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SOUTH AFRICAN REVENUE SERVICE

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HEADS OF SECTIONS – HEAD OFFICE
INSPECTORS OF THE SOUTH AFRICAN REVENUE SERVICE
TUTORS

EMPLOYEES' TAX: INDEPENDENT CONTRACTORS

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1. **Introduction**

- 1.1 The concept of an “independent trader” or “independent contractor” (for all practical purposes, the terms are synonymous) remains one of the most contentious features of the Fourth Schedule to the Income Tax Act. A decision in favour of either independent contractor or employee status has a direct effect on the employees’ tax recovered by the South African Revenue Service (SARS).
- 1.2 The concept forms part of the anti-avoidance measures contained in the Fourth Schedule and requires, as a result, special consideration when determining liability for employees’ tax.
- 1.3 In determining the status of a person who is a worker (i.e. someone who has entered into a contract of employment as either an employee or an independent contractor), it is very important to understand, and to accept, that the common law principles in South Africa do not permit a simple “checklist” approach. It follows that there are no hard and fast rules to be followed in determining whether or not a person is an independent contractor. An “overall” or “dominant” impression of the employment relationship must be formed.
- 1.4 The purpose of this circular is to guide and assist SARS officials in forming a dominant impression of the employment relationship, so as to classify the worker efficiently and with confidence.
- 1.5 The circular includes the interpretation of the relevant legislation, an explanation of the so-called Dominant Impression Test, a flow diagram explaining the structure of the legislation, the Dominant Impression Test Grid, and a historical overview of the common law principles. It is not intended as a definitive and binding statement of SARS’s views and should not be relied upon to sustain a technical legal position. It must be anticipated that this circular will be revised constantly in the light of public debate, court judgements and legislative reform.

1.6 By studying this circular, assessors, auditors and inspectors will gain a thorough understanding of the concept of an independent trader (or independent contractor). The common law history will provide confidence through familiarity with the otherwise confusing Latin and legal terms sometimes used by tax consultants. The legislation “flow diagram” and the “Dominant Impression Grid” will provide a useful *aide memoire* or quick reference guide.

1.7 Note: Unless otherwise indicated all references to paragraphs and subparagraphs are to paragraphs and subparagraphs in the Fourth Schedule to the Income Tax Act.

2. **Interpretation of the Fourth Schedule to the Income Tax Act (the Schedule)**

2.1 The Fourth Schedule requires the presence of three elements before employees’ tax can be recovered, namely - an employer paying remuneration to an employee. Employees’ tax cannot, in general, be recovered in the absence of any one of those elements.

2.2 There are two places in the Schedule where it has to be determined whether a person is an employee or an independent contractor, namely:

2.2.1 in exclusionary subparagraph (ii) of the definition of “remuneration”; and

2.2.2 in paragraph 2(5), where it has to be decided whether a labour broker (as contemplated in paragraph (c) of the definition of “employee”), may be exempt from employees’ tax because the labour broker is an independent contractor.

2.3 **Exclusionary subparagraph (ii) of the definition of “remuneration”**

2.3.1 Amounts (that would otherwise be remuneration) paid to a person as contemplated in paragraph (a) of the definition of “employee” in the Schedule is excluded from the definition of “remuneration” in

the Schedule if that person is an independent contractor. The exclusion does not apply to payments made to persons referred to in paragraphs (b), (c), or (d) of the definition of “employee”, or to a person who is not ordinarily resident in South Africa.

2.3.2 The common law principles (see paragraph 4 of this circular) are used to determine whether or not a person is an independent contractor.

2.3.3 Notwithstanding the fact that a person may be an independent contractor under the common law, payments made to the contractor will not be excluded from “remuneration” if one or both of the two conditions mentioned in *provisos* (ii)(aa) and (bb) of exclusionary subparagraph (ii) of the definition of “remuneration” are fulfilled. The two conditions are:

2.3.3.1 if the contractor is subject to the control or supervision of any other person as to either the manner in which his or her duties are performed or to be performed, or as to his or her hours of work; or

2.3.3.2 if the amounts paid or payable for the independent contractor’s services consist of or include earnings of any description which are payable at regular daily, weekly, monthly or other intervals.

2.3.4 The term “person” appearing in paragraph (a) of the definition of “employee” does not include a company or a close corporation. It follows that, unless there is a basis for the application of the substance *vs.* form doctrine or section 103(1) of the Act, payments made to a company or close corporation that is not a labour broker or does not work through a labour are never subject to employees’ tax.

2.4 Paragraph 2(5) of the Schedule

2.4.1 Remuneration paid to a labour broker as contemplated in paragraph (c) of the definition of “employee” is subject to

employees' tax. This is an anti-avoidance measure and must be applied strictly.

2.4.2 The term "labour broker" is defined in paragraph 1 of the Schedule and includes not only the typical *bone fide* labour broker businesses, but also a close corporation, company or trust which contracted with a client (employer) in terms of which the member or employee of the close corporation is required or listed to render the service to the client.

2.4.3 As a relief for *bona fide* labour broker businesses, paragraph 2(5) of the Fourth Schedule exempts a client (employer) of that labour broker from having to deduct employees' tax from remuneration paid to the labour broker.

2.4.4 The exemption only applies if the labour broker is an independent business (a common law independent contractor) and if certain compliance requirements of the labour broker are up to date.

2.4.5 The common law principles (see paragraph 4 of this circular) are used to determine whether or not a labour broker is carrying on an independent business. An independent business can, in general terms, be described as one that is an entrepreneurial enterprise, enjoying such a degree of independence that it can survive the termination of the relationship with its employer or client.

3. **When is it required of SARS to determine the status of a person?**

3.1 As stated in paragraph 2.2 of this circular, there are two places in the Schedule where it has to be determined whether a person is an employee or an independent contractor.

3.2 Where the provisions of exclusionary subparagraph (ii) of the definition of "remuneration" are applicable, it is the responsibility of the employer to determine whether or not the payments made to the person are excluded from remuneration and, therefore, not subject to employees' tax. In this regard:

- 3.2.1 Some branch offices have been entertaining applications from persons apparently falling into paragraph (a) of the definition of “employee” for a determination recognising him or her as an independent contractor under exclusionary subparagraph (ii) of the definition of “remuneration”. In many instances branch offices are complying with the request and issuing a “letter of independence” based on the face value of a written application (often inappropriately made on Form IRP 30(a), which is only intended for use in paragraph 2(5) determinations). As a result of misdescriptions or misrepresentation independence is emphasised in the IRP 30(a) or the employment contract (which is often intended to create a formal impression in favour of independence) it is often the case that these letters are issued to persons who are in fact not independent contractors. This places a strain on SARS’s personnel and administrative resources, leads to misclassifications, and consequently, a loss of revenue. The provision of this “service” may not be continued. Annexure D of this circular contains a letter that must be issued to these applicants.
- 3.2.2 The employer must make the determination required by exclusionary subparagraph (ii) of the definition of “remuneration”. To determine the status of its workers for employees’ tax purposes an employer may make use of the guidelines given in this circular, which is available to the public.
- 3.2.3 An employer who has incorrectly determined that a worker is an independent contractor will be held liable for the non-payment of employees’ tax and the concomitant penalties and interest.
- 3.3 In the event of an application (on Form IRP 30(a)) in terms of paragraph 2(5) of the Fourth Schedule, it is the statutory duty of SARS to evaluate the status of the labour broker. SARS has to determine whether or not the labour broker is carrying on an independent trade or business. A number of operational procedures have been put in place over the years to facilitate this process. These are contained in Circular Minute 40 of 1992

(which included a brochure “Tax Guidance for Independent Contractors and Labour Brokers”), Circular Minute 40 of 1995 and a Minute addressed to branch offices dated 8 April 1993.

