

LHAG Insights



Industrial Relations & Employment



ABOUT THE AUTHORS



Amardeep Singh Toor
Partner
**Industrial Relations &
Employment**
E: ast@lh-ag.com



Wong Lien Taa
Associate
**Industrial Relations &
Employment**
E: wlt@lh-ag.com

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Employee or Independent Contractor – What's the Difference?

In the past year or so, vast amendments were made to the Employment Act 1955 (**the Act**). One of the key amendments due to come into force is the introduction of a set of presumptions as to who is engaged under a contract of service (employment contract) instead of a contract for services.¹ An employee is engaged under an employment contract, whilst an independent contractor is engaged under a contract for services.

With effect from 1 January 2023, it shall be presumed that a person is an employee and not an independent contractor under the following circumstances:

- (a) Where his manner of work is subject to the control or direction of another person;
- (b) Where his hours of work are subject to the control or direction of another person;
- (c) Where he is provided with tools, materials or equipment by another person to execute work;

¹ Section 101C of the Employment Act 1955

- (d) Where his work constitutes an integral part of another person's business;
- (e) Where his work is performed solely for the benefit of another person; or
- (f) Where payment is made to him in return for work done by him at regular intervals and such payment constitutes the majority of his income.

General position

Whether a person is an employee or an independent contractor is a mixed question of fact and law. It turns on the conduct of the parties to the contract and the inference to be drawn from this; and a classification of the contract.²

The creativity of companies in exploring a myriad of hybrid relationships to avoid being saddled with the obligations imposed on an employer have led Courts to develop various tests to ascertain the true nature of the relationship between the organisation and its workers.

Control test

Control is an important indicium of an employment contract. An employer is one who dictates to their employees, not only what they must do in a job, but also when and how to do it. The degree of control which a company exercises is an important factor, although it may not be the sole criterion.³ This is the traditional “control test”.

Integration test

The Courts consider whether the worker is part and parcel of the business organisation. The test focuses on the worker’s integration into the organisation’s business and questions:

² *Assunta Hospital v Dr A Dutt* [1981] 1 LNS 5

³ *Hoh Kiang Ngan v Mahkamah Perusahaan Malaysia & Anor* [1996] 4 CLJ 687

- (a) Whether the worker is economically dependent on the organisation; or
- (b) Whether the worker's activities are an essential component to the organisation's business.⁴

Multiple test

The Courts weigh multiple factors that may favour, on one hand, an employment contract and, on the other, a contract for services before determining where it tilts. The central elements of the multiple test are:

- (a) Whether the worker provides his own work and skill in return for remuneration;
- (b) Whether there is a sufficient degree of control to enable the worker to be called a servant; and
- (c) Whether there are any factors inconsistent with the existence of an employment contract which negates the existence of a master/servant relationship.⁵

Entrepreneur test

This test focuses on the question; "*Whose business is it?*". It necessitates consideration of the following factors: (a) Control; (b) Ownership of tools; (c) Does the individual have a chance of profit; and (d) Who bears the risk of loss.⁶

Factors

The Courts have used a variety of tests to reflect the realities of a modern economy and the relationships between parties engaged in diverse economic sectors. To determine whether there is an employment contract or a contract for services, the correct approach is to apply the various considerations relevant to each test collectively, for their combined effect.⁷

⁴ *Ekajaya (M) Sdn Bhd v Ahmad Mahad & Ors* [2014] 6 CLJ 1005

⁵ *Ekajaya (M) Sdn Bhd v Ahmad Mahad & Ors* [2014] 6 CLJ 1005

⁶ *Ekajaya (M) Sdn Bhd v Ahmad Mahad & Ors* [2014] 6 CLJ 1005

⁷ *Mary Colete John v South East Asia Insurance Berhad* [2010] 8 CLJ 129 citing *Chitty on Contracts Vol. II Specific Contracts (13th Edition)*

Some of the relevant factors are seen below:

- (a) Control: An independent contractor is typically free to conduct his dealings with a high degree of independence where the company does not directly supervise or control the day-to-day operations of his business and has not assigned work or business to him.
- (b) Training: Mandating company-provided training is indicative of an employment relationship in which the company determines the methods by which work is accomplished.
- (c) Business integration: Workers whose services are not an essential component of the company's business are likely to be considered independent contractors.
- (d) Subordinates: An independent contractor relationship is indicated by the worker's freedom to hire subordinates where the terms and conditions of employment are fixed unilaterally by the worker and expenses are borne by the worker.
- (e) Duration of relationship: A continuous and prolonged relationship between a company and a worker is indicative of an employment relationship.
- (f) Comparison with employees: The Courts will consider whether there were other workers who performed similar work but were employed by the company under an employment contract with different terms and conditions.
- (g) Annual appraisals: Where the worker was not subject to scrutiny of an annual appraisal by the company, such is indicative of an independent contractor relationship.

