practices (the concept of an inquiry is explained in paragraphs 78-81 below).

We recommend providing a clear legislative "starting point" for the distinction between employment and contracting

46. The current, minimal definition of "employee" in section 6 of the Employment Relations Act 2000 is based on the common law concept of a "contract of service". The legislation also contains directions to the courts as to what they should consider when asked to decide the "real nature of the relationship" between parties (they must consider "all relevant matters," and are not to treat as determinative any statement by the parties that describes the nature of their relationship).

47. As a first step towards creating a more generalisable employee/contractor "boundary", we think it is necessary for the legislation to provide a clearer conceptual starting point. Rather than providing *just* a list of indicia that point one way or another in different contexts, a succinct legislative definition could aim to encapsulate what the various "tests" are driving towards.

48. Courts themselves have often described the "core" difference between employment and contracting (self-employment) in terms of "working in service of another" vs entrepreneurship. In *Leota*,[3] for example, Chief Judge Inglis said:

> An employee works for the employer, within the employer's business, to enable the employer's interests to be met. An independent contractor is an entrepreneur, providing their labour to others in pursuit of gains for their own entrepreneurial enterprise.

49. In the same judgment, Chief Judge Inglis said that "the essential issue in a case such as this is whether the worker serves their own business or someone else's business."

50. Statements such as this reflect what we take to be the economic basis for the distinction between employees and contractors. Someone who is genuinely in business for themselves takes risks and seeks to generate returns that accrue to their own business. In functional terms, they are operating as a "firm" in their own right (i.e. directing the use of labour, capital and technological innovation to produce goods and services that markets want).

51. Employees, by contrast, as Professor Andrew Stewart has put it, generally work "on the basis that some remuneration at least will be received for their efforts," and that "someone else is ultimately responsible for making the decisions that will determine whether they continue to be given a chance to earn that remuneration."[4]

[3] Leota v Parcel Express [2020] NZEmpC 61.

[4] Professor Andrew Stewart, "Submission on Independent Contracting and Labour Hire" (2005), p 2: https://www.aph.gov.au/Parliamentary_Business/Committees/House_of_Representatives_committees?url=ewrwp/independentcontracting/subs/sub69.pdf.

52. We note that traces of this basic distinction are reflected in international legislation – notably the current definition of "worker" in the UK.[5] It is also consistent with the so-called "fundamental test" that is referred to by our courts (alongside other factors).

53. We recommend that the core legislative definition of "employee" be redrafted to contain a stronger sense of contradistinction to someone who is genuinely in business for themselves. Further analysis of the policy and legislative drafting implications of this approach would need to be undertaken before it could be implemented.[6] But for illustrative purposes, one possible formulation is below:

Employee means an individual who is engaged by another to perform labour or provide services for reward, and is not, in providing labour or services, genuinely operating a business on his or her own account.

Rec 1: Revise the legislative definition of "employee" to include a strong sense of contradistinction to someone who is genuinely in business on his or her own account. This should be the critical question to answer when deciding whether someone is an employee or a contractor.

Constructing more detailed legislative requirements for worker classification: key design principles

54. The international experience suggests that "high level" definitions are not enough, by themselves, to produce greater clarity or predictability in the law. For example, although the UK's "worker" definition appears to raise the possibility of a simpler test, the UK Employment Appeal Tribunal has commented that, to identify a worker, it will apply the same tests it applies when assessing if an individual is an employee, but with a lower threshold or cut-off point. Considerable scope for ambiguity and subjective decision-making remains.

55. Providing more detailed or prescriptive guidance to courts and to regulated parties about the factors to be considered would in our view help to ensure that a "brighter line" can be drawn between employment and contracting. The goal should be to embed the most useful parts of section 6 case law into the legislation itself, while also allowing some of the less useful indicators referred by courts (and in current public facing guidance) to be de-emphasised or ruled out of consideration altogether.

