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"The agreement states that I am an independent contractor, so why is PAYE being deducted?"

Employers are often faced with the question of whether or not to deduct employee's tax (Pay-As-You-Earn/PAYE) from persons who label themselves as independent consultants or contractors.

As a starting point, it is important to clarify that the label given to a person does not determine whether or not the employer is required to deduct PAYE from amounts paid to that person. SARS' Interpretation Note 17 (the Interpretation Note) makes it clear that the liability of an employer to deduct PAYE is largely dependent on whether or not "remuneration" as defined in the Fourth Schedule to the Income Tax Act is paid. Subject to certain conditions, amounts that are paid to an independent contractor for services rendered are excluded from "remuneration" as defined, in which case the employer has no liability to deduct PAYE from the amounts so paid.

Two sets of tools are available to determine whether a person is an independent contractor for PAYE purposes, namely the statutory tests and the common law tests. Both tests are briefly discussed below. Practically, the statutory tests are considered first. If they do not apply, the common law tests are applied to finally determine whether the person is an independent contractor or an employee.

Statutory tests

Firstly, it must be determined whether or not the independent contractor employs throughout the tax year three or more employees (true employees in terms of the common law tests) who are on a full-time basis engaged in the business of the independent contractor of rendering services and who are not connected persons in relation to the independent contractor. If this is the case, the person in question will be deemed to be independent for purposes of the Fourth Schedule and will not be subject to PAYE. If this is not the case, the employer should proceed to the two "further" tests.
The two “further” tests can be summarised as follows:

- It must be determined whether the services are required to be performed mainly at the premises of the client. If the services are required to be performed mainly at the premises of the client, proceed to the next test (immediately below). If not, the “further” statutory tests do not apply.
- It must be determined whether the person who rendered or will render the services is subject to either the control or the supervision of the client as to the manner in which his or her duties are performed or to be performed or as to his or her hours of work. If so, the “further” statutory tests apply.

If the “further” tests apply, a person is deemed not to be an independent contractor for purposes of PAYE and, accordingly, PAYE must be deducted from amounts paid to such person. If they do not apply, the employer must continue to apply the common law “dominant impression” test.

Note that an independent contractor who is deemed not to be an independent contractor for purposes of PAYE (and who is therefore subject to PAYE) is not also deemed to be an “employee” (although he is also subject to PAYE, like an employee). An independent contractor who is truly independent under common law will remain unaffected by the deeming provisions of the statutory (PAYE) tests. This means that the independent contractor will not be affected by the limitations on deductions imposed by section 23(m) of the Income Tax Act.

**Common law tests**

- Save for the statutory rules, there are no fixed rules that can be applied to determine whether or not a person is an independent contractor and the Interpretation Note confirms that the common law tests do not permit a “checklist” approach. In terms of the common law tests, a “dominant impression” of the employment relationship must be formed.
- The dominant impression test is split into several indicators of differing significance or weight (none of which is conclusive by itself), which have to be applied in the relevant context. The Interpretation Note states that the “dominant impression” test is “an analytical tool that is designed for application in the employment environment to establish the dependence or independence of a person”. The assessor must analyse the employment relationship in the light of all the indicators and their relative weightings, and arrive at a
In certain circumstances, a person cannot be considered to be an independent contractor for PAYE purposes, irrespective of the nature of his relationship with the employer. In these circumstances, it is not necessary to apply the statutory and common law tests. One example is a person who is not tax resident in South Africa - any amount of "remuneration" paid to a non-resident person will be subject to PAYE, notwithstanding the fact that the person may carry on a trade independently from the person paying him.

It is the responsibility of the employer to determine whether or not the payments are subject to PAYE. It is advisable that the employer retain documentary proof of his/its analysis in arriving at a conclusion as to whether or not a worker is considered independent after applying the statutory (and possibly also the common law) tests. An employer who has incorrectly determined that a worker is an independent contractor is liable for the PAYE that should have been deducted, as well as associated penalties and interest.

If an employer has any uncertainty as to whether or not to deduct PAYE from payments made to a person who considers himself to be an independent contractor, it would be advisable to obtain advice from a specialist tax advisor.

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