4. **The Common Law Dominant Impression Test**

4.1 The current South African common law position is that the so-called “Dominant Impression” Test (the Test) must be applied to determine whether a worker is an independent contractor or an employee. The Test requires an examination of several indicators, of differing significance or weight, depending on the context. At common law, no single indicator is conclusive or determinant of a person’s status. The Test is essentially an analytical tool, designed for application in the employment environment, to be used to establish the dependence or independence of a person. The person can be a worker or a business.

4.2 The Test is relevant in three contexts, the first two of which are strictly Fourth Schedule determinations:

4.2.1 Firstly, in exclusionary subparagraph (ii) of the definition of “remuneration” determinations, where the two strict and conclusive conditions (control and regularity) mentioned in paragraph 2.3.3 of this circular are not present. Here, the Test is applied to determine the degree of dependence of a person who is typically a worker;

4.2.2 Secondly, in paragraph 2(5) determinations, where it has to be decided whether a paragraph (c) “employee” (a labour broker) is carrying on an independent trade. Here, the test is applied to determine the degree of dependence of a person which is a business, either a “normal” labour broker with many “employer clients” and “workers” on its books, or (for example) the single member close corporation which supplies its sole member as the worker. In applying the test, focus is on the business and not the worker supplied by the business;

4.2.3 Thirdly, when seeking to apply the substance *vs.* form doctrine, or section 103(1) of the Act. Here, the test is applied to assist in assessing probabilities and normality relating to incorporated-employee or interposed entity schemes like the single member close corporations which avoid labour broker status by claiming to supply a service and not the worker.

5. **How to apply the Test**

5.1 The “Common Law Dominant Impression Grid” (the Grid), in **Annexure A**, sets out twenty of the more common indicators in tabular form. The list of indicators is not exhaustive. The twenty indicators are interrelated, to some extent some are subcategories of others, or differ only in degree. Depending on the circumstances, some indicators may be or in time become irrelevant, while others may be or become more relevant. The twenty indicators indicate whether or not there has been the “acquisition of productive capacity” (i.e. of labour power, capacity to work, or simply, effort). The indicators have been classified into three categories, namely those relating “**most directly to the acquisition of productive capacity**” that tend to be conclusive, those establishing “**the degree of control of the work environment**” that tend to be persuasive, and those which **are resonant** of either an employee/employer relationship or an independent contractor/client relationship, which are relevant. This classification and weighting is intended to assist assessors in making the determination. The weightings are based on SARS’ assessment as to what is appropriate and fair to an employee *vs.* independent contractor determination in the employees’ tax context.

5.2 The Grid breaks the employee *vs.* independent contractor *spectrum* into twenty *sub-spectra*. The typical employee and the typical independent contractor represent the polar opposites of a *spectrum*. The Grid is a guide and should not be used as a checklist according to which a certain “score” is conclusive either way. Each indicator must itself be analysed with due regard for the particular context (kind of industry, kind of business, kind of customer, kind of worker), and how the business actually

operates. The assessor must analyse the employment relationship in the light of all the indicators and their relative weightings, and arrive at a dominant impression, in favour of either the acquisition by the employer of the worker's productive capacity (effort), or of the result of the worker's productive capacity. This dominant impression will be the basis for classification of the employment relationship as either an employee relationship or an independent contractor relationship.

- 5.3 The key to the exercise is flexibility, practicality, and gathering the fullest information through thorough investigation. The employer and the worker (or business) must be required to furnish a detailed motivation (preferably on affidavit) as to why any particular indicator does not indicate what it apparently does. The assessor should interview (and take affidavits from) not only the parties to the contract, but also closely connected third parties (any labour brokerage, employment agency, immediate supervisors, co-workers, trade union organisers and shopstewards active in the workplace, any works committee, bargaining council, and so on). The assessor's conclusion must be supported by the information gathered. It is not sufficient to record a mere "gut feeling".

6 **The Common Law Dominant Impression Indicators (the Indicators)**

6.1 **Near conclusive indicators of the acquisition of productive capacity (i.e. of employee status or non-independent business status)**

The indicators in this category provide insight into the quality of control, the nature of financial relations, and the degree of exclusivity of the relationship. The existence of a clause or clauses containing this category of indicator is nearly conclusive in favour of an employee relationship, because these indicators are considered to relate most closely or directly to the essence of the distinction between the two contracts, i.e. the acquisition of the worker's productive capacity as opposed to the result. The indicators are:

6.1.1 Control of Manner

This indicator examines the quality (i.e. whether intended to acquire control of productive capacity or not), rather than the degree or extent, of control. The employer controls the manner in which work is done either by detailed instructions, by training, by requiring that prior approval be sought by, or by instituting disciplinary steps in the event of unacceptable performance by, the worker. In this regard:

- 6.1.1.1 Control of manner means control as to which tools or equipment to use, which other workers to involve or employ, which raw materials to use and where to obtain them, which routines, patents or technologies to use and so on, all of which are those elements of commanding and directing an operation which are necessary in rendering a particular business result;
- 6.1.1.2 Where the employer has the contractual power to control the manner of use of a worker's productive capacity, it is likely that the employer intended to acquire (and the worker acquiesced in the surrender of) productive capacity. However, the absence of this form of control does not mean that there can be no employee relationship. Such control is typically present in most employee contracts, because control of a person's manner of working is normally necessary to ensure control of use of the employee's productive capacity (whether labourers, blue collar workers, tradesmen on the shop floor or construction site, white collar workers in large open plan offices, and even of professionals);
- 6.1.1.3 Employment contracts are unlikely to explicitly refer to acquisition of control of manner. This has to be inferred from the contract as a whole. Any form of control must flow from the legal relationship (the contract) itself and not from some extraneous source (e.g. the nature of the trade or profession, of the workplace, or market

conditions). It is sufficient if the right of such control is contractually present, even if it is not exercised in practice. It is the right to control manner, not the practical ability, which is relevant (e.g. a businessman cannot practically control or supervise the manner of working of a specialised professional although the right to do so is retained);

6.1.1.4 A right to control “manner” is sufficient to satisfy the statutorily conclusive “control” requirement in exclusionary subparagraph (ii)(aa) of the definition of “remuneration”. An actual exercise of this right is not necessary.