56. As a starting point for this work, we have agreed on a set of nine "design principles" (set out below) which could be reflected in the broader legislative schema setting out how decision-makers are to approach questions of employment status. In expressing the principles, we have used the term "person performing work" (PPW) to refer to someone who is

[5] "Worker" is defined as someone who works under "any contract […] whereby the individual undertakes to do or perform personally any work or services for another party to the contract whose status is not by virtue of the contract that of a client or customer of any profession or business undertaking carried on by the individual." In the UK, "worker" is an intermediate category and is not equivalent to "employee". Worker status carries some but not all employment entitlements.

[6] This would include considering interactions with other legislation, and the current definition's role in contexts other than employee/contractor disputes. For example, section 6 is relevant in the context of employee/volunteer issues and has also been referred to by courts when considering the distinction between "casual" employment and permanent/ongoing work.

contractually required to perform work for another person (PPW would include employees and contractors). We have used "hiring entity" as a generic term for those who hire others to perform work (this is intended to include people who do not identify themselves as "employers").

57. Taken as a whole, the principles aim to:

- provide meaningful indicators to guide decision-making by "hiring entities" about whether the PPW is genuinely in business on their own account
- provide clearer policy positions on some matters that we take to be ambiguous, currently, in New Zealand law (for example, the importance of party intention)
- convey the idea that people who engage others to perform work should have a duty to consider the correct legal classification of their relationship with the other party.

58. There would be a range of ways to reflect the following principles in legislation. As with our earlier recommendation, further policy and legal analysis would be necessary to fully evaluate the impacts of these principles before they could be given effect.

59. In the case of apprenticeships (and similar arrangements), we have taken the view that these should be explicitly "carved in" to the definition of employee – as they are in the UK for example. These are not genuinely business to business relationships. Arguably this is strongly implied by our existing legislative settings,[7] but the widespread misclassification we have heard about in this context suggests that a more explicit legislative clarification is needed.

The nine design principles

The nature of the test and who bears the responsibility for classification decisions

i. The test for whether someone is an employee should be an objective one and the intention of the parties is not material. The PPW's understanding of the distinction between employment and contracting relationships has no bearing on the validity of the initial classification decision. This is not a question of "informed choice".

ii. The classification decision and the onus of proof sits with the hiring entity. If a PPW would prefer to be engaged as a contractor, this preference alone does not remove the need for the hiring entity to consider the PPW's correct classification (based on whether the PPW will, in providing labour, be genuinely operating an independent business on their own account). It follows from this principle that the issue of attaching penalties for intentional or reckless misclassification would need to be considered.

The legislation needs to make it clear that to be "genuinely in business on one's own account" requires indicators that get to the substance of commercial activity

iii. The most crucial elements of the distinction are reflected in the table below.

[7] Section 362 of the Education and Training Act 2020 states: "Training agreements and apprenticeship training agreements are part of the employment agreement between the employee and employer concerned."

A person who is genuinely in business on their own account will demonstrably:	By contrast, an employee will typically:
• be responsible for managing their business operations (this includes making decisions about the best use of labour and capital resources to maximise productivity)	• have a limited ability to influence the overall productivity of a business operation, other than by increasing personal efficiency or effort
• be free to contract with other businesses to provide the same or similar services, and build and maintain a varied client base	• be identified as "part of" the hiring entity's operation, and consequently have limitations on their ability to work for other organisations
• generate gains that accrue to their own business enterprise (e.g. an expanded client base, good will)	• not accrue business gains of their own (any gains that could be reflected on a business's "balance sheet" accrue to the hiring entity)
• have business resources available to assist in providing services (these business resources may be supplemented with resources provided by the hiring entity in some circumstances, where this is necessary to perform the services required under the contract).	• not be required to provide significant resources to enable the work to be carried out (note that this needs to be read in conjunction with principle v, below).

