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Consultant or employee – differences and consequences

Hiring consultants can be an attractive alternative to hiring employees for various reasons. In particular, it may be attractive to small or new and/or foreign companies that want to enter the Swedish market but are not yet ready to take on the responsibilities of an employer. Consultants may also be needed during work peaks, when a company needs a specific task done or specialist competence within a certain area. Many consultancy agreements are, however, legally to be regarded as employment agreements, which may lead to unexpected consequences in relation to employment and tax law. In this article we illustrate these issues (mainly from an employment law perspective) and explain how to minimise the risk that a consultancy agreement is deemed to be an employment agreement.

Who is an employee?

The distinction between an employee and a consultant is determined on purely objective grounds. Thus, it is not possible to "contract out" of the responsibilities of an employer if the working individual falls within the definition of an employee.

As a main rule, a consultant is significantly more independent than an employee. This applies both in relation to working hours and the working place, but also in relation to the work result and economic risk.

The following circumstances generally indicate that a working individual is an employee:

1. The working individual must carry out the job him- or herself, regardless of whether this is expressly stated in the parties' agreement or implied by the parties.
2. The working individual has actually performed all or nearly all of the work.
3. The working individual's obligations include that he or she must be available for work as tasks arise.
4. The relationship between the parties is permanent in nature.
5. The working individual cannot at the same time perform similar work of any significance for any other party, whether because of a direct prohibition or as a result of the working conditions, for example because the employees' time or efforts do not suffice for any other work.

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6. The working individual is subject to specific instructions or close supervision in relation to the manner in which the work is performed, the working hours or the work place.
7. The working individual uses machinery, tools or raw materials in his or her job which are provided by the other party.
8. The working individual is reimbursed for his/her direct expenses, such as travel.
9. Remuneration for work is paid, at least partly, in the form of a guaranteed remuneration.
10. The working individual is on equal terms with employees from an economic and social point of view.
11. The working individual does not have any duty to "rectify" defective work free of charge.

The opposite circumstances would suggest that the working individual is a consultant in relation to employment law. When drafting a consultancy agreement we recommend that the aforementioned 11 points are taken into consideration to decide whether the terms or the structure of the agreement should be changed in any way in order to reduce the risk that the consultancy agreement might be deemed to constitute an employment agreement. For example, is it necessary for the consultant to work with a computer provided by the company hiring the consultant, or could a computer owned by the consultant be used?

Legal consequences

The distinction between employee and consultant is important since mandatory legislation and rules such as the Employment Protection Act and the Annual Holidays Act apply in an employment relationship but do not cover consultants. If it is deemed that there is an employment relation, this means for example that notice of termination by the employer must be based on objective grounds, that the consultant may be entitled to holiday pay and compensation for overtime, etc. Even historical, accumulated holiday pay and overtime compensation may have to be paid to a consultant who is legally deemed to be an employee.

If the company in question is bound by a collective bargaining agreement, this may also entail consequences in relation to trade unions if the consultant is actually an employee and it turns out that by hiring the consultant, the company avoided provisions in the parties' bargaining agreement relating to working hours, salaries etc.

From a taxation point of view, the employer's liability means that the commissioning company in question may be liable both for withholding income tax and for payment of social security tax. Even in relation to legal persons, such as joint stock companies,

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which are not registered for F-tax, a company that has paid remuneration for work must withhold income tax. However, social security tax is never paid for legal persons.

If the consultant is registered for F-tax, the paying company must not withhold income tax or pay social security tax in relation to the remuneration. A person who is registered for F-tax pays his or her own income tax and social security contributions.

In the context of the above, it may seem as though a commissioning company, from a fiscal point of view, does not need to worry about unforeseen tax consequences as long as the consultant is registered for F-tax. However, even though F-tax registration is important and decisive in many ways, situations may arise in which a commissioning company becomes liable for withholding income tax and social security tax where a consultant is registered for F-tax, for example if the registration is cancelled during the performance of the assignment, or if there is an obvious employment relationship and the commissioning party has failed to report this to the Swedish Tax Agency. The Tax Agency may also hold that an individual behind a consultancy company is actually an employee in legal terms (Sw: genomsyn). We should also mention that there may be adverse tax consequences if the consultant has been VAT registered and input/output VAT must be adjusted retroactively since there in fact has been an employment relationship between the parties.

In the light of the above, F- tax is an important factor when assessing whether a person is a consultant or an employee, but if it is clear, based on other grounds, that there is an employment relationship, the approval for F- tax is not applicable in relation to the assignment in question.

Finally, there is also a risk that the commissioning company may have to pay a tax surcharge if the company had a duty to withhold tax but neglected to fulfil this obligation and if the company submitted incorrect information to the Tax Agency. The consultant may also have to pay a tax surcharge if the consultant submitted incorrect information to the Tax Agency regarding his or her type of income.

Conclusion

If a consulting relationship is found to actually be an employment relationship, both the commissioning company and the consultant in question may face unpleasant employment law and tax surprises. When preparing guidelines for a consultancy relationship and drafting a consultancy agreement, there are a number of factors which can be adjusted in order to reduce the risk that the consultancy agreement is legally deemed to be an employment agreement. From the commissioning company's point of view, it is also important to state that the consultant must be

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registered for F-tax throughout the whole of the contractual term. A company hiring a consultant should also try to negotiate that the consultant indemnifies the company in the event the commissioning company is ordered to pay tax, tax surcharges and/or social security contributions. It is important to think through what the company needs. Often, a company wants to "bind" a consultant in a way that gives no room for the independence that distinguishes a consultant from an employee. Similarly, a consultant often wants to be guaranteed a certain economic security which actually puts the consultant on equal terms with an employee.

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