6.1.2 **Payment Regime**

A worker can be paid with reference to a result (in which the manner of use is not controlled) or to effort (the use of productive capacity in a specific manner for the payment period). Payment without material reference to result indicates employee status, because the worker is then being paid for effort. Conversely, payment with reference to a product or result indicates independent contractor status or independent business status. It should be noted that:

6.1.2.1 The reference to payment for a “result” in a contract may sometimes be misleading. Any employer (business) incurs employment expenses to achieve “results”. An employer expects results from both the employees and the independent contractors it employs. In the case of an employee, the employer controls the employee’s effort to achieve the employer’s result (if the employer is dissatisfied, it generally cannot apply financial sanctions (reduce remuneration) but can increase control through supervision, training, or dismissal for incapacity). In the case of an independent contractor, the employer does not control the independent contractor’s effort, but purchases the

independent contractor's result (if the employer is dissatisfied, it can only apply financial sanctions through accepting the result but paying a portion of the contract price, or by refusing to pay or accept the result).

6.1.2.2 Payment at regular intervals (whether at a fixed rate per time interval or at a fixed rate per hour) which fluctuates depending on the hours actually worked, but without material reference to output or result for that interval, indicates that the acquisition of a worker's effort (productive capacity), rather than the result of effort (productive capacity deployed), is the object of the contract.

6.1.2.3 Payment by time-periods (i.e. payment for a result but with the reward merely calculated by time-periods worked) or payment for a service (in the sense of a result) must be distinguished from payment for time (payment for the worker's effort over time, often measured in hours worked). If the employer is, for example, entitled to a worker's services for all normal business or working hours, the employer has effectively acquired exclusive use of the productive capacity of the worker, indicating the status of an employee.

6.1.2.4 Regular payment is conclusive for purposes of exclusionary subparagraph (ii)(bb) of the definition of "remuneration". The word "regular" in the phrase "regular intervals" in that subparagraph must be interpreted so as to require a contractual right on the part of the independent contractor to demand payment at those regular intervals. Whether or not the payment amounts fluctuate would have no effect on the regularity of the payments.

6.1.3 **Person who must render the Service:**

The employee contract is one of personal service (i.e. the employee is at the "beck and call" of the employer). If there is no

obligation to serve personally, the contract cannot be an employee contract. An obligation to provide personal service indicates that the object of the employment contract is the acquisition of that worker's productive capacity or effort, rather than the result of the efforts of that worker (or business). However, a person can still be an independent contractor though the contract makes personal service obligatory. But if the employer has a contractual right to insist on personal service and to object to substitution (e.g. the worker substitutes his or her own employee for her or himself), or if the worker may not freely hire, fire, pay or supervise his or her own assistants, an employee relationship is indicated. A contractual right to substitute, indicates an independent contractor relationship;

6.1.4 Nature of Obligation to Work

A contract where the obligation to work is delineated by time and not result, indicates an employee relationship, because it amounts to the acquisition of productive capacity or effort. An obligation to work "full-time" indicates an employee relationship, because it means the exclusive acquisition of the worker's productive hours, and therefore an intention to exclusively acquire the worker's productive capacity. A contractual obligation to work (no choice as to whether to work or not) indicates an employee relationship. The existence of an obligation to be present and available to work, regardless of whether work is available, indicates that the acquisition of productive capacity was the employer's foremost consideration. An easy example is the shop assistant who must be present behind the counter, in case a customer enters the store, and if trade is non-existent, the shop assistant is entitled to remuneration until the employment contract is lawfully terminated.

6.1.5 Employer (client) base

The contractual right to deny a worker the opportunity to service other employers amounts to acquisition of exclusive use of the worker's productive capacity (a form of the "economic reality" test as referred to in Annexure "C"). In the absence of such a

contractual right to exclusivity, the absence of a multiple and concurrent client base may be a persuasive indicator or merely another relevant indicator, depending on the context and the reasons for there not being a multiple concurrent client base. It should be noted that:

6.1.5.1 The typical independent contractor is free to seek out business opportunities, is entrepreneurial (seeks out new business opportunities or sources of income) and consequently has a multiple and concurrent client base, and is not economically dependent on one employer;

6.1.5.2 The typical employee (or non-independent “business”) is bound contractually (at least in his job function and during business hours) to an exclusive relationship with the employer, and may not work for a competitor or any other employer. The employee is constricted in developing a client base, and typically has no client base. The fact that the employer turns a blind eye to night or weekend work (e.g. within the employee’s field of expertise but not in competition with the employer) may mean that the worker is both an employee (in relation to that employer), and an independent contractor in relation to other employers (clients). This may affect the availability of deductible expenses, but not the obligation to withhold PAYE by the main employer.

6.1.6 **Risk, Profit and loss**

An exposure to risk (opportunity to enjoy profit or suffer loss) may indicate a degree of economic independence or non-exclusive acquisition of productive capacity, which is consistent with an independent contractor (independent business) relationship and inconsistent with an employee relationship (a form of the “economic reality” test, described in Annexure “C”). In this regard:

6.1.6.1 An employee’s remuneration, like the income of most independent contractors, is not directly dependent on the

employer's sales (unless a commission agent), cash flow or profitability (although employees rank before independent contractors on insolvency of the employer). Risk related to the employer's profitability or solvency is, therefore, not relevant;

6.1.6.2 Where a person (worker or business) is not directly exposed to performance or market risks, this may indicate an employee relationship. An employee is generally paid regardless of defective workmanship, while an independent contractor may only be entitled to a reduced fee or no fee in similar circumstances. An employee receives a fixed salary irrespective of incompetence, inefficiency, wastefulness or "cost or time over-runs" occasioned by him or her, while an independent contractor might typically agree on a fee or price and bear the risk of loss if performance costs exceed that fee or price. Employees do not bear the risk of increases in raw material prices, while the owner of the stock or inventory would ordinarily be an independent contractor;

6.1.6.3 An independent contractor is free to make business decisions which directly affect profitability (levels of inventory, pricing, staffing, financing (purchase or lease) while an employee does not make such decisions (unless mandated to do so by the employer on behalf of the employer).