The legislation should also seek to de-emphasise or explicitly rule out some of the customary indicia for "being in business", as they are superficial and open to manipulation

iv. The transactional or formal characteristics of a relationship (e.g. the fact that the PPW issues an invoice to the payer in order to be paid, is paid through an interposed structure such as a company, is required to manage their own tax affairs, or is required to provide their own insurance) should have no bearing on the hiring entity's classification decision.

v. Requiring someone to own and maintain assets or equipment that will be used to perform work for the hiring entity, as a condition of entering a contract, should not – on its own – justify a contractor/principal relationship being constructed rather than an employment relationship. Provision of resources is a necessary precondition for someone to be genuinely in business on their own account, but it is not a reliable indicator on its own.[8]

[8] The actual use of privately owned assets / vehicles is not necessarily inconsistent with an employer/employee relationship. This is already acknowledged in some employment law guidance.

vi. Requiring or allowing someone, as a matter of contract, to delegate or subcontract tasks to other workers in order to ensure a continuous supply of labour to the hiring entity should not have a bearing on the classification decision.

Elements of control and integration are strong indicators of the PPW being employed, rather than being in business on their own account

vii. If the contract provides for extensive control by the hiring entity over the manner in which work is performed (e.g. specifying routes or operating procedures), as opposed to merely holding the PPW to account for outcomes, this is more consistent with an employment relationship than a contractor/principal relationship.

viii. If the contract requires the PPW to only use the principal's signage and branding, and/or to wear a uniform that holds them out as a representative or agent of that company, this suggests that the hiring entity should classify the PPW as an employee (it is consistent with complete integration into the hiring entity's operation, and inconsistent with the PPW being genuinely in business on their own account).

ix. If the PPW will be providing labour under an apprenticeship agreement or a similar arrangement, they cannot, in providing that labour, be "genuinely operating a business on their own account".

Rec 2: We recommend that the nine design principles we have agreed to (above) be used as the basis for constructing more detailed, objective and prescriptive legislative requirements for worker classification. The aim should be to create an effective legal duty on "hiring entities" to step through a robust decision-making process when considering worker classification, guided to a large extent by the legislation itself. The hiring entity will be responsible for making this decision correctly.

Comment on the effects of adopting this definition of employment

60. One of the key aims of adopting the approach above would be to provide greater upfront certainty into the contracting environment. Hiring entities would have a clear obligation to decide a worker's status, based on factors that get to the substantive differences between employment and independent business. This system would aim to reduce the current reliance on the dispute resolution system, with its ex-post determinations of status, and instead encourage more rigorous up-front discussions and decisions about classification and business models.

61. But we wish to emphasise that any attempt to "clarify" the boundary would also, inevitably, shift the current de facto boundary (as expressed in prevailing classification practices). A clearer legislative position – particularly one that removes any emphasis on party intention – would mean that some parties who currently consider themselves contractors would find that they were covered by employment law. The abruptness of these impacts would vary depending on which transitional provisions were built into the legislation (e.g. the amount of lead-in time, whether the definition would apply immediately to all sectors, and the extent of any retrospective effect).

62. The more definite approach to the employee/contractor boundary we have suggested would impact most on sectors where workers are routinely classified as contractors despite lacking

the attributes of genuine commercial independence. Some business models in these sectors would need to change to conform with the new legislative schema.

63. We have not attempted to assess the impacts of our suggested approach across every potentially impacted sector. For this reason, we recommend that the Government develop a more detailed policy proposal based on our recommended approach, and then publicly consult on it. This would provide an opportunity to identify any unintended consequences and to design ways to mitigate them.

64. We suggest that the policy proposal being consulted on include consideration of how the most affected sectors may need to transition towards using more employment relationships. For example, some contractors are required to purchase assets that are branded to the hiring entity, or buy into franchises. Some of these contractors would likely be classified as employees under the new legislative schema. Where this occurs, it would be important that thought has been given to the matter of how a move into an employment relationship would impact the value of these assets and investments, and what role the employer should play in ensuring their employee is no worse off.

Rec 3: Note the Group's view that further policy work and consultation should be prioritised as a next step, to understand the impacts, manage the risk of unintended consequences, and consider how business models could transition away from unlawful classification practices in a way that is fair for the people involved.