- (h) Promotion and demotion: The prerogative of the company to promote and demote a worker is an indicium of an employment.
- (i) Retirement: Mandatory retirement upon reaching a specified age is an indicium of employment.
- (j) Flexibility of schedule: An independent contractor is typically free to choose his daily business schedule; working hours; and whether or not to work on any given day.
- (k) Full-time work: Full-time work that consumes the majority of a worker's time or prevents them from performing any other work supports a finding of an employment relationship.
- (l) Leave entitlement and procedure: Unlike an employee, an independent contractor may not be entitled to annual leave/medical leave etc. Independence in regard to time-off or annual leave where the worker does not require permission from a superior indicates an independent contractor relationship.
- (m) Exclusivity: An independent contractor is usually free to conduct other business without interference from the company. This may however be subject to certain restrictions such as engaging with a direct competitor etc.
- (n) Other engagements: An independent contractor is typically a worker who is not economically dependent on the company and is engaged in other work.
- (o) Reimbursement of expenses: Independent contractors typically bear the cost of business expenses such as licensing fees etc.
- (p) Office space: An independent contractor relationship is indicated by the worker maintaining

an office space at his own expense and/or where the worker is not provided an office space by the company at its premises.

- (q) Need for on-site services: Requirement for the worker to work on the company's premises is indicative of an employment relationship.
- (r) Method of payment: The absence of a fixed salary and payment on commission basis is indicative of an independent contractor relationship.
- (s) Provision of tools: Workers who perform a majority of their work using company-provided equipment, tools, and materials are more likely to be considered employees.
- (t) Autonomy of business structure: Business autonomy, such as the freedom to incorporate a company to conduct business, employ subordinates, spend on advertising and other aspects of his business is indicative of an independent contractor relationship.
- (u) Realisation of profit or loss: The opportunity for profit or loss based on the worker's business and managerial decisions without any predetermined earnings is indicative of an independent contractor relationship.
- (v) Acknowledgement from the worker: The Courts will consider the worker's conduct, such as: (a) Payments not being paid directly to the worker but remitted to a private company nominated by the worker; (b) The worker paying income tax as an employee of the private company; and (c) Declarations made to authorities such as the worker filing tax returns as an individual carrying out their own business (Form B) instead of an employee (Form BE).

Head Office

Level 6, Menara 1 Dutamas
Solaris Dutamas
No. 1, Jalan Dutamas 1
50480 Kuala Lumpur
Malaysia
Tel: +603 6208 5888
Fax: +603 6201 0122

Johor Office

Suite 21.01
21st Floor, Public Bank Tower
No.19, Jalan Wong Ah Fook
80000 Johor Bahru, Johor
Tel: +607 278 3833
Fax: +607 278 2833

Penang Office

18-33-A3 Gurney Tower
Persiaran Gurney
10250 Georgetown
Pulau Pinang
Tel: +604 299 9668
Fax: +604 299 9628

Email

enquiry@lh-ag.com

Website

www.lh-ag.com

Conclusion

There is a clear shift away from the initial position taken by the Courts where control was the most important indicia of employment. Presently, a more realistic position is taken where focus is placed on the fundamental issue of whether a person is carrying on a business on his own accord.

The aforesaid set of presumptions introduced to the Employment Act 1955 with effect from 1 January 2023 may entail far reaching consequences on the operations and finances of a company, should the Courts establish the existence of an employment relationship. This includes, among others, the company being imposed with: (a) Obligations under the Employment Act 1955; (b) Obligation to make payment of statutory contributions for Employees Provident Fund (**EPF**), Social Security Organisation (**SOCSSO**), Employment Insurance System (**EIS**) as well as the Human Resources Development Fund (**HRDF**); and (c) Tax obligations. The company may also be directed to make payment of outstanding contributions under EPF, SOCSSO and EIS. Companies may also find themselves open to unjust dismissal claims under the Industrial Relations Act 1967 from these workers.

Companies who engage independent contractors should therefore review the documentation pertaining to the engagement of these workers. It should also review its operations and business model to withstand when audited against the various tests applied by the Courts.

If you have any queries please contact associate, Wong Lien Taa (wlt@lh-ag.com), or partner, Amardeep Singh Toor (ast@lh-ag.com).