6.2 **Persuasive indications of the acquisition of productive capacity (of employee status or non-independent business status)**

This category examines the degree or extent of behavioural control, as well as the purpose of acquiring control. The existence of a clause containing this category of indicator, depending on the extent to which and purpose for which control is acquired, may be persuasive, one way or another. These indicators may be persuasive because of their relationship

to the extent of control, and the relationship of the extent of control to the acquisition of labour power. Control enables management to convert productive capacity into productive activity. Some examples are:

6.2.1 **Supervision**

The employer controls the work done and the environment in which the work is done by giving instructions as to the location, when to begin or stop, pace, order or sequence of work, or the like. Such “supervision” is typical of most workplaces or employment relationships, and may indicate either employer measures to control what it has contractually acquired (productive capacity), or merely employer measures to co-ordinate the work of independent contractors, or of those of its workers who are independent contractors with those of its workers who are employees. It should be noted that:

6.2.1.1 The greater the degree of supervision (i.e. the scope or extent of instructions, or the sanctions for non-compliance), the greater would be the indication in favour of employee status. The degree of supervision required by the employer may differ depending on the nature of the business or of the worker, and supervision is not an essential feature of an employee contract (e.g. it may be largely absent in the case of certain tradesmen or professionals). The degree of such control must be measured against that level of supervision which the nature of the work requires;

6.2.1.2 Independent contractors normally enjoy autonomy as regards the order or sequence of work, although supervision is sometimes present in independent contractor contracts, where, despite a contractor’s independence, control of working may nonetheless be desirable, though only to ensure efficiency, or “good governance” in the workplace, as opposed to ensuring control of a person’s productive capacity. Supervision in the sense of mere monitoring of performance (without

the right to intervene) is unlikely to be relevant. Unless imperatives inherent in the nature of the employer's premises (e.g. the need for safety or coordination with employees), or the task, the profession, trade or the industry (e.g. relevant legislation or the nature of technology), dictate that the employer control the order or sequence of work, then such control would be persuasive in favour of an employee relationship;

6.2.1.3 Any form of supervision must flow from the legal relationship (the contract) itself and not from some extraneous source like the nature of the trade or profession or of the workplace or of market conditions. It is sufficient if the right of such control is contractually present, even if it is not exercised in practice;

6.2.1.4 A restraint of trade involves control of the future use of productive capacity, and is intended to prevent unfair competition by protecting sensitive business information, as well as to promote stability of employment. A restraint can only exclude a worker from working for or as a specific class of employer for a specific period and in a specific area. However, since future employment is restricted while the maintenance of the current employment relationship is promoted, some degree of control (e.g. of the entrepreneurial development of the worker's potential client base) is present. Although a restraint of trade can be imposed on an employee or an independent contractor, independent contractors would ordinarily be subject to a "secrecy clause". A restraint of trade would tend to indicate an employee relationship.

6.2.2 Reports

A reporting regime indicates that a measure of supervision exists, albeit indirect and historic in nature. The existence of a reporting regime, depending on factors such as content, detail, regularity,

and obligatoriness, can be persuasive in favour of an employee relationship. A reporting regime, where it amounts to control of the manner in which work is done, is sufficient to satisfy the “control” requirement in exclusionary subparagraph (ii)(aa) of the definition of “remuneration”);

6.2.3 **Training**

The typical independent contractor invests in his or her own training, and is free to choose his or her own production techniques. Typically, an employer might provide training to an employee but not to an independent contractor. Training can serve as a technique of supervision (ensuring co-ordination), or of control (ensuring that the employer’s techniques are followed to control the manner of working):

- 6.2.3.1 Training relates to the degree or extent of control (e.g. supervision) where it is intended to improve productivity by increasing technical competence, productivity and goodwill, by promoting uniformity of production techniques and procedures, knowledge of employer administrative and IT systems, etc;
- 6.2.3.2 Training would relate to the quality of control (e.g. control of manner) where it’s purpose is to promote an exclusive production technique or form of service provision (e.g. client etiquette), in which case, it may amount to a near conclusive indicator, and would be sufficient to satisfy the statutorily conclusive “control” requirement in exclusionary subparagraph (ii)(aa) of “remuneration”);
- 6.2.3.3 Training may not necessarily indicate an employee relationship, e.g. in respect of “product training” given to a broker house or a commercial traveller, who may still be independent contractors.

6.2.4 **Productive time (control of working hours, the working week)**

Where the worker has contracted away his or her right to control his or her time, even for only a portion of his or her productive hours, there is at least a persuasive indicator in favour of an employee contract. An employer's exclusive entitlement to all of a worker's productive hours may indicate exclusive acquisition and control of productive capacity – a near conclusive indicator. **(A right to control working hours, even if not all available working or business hours, is sufficient to satisfy the statutorily conclusive “control” requirement in exclusionary subparagraph (ii)(aa) of the definition “remuneration”, and actual exercise of this right is not necessary)** Examples of control over productive time are:

6.2.4.1 **Control of Work Periods**

Ordinarily, an independent contractor can choose which client/employer he services on a particular day or in a particular period of a day. Therefore, clauses controlling “work periods” (hours of work, working days, sick or annual leave) reflect the acquisition of control of the period in which work is done. While control of “work periods” is normally associated with an employee relationship, this indicator is not decisive and the purpose of acquisition of such control must be established;

6.2.4.2 **Amount of time**

Ordinarily, an independent contractor can choose which client/employer he services at a particular time of the day. Therefore, a clause indicating that the worker works part time for a specific daily time slot would be at least persuasive in favour of an employee relationship. Of course, some employees, on the basis of trust or practice, work in their own time. While control of “work hours” is normally associated with an employee

relationship, this indicator is not decisive and may turn on the purpose of acquisition of such control, namely:

6.2.4.2.1 Such control can be acquired for purposes of co-ordination of a mixed employee/independent contractor workforce, and it's existence is incidental to the independent contractor's contract;

6.2.4.2.2 Such control can be acquired for the purpose of ensuring that the productive capacity of the true employee is optimally used, and its existence is intrinsic to the employee's contract. It may also indicate acquisition of exclusive use of productive capacity. Ordinarily, the greater the amount of time so controlled, the greater the impression of employee status should be.

6.3 Indicators resonant of (i.e. creating an immediate or superficial impression of) an employee relationship or an independent contractor relationship

This category of indicator (when *bona fide*) may give insight into how the parties viewed their relationship. The existence of a term containing such an indicator, or of an aspect of the employer/worker relationship embodying such an indicator, ordinarily would be regarded as relevant one way or the other, and must be considered in forming a dominant impression. However, it is considered that these indicators are either most susceptible to deceptive contractual manipulation or relate most tenuously to the essence of the distinction between the two contracts. Some examples are:

6.3.1 Tools, materials, stationery etc

An independent contractor characteristically possesses (i.e. has invested in) his or her own tools or equipment, production or office

materials, business stationery, etc, and provides other necessary raw materials. Therefore, provision by the employer of office equipment or tools, stationery etc., tends to indicate a degree of dependence and lack of investment, and hence the existence of an employee relationship;