Opportunities for system changes to support the implementation of a clearer employee/contractor boundary

65. If the Government were to implement the Group's core recommendations (as above), this would present an opportunity to make supportive changes to enhance the systemic impact of a revised definition. The Group has not provided firm recommendations about these, but we do wish to highlight four areas for further consideration:

- Providing clear, consistent guidance across all government channels – and considering how business support services could assist firms to make better decisions about worker classification.
- Allowing judicial determinations to be framed as having applicability beyond one individual, in appropriate circumstances.
- Better enabling proactive regulatory interventions (including interventions that focus on firm and sectoral-level business models rather than discrete relationships).
- Exploring ways to use the tax system to encourage better classification practices by firms.

Guidance and support services

66. A new legislative position on the employee/contractor boundary would in the first instance require detailed guidance, to assist the majority of firms who would voluntarily seek to comply. Clearer legislation would allow for government agencies to produce information and education to support hiring entities and workers to make correct decisions.

67. If the legislative definition of employee was harmonised across employment and other legislation (notably tax – as discussed in paragraphs 83-91 below), this would support the consistency of guidance provided across government channels (e.g. Inland Revenue, employment.govt.nz, business.govt.nz).

68. There may be a case for government supports to expand beyond the usual use of publications and call centre services – towards providing more hands-on business support services, where firms are required to consider their classification practices across an entire business model. The cost of these interventions could be offset by the downstream savings of avoiding the need for recourse to the dispute resolution system.

Rec 4: We recommend a comprehensive package of guidance and support services (consistent across all government channels) be developed to support better classification practices by firms in the first instance, reducing reliance on the dispute resolution system.

Judicial determinations with broader applicability

69. As it stands, the precedent effect of judicial decisions about employment status is tightly circumscribed, and this appears to be a deliberate design choice by Parliament. Courts *must consider all relevant matters* that could influence a decision about a person's employment status – and those "matters" are numerous and include questions about party intention. Accordingly, courts routinely emphasise that a section 6 determination applies to a very particular set of facts and is not to be taken as applying to anyone other than the party who sought it.

70. When it was originally introduced, the *Employment Relations Bill* envisaged a very different system, where applicants (including unions or labour inspectors) could apply to the Employment Court for a declaration that a "particular group or class of persons" were employees.[9]

71. A version of this option was included in the *Better Protections for Contractors* discussion document (option 7). We think that this option should be pursued further as it appears more efficient for questions about classification to be asked and answered in the most generic way possible, rather than person by person.

72. We note that, if the employment status test were re-drafted along the lines we have suggested, then this would have some effect in giving decisions broader applicability. Moving towards a more objective test which removed some of the factors that are currently relevant to assessing employment status would arguably make determinations more "mappable" onto other comparable situations. A more objective test could also make representative actions[10] (as currently allowed under the High Court rules) a more realistic possibility in the context of employee/contractor issues.

[9] Employment Relations Bill 2000 (8-1), s 154.

[10] Representative actions are where a small number of plaintiffs bring an action on behalf of a larger group of plaintiffs. The High Court rules (which bind the Employment Court) allow for such actions where they are in the best interests of justice, e.g. it should be in the interests of the courts to not have to deal with the same matter over and over again. The court must be satisfied that the members of the class have a shared interest in the same legal issue being resolved and that the defendant would not be denied the opportunity to adequately defend the claim if the representative action were allowed.

73. We do not propose a return to the very broad model whereby courts could be asked to decide that a determination applied to any "group or class of persons" (as proposed in the original Employment Relations Bill). But for reasons of efficiency, we think there is a case for exploring a more limited version of this idea. The Court or Authority (as appropriate) could be asked to decide whether a determination should cover other workers performing similar work for the same "hiring entity", under fundamentally similar contractual terms.

74. It would be important to ensure that workers potentially affected by such a decision were notified and given an opportunity to participate in the judicial process. The recently amended Equal Pay Act 1972 gives one model for how this could be achieved. Section 13U of that Act requires employers to notify other employees potentially affected by a pay equity claim that an arguable claim had been initiated.

75. Further work should also be undertaken to assess the value of a class action regime in this context (where a group of workers seeks to have their employment status settled at the same time). The Group has not discounted this option.