6.3.2 Office or Workshop

An independent contractor characteristically operates from his or her own premises (owned or leased, it represents investment in his or her enterprise), and is only temporarily and sporadically present at the employer/client's premises. Therefore, provision by the employer of an office or workshop, of administrative, secretarial or marketing services, or where the person's (worker's or "business's") work continually and invariably occurs at the usual place of business of the employer or where the employer instructs the person as to which location work will be conducted, may tend to indicate dependence, control, lack of investment, and hence, an employee relationship;

6.3.3 Integration/Employer's Usual Work Premises

Where the person (worker or "business") is integrated into and operates in or from the employer's usual place of business, (particularly if the person cannot sustain his or her activities other than at the employer's usual work premises) there is probably a degree of dependence and symbiosism inconsistent with an independent contractor relationship. The usual place of business of the employer may be understood to comprise all those places where the employer enterprise conducts any business related activity;

6.3.4 Integration/Usual business operations

An independent contractor is in essence another employer running a separate business. Therefore, where the person (worker or business) is engaged in activities which are integral, accessory or ancillary to the employer's business or usual business operations, this may indicate an employee relationship, particularly if economic survival of the person as an "entrepreneurial entity" is

not possible outside of the employer's normal business operations, or if the person's function is ordinarily and continually critical to the employer's survival. The employer's business, or the usual course of the employer's business, may be characterised as the main reason for that business being in existence, or, as that service which, if not performed, would cause the business to cease to exist;

6.3.5 Integration/Hierarchy & Organogram

An independent contractor is characteristically independent, and therefore not integrated into any one client's organisation, nor reflected on any one client's organogram. Where the person (worker or "business") has a job description (as opposed to a general professional capacity), and a position in the employer's hierarchy (and is reflected on the employer's organogram), this may be an indication of employee status (an indication of how the parties perceived the relationship);

6.3.6 Duration of Relationship

In general, where the parties contemplate an open ended or indefinite relationship (rather than one limited with regard to a result), an employee relationship may to some degree be indicated. An employee contract is normally indefinite and terminable on notice, while an independent contractor contract is finalised or terminated on achievement of a result or production of the thing. However, a fixed term contract may still be an employee contract, and an independent contractor may be engaged on an indefinite basis. This illustrates well that clauses resonant of one or other relationship are not conclusive, and that the relationship must be investigated thoroughly, and considered in the light of all the other indicators;

6.3.7 Termination and breach of contract

The threat of termination is a form of control normally associated with an employee relationship, though it could as well be associated with an independent contractor's contract to provide a service (guarding, bookkeeping, etc), though less so with an

independent contractor's contract to manufacture a thing. Where the employer has the right to dismiss on notice (Labour Relations Act aside) and/or the person (worker or "business") has the right to resign (Basic Conditions of Employment Act aside), prior to completion of any task or before any result is achieved, without being in breach, this may be an indication in favour of an employee relationship. An independent contractor ordinarily would be in breach if the person "moved on" (abandoned the contract) prior to producing the thing or achieving the result. This illustrates again that clauses resonant of one or other relationship are not always useful;

6.3.8 **Significant Investment**

Where conduct of an enterprise requires investment, it is normally the employer who makes this investment (an employer of an employee normally provides the employee with the premises, tools, raw materials, training, support services and other inputs), while the employee normally has no significant investment in any of these inputs. On the other hand, the typical independent contractor normally has made a significant investment in his, her or its business;

6.3.9 **Bona fide business expenses, bona fide statutory compliance**

Typically, an employee incurs no "business expenses" (overheads, etc) and is reimbursed for travel expenses, while an independent contractor incurs business expenses (advertising, entertaining, bookkeeping, wages, travel, etc), and builds these into the fee or contract price. Similarly, an employee might (or might have to) register with a trade or professional association, but would not register with the Department of Labour (as a labour broker or employer), or with SARS for VAT (as an "enterprise"), PAYE (as an employer) or RST. In this regard the following should be noted:

6.3.9.1 **Stereo-typical Labels**

Headings, labels or terminology may be intended to deceive. Not only should a sound legal and factual

(business purpose) basis exist for their presence, but their presence should be consistent with the manner in which the parties actually conduct their relationship. The mere presence of headings, labels, or terminology resonant of an independent contractor contract does not necessarily mean that there is an independent contractor relationship. Similarly, the mere presence of headings, labels, or terminology resonant of an employee contract does not necessarily mean that there is an employee relationship. The mere absence of such labels is likewise not necessarily significant either way;

6.3.9.2 **Stereo-typical Clauses or statutory compliance**

Like labels, the insertion of typical clauses or the fact of statutory compliance or membership of a professional or trade regulatory authority may be intended to deceive. Not only should a sound legal and factual basis (business purpose) exist for the expenses claimed, but these indicators should also be consistent with the manner in which the parties actually conduct their relationship. For example:

6.3.9.2.1 An independent contractor characteristically makes provision for his own insurance and retirement. Therefore, the provision of typical employee benefits would tend to indicate an employee relationship;

6.3.9.2.2 Either the independent contractor or employer may insist on certain clauses (invoicing, labour law recourse, risk insurance, cancellation and damages, etc), or on compliance with certain fiscal (VAT, PAYE, etc) or labour statutes. The mere presence of clauses, or the fact

of such compliance, though resonant of an independent contractor contract, does not necessarily mean that there is an independent contractor relationship. Similarly, the mere absence of such clauses or compliance does not indicate that there is no independent contractor relationship.

6.3.9.3 Stereo-typical expenses

Like labels, the claiming as deductions of typical expenses may be intended to deceive. Not only should a sound legal and factual basis (business purpose) exist for the expenses claimed, but these expenses should have actually been incurred, and should be consistent with the manner in which the parties actually conduct their relationship. Just as employee status does not automatically disqualify all expenses, so too does independent contractor status not mean that all expenses should not be scrutinised.

6.3.10 Viability on Termination

A person (worker or “business”) who is not viable on termination of that person’s current contractual relationship, might be regarded as being an employee, or as a person who was not carrying on an independent trade (a form of the “economic reality” test). This factor may be persuasive or even nearly conclusive in favour of non-independence for purposes of paragraph 2(5) of the Schedule. In this regard:

6.3.10.1 A person (worker or “business”) may be said to be “viable on termination” when the person is economically independent of the employer in the sense that the person can survive the termination of the contractual relationship with that particular employer without being obliged to approach an employment agent or labour broker (at least in the medium term). This indicator

might be less significant in the case of a person with prior activity as an independent contractor, or a person regarded by prevailing norms and customs as an independent contractor;

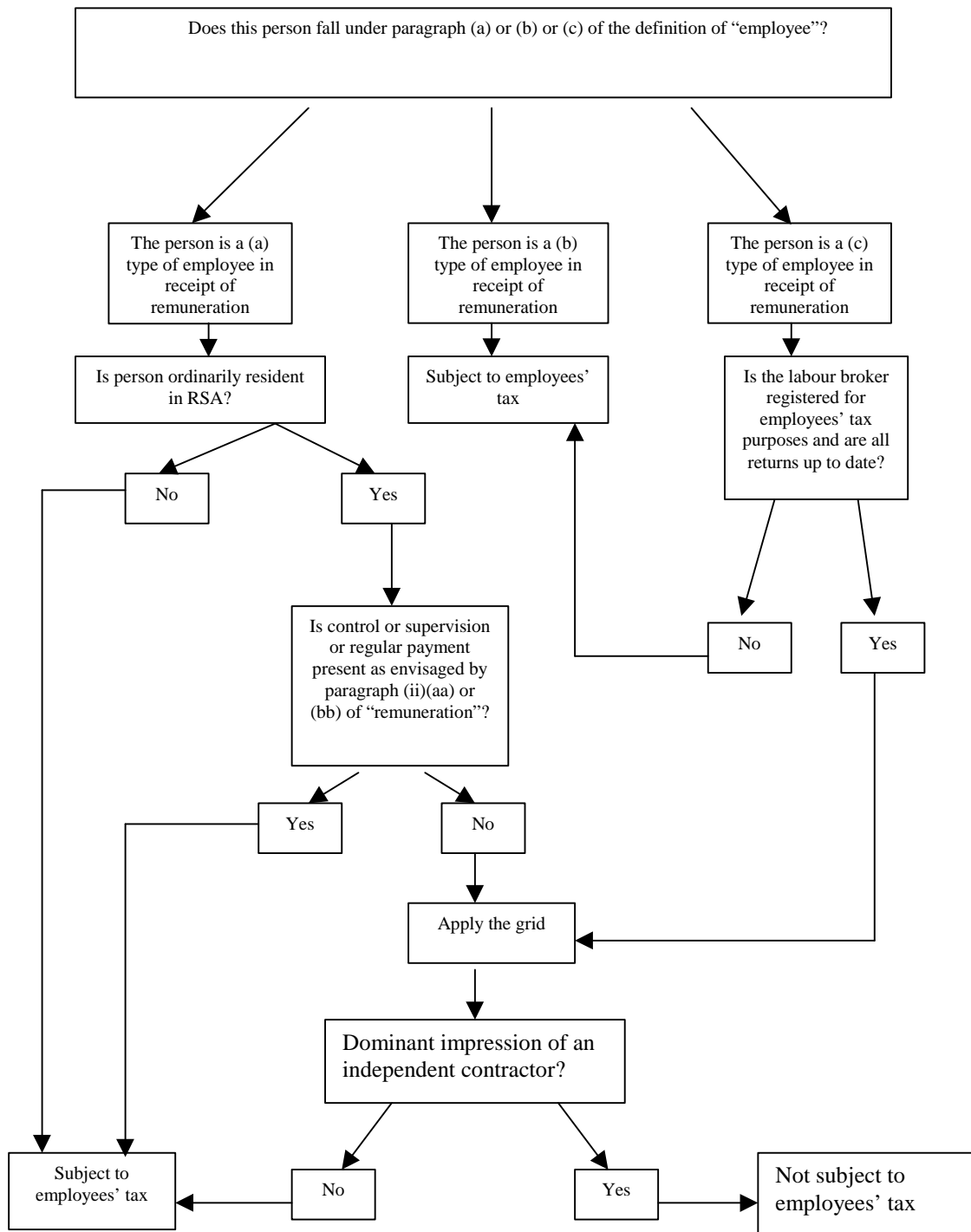
6.3.10.2 Where a person seeking to be characterised as an independent contractor has a prior history in business as one, then indicators such as the lack of a multiple concurrent client base, or economic dependency on the current employer, would possibly be less significant.

6.3.11 Industry norms and custom

There may be a norm or custom in the industry or sector that the person (worker or “business”) is an independent contractor, in which case it may be less likely that that person would contract in the form of an employee. Norms or customs might create a “trading climate”, which either militates against or promotes economic viability.

7 **Summary**

By way of a flow-diagram, the following steps should be followed when a determination is made in terms of either exclusionary sub-paragraph (ii) of the definition of “remuneration” in the Fourth Schedule or paragraph 2(5) of the Fourth Schedule:



- 8 Circular Minute No.21 of 1999 relates to “Administration costs” and was issued to all Regional Head Offices, Departmental Receivers of Revenue, Heads of Sections in Head Office, Inspectors of the South African Revenue Service and Tutors.

JDV SYMINGTON

for COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE

ANNEXURE “A”

COMMON LAW DOMINANT IMPRESSION TEST GRID

	INDICATOR	SUGGESTS DEPENDENT WORKER STATUS	SUGGESTS INDEPENDENT CONTRACTOR STATUS-
NEAR CONCLUSIVE Control manner/Exclusive Acquisition.	Control of Manner of working	Employer instructs (has right to) which tools/equipment, or staff, or raw materials, or routines, patents, technology	Person chooses which tools/equipment, or staff, or raw materials, or routines, patents, technology
	Payment Regime	Payment at <u>regular intervals</u> /by a rate x time-period, but regardless of output or result.	Payment by a rate x time-period but with reference to results , or payment by output or “results in a time period”.
	Person who must render the service	Person obliged to render service personally, hires & fires only with approval	Person, as employer, can delegate to, hire & fire own employees, or can subcontract
	Nature of obligation to work	Person obliged to be present, even if there is no work to be done	Person only present and performing work if actually required, and chooses to
	Employer (client) base	Person bound to an exclusive relationship with one employer (Particularly for independent business test)	Person free to build a multiple concurrent client base (esp. if tries to build client base - advertises etc)
	Risk/Profit & Loss	Employer bears risk (pays despite poor performance/slow markets) (particularly for independent business test)	Person bears risk (bad workmanship, price hikes, time over-runs)
PERSUASIVE Extent of Control	Instructions/Supervision	Employer instructs on location, what work, sequence of work, etc. or has the right to do so	Person determines own work, sequence of work, etc. Bound by contract terms, not orders as to what work, where, etc
	Reports	Control through oral/written reports	Person not obliged to make reports
	Training	Employer controls by training the person in the employer’s methods	Worker uses/trains in own methods
	Productive time (Work hours, work week)	Controlled or set by employer/Person works full time or substantially so	At person’s discretion
RELEVANT Labels, clauses, compliance, economic circumstances, “resonant” of	Tools, materials, stationary, etc	Provided by employer, no contractual requirement that Person provides	Contractually/necessarily provided by Person
	Office/ Workshop, Admin/ secretarial, etc	Provided by employer, no contractual requirement that Person provides	Contractually/necessarily provided by Person
	Integration/Usual premises	Employer’s usual business premises	Person’s own/leased premises
	Integration/Usual business operations	Person’s service critical/integral part of employer’s operations	Person’s services are incidental to the employer’s operations or success
	Integration/Hierarchy & Organogram	Person has a job designation, a position in the employer’s hierarchy	Person designated by Profession or Trade, no position in the hierarchy
	Duration of Relationship	Open ended/fixed term & renewable, ends on death of worker	Limited with regard to result, binds business despite worker’s death
	Threat of termination/ Breach of contract	Employer may dismiss on notice (LRA equity aside), worker may resign at will (BCEA aside)	Employer in breach if it terminates prematurely. Person in breach if fails to deliver product/service
	Significant Investment	Employer finances premises, tools, raw materials, training, etc	Person finances premises, tools, raw materials, training, etc
	Employee Benefits	Especially if designed to reward loyalty	Person not eligible for benefits
	Bona Fide expenses or statutory compliance	No business expenses, travel expenses and/or reimbursed by employer. Registered with trade/professional Association	Over-heads built into contract prices. Registered under Tax/Labour Statutes & with trade/professional Association
	Viability on Termination	Obliged to approach an Employment agency of labour broker to obtain new work (particularly for independent business test).	Has other clients, continues trading. Was a labour broker or independent contractor prior to this contract
Industry Norms, Customs	Militate against independent viability Make it likely Person is an employee	Will promote independent viability Make it likely Person is an independent contractor or labour broker	