Rec 5: We recommend allowing judicial determinations on employment status to cover other workers performing similar work for the same hiring entity under similar contractual terms (even if only one worker seeks a judicial decision). Further work should be completed to assess the value of allowing groups of workers to seek employment status determinations

Proactive regulatory interventions in the employment system

76. We envisage that information and education would be the initial focus for regulatory agencies if a new definition was implemented. It would also be important to ensure also that placing a stronger onus on hiring entities to make correct decisions (as we have proposed) is backed up by an appropriately graduated suite of regulatory interventions, combined with suitable powers and resources for the Labour Inspectorate and other parts of the employment system.

77. Importantly, this should include options for identifying and addressing misclassification without reliance on an individual complainant wanting to pursue the matter. This is in keeping with our view that correct classification should be considered an objective question, without necessarily considering the intention of individual parties. It also reflects the reality that many misclassified contractors are unable to pursue a legal process because of the power imbalances inherent in their relationship with the hiring entity. Proactive regulatory interventions can therefore be seen as another way to allocate the costs of challenging misclassification more fairly (this objective is also implicit in our recommended approach to judicial decisions, discussed above).

78. We also suggest exploring opportunities for regulatory interventions to tackle the misclassification issue at a systemic level. One possibility would be to use inquiries or regulator-led studies as a way of providing a deeper analysis of classification practices at the level of sectors or business models. This approach would be more expansive in its ambit than traditional enforcement activity.

79. Publishing inquiry findings and recommendations would provide a mechanism for "feeding back" information to the market about misclassification. An inquiry system could also be structured such that, where appropriate, inquiries lead to direct enforcement action, without recourse to the courts.

80. Comparable examples of inquiries or studies in other jurisdictions include:

- Inquiries have been relatively common in the Health and Safety domain (e.g. the industry led inquiry into health and safety practices in the forestry industry from 2014).
- The Commerce Commission's "competition studies" regime. These studies have a statutory basis, and the Commission can use its existing powers to gather evidence where necessary.
- Australia's Fair Work Ombudsman carries out inquiries into "businesses, industries, regions, supply chains, labour markets or a combination of these."[11] These tend to produce both systemic recommendations and (in some cases) enforcement action.

81. The Group has not considered in detail how system-level inquiries could be conducted, but we believe that there should be a clear statutory basis for any inquiry model. We acknowledge that the Labour Inspectorate as it is currently configured would require additional resources, capability and potentially statutory powers if it were to be tasked with performing this function.

82. More generally, we observe that all the regulatory interventions we have discussed in this section (from providing guidance, through to proactively conducting inquiries) might require specialist skills and deep knowledge of sectors. This too would have resourcing implications for the regulator(s) concerned.

Rec 6: In designing regulatory systems to respond to worker misclassification, we recommend exploring options that would allow for regulators to intervene without relying on an individual complainant wanting to pursue the matter. Inquiries or regulator-led studies provide a potentially powerful mechanism for responding to misclassification at the level of sector or business model, and we recommend that this option be pursued.

Making better use of the tax system

83. Where hiring entities get their classification decisions wrong, this often also means that the parties' tax decisions are wrong, right from the start of their working relationship. Emphasising better upfront classification decisions, as we have suggested, will set workers and businesses up for success in both the employment and tax systems. Aligning the employee/contractor boundary across the employment and tax systems will maximise the benefits of legislative reform.

84. Employment status largely determines whether a firm must deduct tax on a worker's behalf (through the PAYE system for employees), or if the worker must file an individual tax return (for self-employed contractors). PAYE (a type of withholding) is an effective mechanism to ensure payment of tax and the efficient distribution of compliance costs.

85. To date, Inland Revenue's (IR's) preferred mechanism to bring contractors within the tax withholding rules has been the "schedular withholding payments" regime.[12] Due in part to

[11] See: https://www.fairwork.gov.au/about-us/compliance-and-enforcement/reporting-outcomes/inquiry-reports.