ANNEXURE “B”

The concept of “independent contractor” at Common Law

- a) An independent contractor, in the sense used in this Circular, is perhaps a colloquial term for a small-time sub-contractor. An independent contractor is after all merely another word for “entrepreneur”, or more significantly, “employer” (or potential employer). The word “independent” in the concept “independent contractor” refers to independence in respect of the employer’s organisation, as well as in respect of the employer’s control. An independent contractor must be understood in contrast to its counter-part, the employee. Legally, the two terms (independent contractor, employee) are mutually exclusive, direct opposites. Many pieces of legislation (The Income Tax Act, the Compensation for Occupational Injuries and Diseases Act, the Unemployment Insurance (Fund) Act, and many discrete bodies of common law (delict (vicarious liability), employment law), are based on this notion of mutual exclusivity. However, this notion of mutual exclusivity is itself no longer easily reconcilable with sociological reality, as technological advances and global integration expand the ever-changing grey area between the two polar extremes of employee and independent contractor. This circular minute attempts to assist assessors to determine where to draw the line in each particular case.
- b) The Fourth Schedule statutory concept of an “independent trader” is similar to the common law concept of an “independent contractor”. The main difference between the two terms, is that the definition of “remuneration”, through *proviso* sub-paragraphs (ii)(aa) and (ii)(bb) to exclusionary subparagraph (ii), selects two of many possible indicators, to form a strict test to disqualify as independent traders, persons who might otherwise qualify as common law independent contractors.
- c) South African law traditionally refers to the independent contractor contract as a contract of *locatio conductio operis*. Roman labour law used the term *locatio conductio* to include three types of transactions, namely:
- (i) *locatio conductio rei*, which is the letting and hiring of things (hire-purchase or lease contract);

- (ii) *locatio conductio operarum*, which is the letting and hiring of services (the master/servant or employer/employee contract);
- (iii) *locatio conductio operis*, which is the letting and hiring of work (independent contractor contract).

d) It is the concept of *locatio conductio operis*, and the distinction between this term and the term *locatio conductio operarum* that need to be studied. The differences between the two concepts, as derived from South African common law, will supply the guiding principles needed to determine whether or not a person is in receipt of remuneration as defined in the Fourth Schedule.

e) Before turning to the *locatio conductio operis* (the contract for work or services, i.e. the independent contractor), it is necessary to analyse the term *locatio conductio operarum* (the contract of service, i.e. the employer/employee) more specifically.

- (i) The contract of service is a bilateral, consensual contract between two parties agreeing typically to at least two things, namely, the services to be rendered and the remuneration to be paid. The focus is on effort and personal service (*operae suae*, roughly meaning “personal service”) to be rendered and not on a specific result (*opus*, roughly meaning “a work” or “a product”) to be achieved. The employer (in this case the *conductor*, which roughly means “the controller” or the one who brings together) could avail himself of the *actio conducti* to enforce due performance of the services promised, while the employee (in this case the *locator*, which roughly means “the person placing or locating his or her productive capacity in the market” or “for making his services available”) can rely on the *actio locati* to enforce payment of the promised remuneration. The question of risk and liability plays an important distinguishing role and was, in Roman law, settled in a finely balanced manner. As far as risk is concerned, the question is whether counter-performance (in this case payment of the remuneration) still has to be made even though rendering of the performance has become impossible. An employee does not, as a rule, lose his claim for remuneration, except if it is due to the employee’s fault. It follows that a person who is party to a contract of service will,

generally, continue to be entitled to claim remuneration from his employer even when he or she cannot, by no fault of his or her own, render the service to the employer. This aspect can, naturally, be changed by way of a provision in the contract (e.g. limiting sick leave) or by retrenchment.

- (ii) The term *locatio conductio operis* (contract for work or services, i.e. the independent contractor), on the other hand, under Roman law, constituted a contract in terms of which it was not the services as such which were the object of the contract, but the result, the particular job to be done as a whole. One person undertakes to perform or execute a particular piece of work, and he or she promises to produce a certain specific result. This person is called the *conductor operis* (meaning contractor of works, which roughly means the “controller of works” or the “controller of results”). The person commissioning the work (the customer or client) is the *locator* (meaning “the person placing or locating a job on the market”) who places out the work to be done. The decisive feature of contracts for work or services under Roman law was that the customer was not interested in the personal services or the labour (productive capacity) as such, but in the product or result of such labour. The *conductor* was responsible for producing that result which he or she had contracted to produce, whether or not he made use of other persons (his own employees) to do the work, and whether or not he did so personally. In other words, the *conductor* is responsible for the success of the work. He has to face the problem of liability for defects under the contract of work. He, generally, would not be under the control and supervision of the *locator* (the customer or client).

ANNEXURE “C”

The current Common Law position in South Africa

1. **The historical development of employee/independent contractor tests:**

Over time, the courts have developed a variety of tests intended to assist in determining the object of an employment contract, but all might be said to fall into two main categories:

1.1. The “**control**” test:

As a single indicator test, control used to be conclusive. Employment used to be based more transparently on obvious class distinctions and hierarchies, and was described as a master/servant relationship. Control was crude, and therefore an obvious, conclusive criterion, focusing on either the power to dismiss, to supervise or control the manner of working, or control of productive capacity itself;

1.1.1. The doctrine of “vicarious liability” (from the common law of Delict or negligence), based on the consideration that the employer is liable for his worker’s negligence because he should have exercised his contractual right of control so as to prevent the negligent act, led to conflation of the control requirement with an employee status requirement, and hence to the over-emphasis of control in other branches of the law in which the employee/independent contractor distinction was relevant;

1.1.2. The notion of control remains important, although it has undergone substantial refinement over the years.

1.2. The “**intuitive**” tests.

Improvements in production technology together with mass secondary education and tertiary education, made control in certain job categories more indirect and diffuse. The courts were obliged to develop ever more sophisticated tests. This was accompanied by the gradual realisation that the essence of the distinction was not control but whether the employer had acquired the worker’s productive capacity or the result of the worker’s

productive capacity. The following intuitive tests have been alternatively invented and discarded by the courts:

- 1.2.1. The “its what you think it is” test, based on the question “what would the man in the street, or a co-worker, characterise this worker as?”;
- 1.2.2. The “economic reality” test, based on the question “is the person performing the services in business on his own account?” Another form of this test is based on the question “is the person performing the services economically dependent on or independent of the business for which the services are being performed?” A substantial body of jurisprudence holds that the “economic reality” test is particularly appropriate for tax and social security legislation, where it is applied to promote a characterisation which advances the purposes of such legislation;
- 1.2.3. The “organisation” test, a multi-factor test with no conclusive indicator, based on the question “is the person part of the commercial or industrial organisation?”. Similar to this is the “integration” test, also a multi-factor test with no conclusive indicator, based on the question “is the person integral to or accessory to the organisation?”;
- 1.2.4. The “dominant impression” test, a multi-factor test with no conclusive indicator. It amounts to saying, “take cognizance of all the facts before you decide, and arrive at a dominant impression to which effect must be given. Further improvements in production technology together with wide-spread tertiary education, and the decline of smokestack industries together with the rise of service industries, led in certain job categories to control becoming even more indirect and diffuse, and employer organisation less distinct. At the same time, employer aversion to vicarious liability suits, unionisation, employment related social legislation and tax legislation, together with worker’s wishes for increased income, led employers and workers to collaborate to avoid the employee relationship, and sometimes, to collaboration in simply obfuscating the features of the employee relationship. The dominant

impression test, which includes features of all previous tests, is presently the test sanctioned by the Supreme Court of Appeal.

2. The Dominant Impression test first emerged in South Africa, in a judgement by Joubert JA in the case of *Smit v. Workmen's Compensation Commissioner*. The Appellate Division rejected the crude "control" test, stating that the employer's right of supervision and control is merely one out of several indicators (albeit an important one) in favour of a contract of service (an employee contract). See ***Smit v. Workmen's Compensation Commissioner 1979 (1) SA 51 (A)***
Brassey, M: The Nature of Employment, 1990 (11) ILJ 889
3. More recently, in *Liberty Life Association of Africa Ltd v. Niselow*, Nugent J (sitting as a judge of the Labour Appeal Court) stated that an employee performs by making his productive capacity available to the employer, irrespective of whether there is work to be done, while the independent contractor commits himself only to deliver a product or end result of his or her productive capacity. He stressed that central to the inquiry was whether or not the relationship was one in which the worker placed his productive capacity at the disposal of the employer. The inquiry should be directed towards the worker's obligations rather than his or her rights, and the extent to which the other party (employer) acquired rights relating to the use to be made of his or her productive capacity. A decision must be made taking into account all the relevant facts (indicators), so as to form a dominant impression in favour of one or other contract. No single indicator is necessarily decisive, although facts which indicate the acquisition of the worker's productive capacity might carry more weight. Nugent J's views were subsequently approved by the Supreme Court of Appeal, and have been followed by the "new" Labour Court as well. Also compare:
 - ***Liberty Life Association of SA Ltd v Niselow (1996) 17 ILJ 673 (LAC)***
 - ***Niselow v Liberty Life Association of SA Ltd v Niselow 1998 (4) SA 163 (SCA)***
 - ***SABC v McKenzie [1999] 1 BLLR 1 (LAC)***
4. The current South African position therefore, is that the "Dominant Impression" test must be applied. However, in distinguishing between an **employee** and an **independent contractor** (independent trader), one must commence with an

analysis of the written employment contract. The object of the contract (acquisition of productive capacity or result) must be established. The object of the contract is not a mere indicator, but determines the legal nature of the contract, because it determines the respective parties' rights and obligations under the contract. The parties' rights and obligations under the contract in turn determine the nature of the contract. The object which one must establish, is the pre-eminent object:

4.1. If the object is the placing of one person's labour power or productive capacity (whether capacity to provide a service or to produce things) at the disposal of another, enabling the acquisition of that productive capacity itself and not simply the results of that productive capacity, then the contract is one for employment of an employee (*locatio conductio operarum*, a contract of service). The essence of an employee contract is the acquisition of productive capacity by the employer, and the concomitant surrender of productive capacity by the employee;

4.2. If the object is the acquisition of the **result** of deployed productive capacity (of a produced thing or of a provided service), then the contract is for the employment of an independent contractor. The essence of an "independent contractor" contract (*locatio conductio operis*, contract for services or work) is that the independent contractor only commits himself to deliver the product or end result of that capacity.

4.3. The object of the contract must be determined by an analysis of the terms of the contract:

4.3.1. To the extent that the written contract is in any way insufficient for this purpose (if there is no written contract, or if the written contract (the form) is a sham), the object of the overall (oral) contractual relationship may be determined from an analysis of the parties own perception of their relationship (loosely, the oral contract), and the manner in which the contract is carried out in practice (the substance of the relationship). Even if a written contract does exist, one should always interview the other parties to the contract, and related third parties. The more widely the

assessor investigates in this fashion, the more effectively the assessor contests the evidential terrain (and discovers whether or not the written contract is a sham) and prevents the taxpayer from one-sidedly determining a false but favourable factual matrix according to which his or her case is then assessed;

4.3.2. While words such as “employment” and “employer” are ambiguous and can describe both an employer/employee relationship or an employer/independent contractor relationship, the word “employee” is unambiguous and can’t be used to describe an independent contractor. However, in determining the true relationship, labels (whether at the head of or in the body of the contract, whether written or oral) are not decisive, but if the labels used are not set out to deceive, they are an important indicator of what the intended object was. By parity of reasoning, mere invoicing, registration with a professional or trade association, and statutory compliance (e.g. VAT registration, any LRA, UIA (i.e. UIF) or COIDA (WCA) registration), should not be decisive (unless bona fide).

5. The current South African position is similar to that in the USA, Australia, and England. As an example, while English law used to place heavy emphasis on the supervision and control test, it now holds that **“There is no one test which is conclusive for determining whether services are performed by an employee under a contract of service or by a person carrying on business on his own account: There are a number of badges of one or other of the relationships and those badges, depending on the context, may carry greater or lesser weight, an overall view must be formed”** as quoted from **Barnett v Brabyn (HM Insp. Of Taxes) 1996 STC 716, 69 TC 133 at 134**

ANNEXURE “D”

Letter to “paragraph (a)” applicants

(Only in original circular to Receivers of Revenue)