[12] Under this regime, certain payments to contractors are "schedular payments", and the payer is required deduct some tax from these payments at source. Certain occupations and classes of contract are listed in a schedule, hence the name "schedular payments".

the highly individualised nature of employee/contractor decisions, which reduces the potential cost-effectiveness of audit activity, IR does not proactively enforce the employee/contractor boundary.

86. If an objective test for employment status were introduced in both employment and tax legislation, and decisions could be applied across groups of workers/taxpayers, it may be that IR could more readily use enforcement of the contractor/employee boundary as a cost-effective mechanism for bringing taxpayers into the withholding rules.

87. This possibility would be contingent on the definition of "employee" being harmonised across employment and tax legislation. Although the regimes are broadly consistent now, there is a subtle difference in that tax legislation relies solely on the common law position on the distinction between employees and independent contractors. IR regards section 6 case law as being "relevant to the extent that those decisions concern the common law on the employee/independent contractor distinction."[13] If employment legislation was revised to move more decisively away from the common law position (as we have proposed), then it would be sensible for tax legislation to be revised to match.

88. Flow-on analysis would be required to maximise the regulatory opportunities created by legislative alignment. For example, a consequential legislative change could allow for two-way information sharing between IR and the employment regulator. This would in turn support the creation of a shared compliance strategy to address matters where tax policy and employment policy have common objectives.

89. We also discussed the possibility of using the tax system more directly as a point of intervention, by requiring "hiring entities" to notify IR of their worker classification decisions. For example:

- Businesses could be required to certify that their decisions had been made based on a reasonable interpretation of the law.
- Treating classification decisions as a "tax position" could allow IR to introduce new penalties in instances where educative approaches have not been effective (e.g. for failing to take reasonable care, or for taking an unacceptable tax position).

90. We recognise that the costs and benefits of such an intervention would need to be carefully weighed. A new reporting requirement would not be as simple as modifying the PAYE system, as the starting point for that system is that the payer has engaged an employee. IR is not automatically notified when a contractor/principal relationship is established. The payer in these situations does not normally need to interact with IR at all (unless the payments are subject to the schedular withholding regime).

91. Requiring hiring entities to "sign off" their classification decisions for tax purposes could be way to give "teeth" to the idea that classification decisions and the onus of proof should sit with hiring entities. We recommend that this idea be explored further to assess its viability as part of a package of changes designed to promote better worker classification practices across the economy.

[13] See Interpretation Guideline: IG 16/01 Determining employment status for tax purposes, p 2. https://www.taxtechnical.ird.govt.nz/-/media/project/ir/tt/pdfs/interpretation-guidelines/ig1601.pdf?la=en

Rec 7: We recommend that the definition of "employee" be aligned across employment and tax legislation. This should include allowing for appropriate two-way information sharing between Inland Revenue and the employment regulator. The Government should explore ways to better use the tax system as an intervention point to encourage better classification practices by firms (including the option described at paragraphs 89-91 above).

Next steps

92. Our report provides a suggested direction of travel for future policy development. We propose that as a next step, the Government develop and publicly consult on a policy proposal that is based on our proposed approach. A primary purpose of this consultation would be to understand the impacts, manage the risk of unintended consequences, and consider how affected business models could transition in a way that is fair for the people involved.

93. We recommend that, at a later stage, consideration should be given to the potential "business to business" interventions identified in the *Better Protections for Contractors* discussion document and by stakeholders. Even when a clearer legislative position is adopted on the appropriate positioning of the employee/contractor boundary, some genuine contractors will still remain subject to unfair and oppressive contract terms. Once the scope of this residual issue is clearer, the government should initiate policy work to address this.

94. The Group also wishes to emphasise that issues relating to job insecurity and inadequate regulatory protection are not exclusive to contractors, but cut across the broader terrain of "non-standard work" (e.g. triangular employment, casual employment). Adopting a stricter approach to the employee/contractor boundary could result in firms placing greater reliance on these other employment models, which can have a similar effect in terms of shifting cost and risk onto workers. The Government should complete further work to ensure that these other types of non-standard work are regulated appropriately.