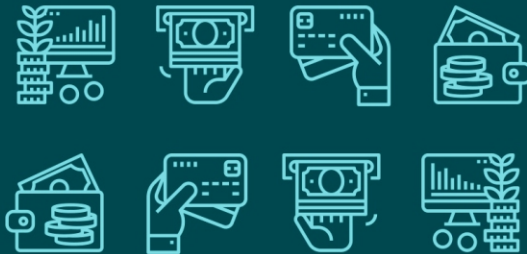
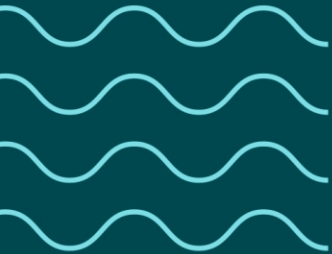


Income Tax Guide: Employee or Independent Contractor? (Exposure Draft)



MALDIVES
INLAND REVENUE
AUTHORITY

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DRAFT

Is this guide for you?

Use this guide if you are:

- a payer or employer
- a worker or employee

This guide will help you decide whether the relationship between a payer and a worker is an employment under a contract of service or not, for income tax purposes.

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I. Introduction

Employee Withholding Tax (EWT) is the portion of remuneration that is held by the employer as a part of the income tax of the employee. Where applicable, payers are required to withhold employee withholding (EWT) from the remuneration paid to employees. Since this is mandated under the Income Tax Act, it is imperative that payers and workers alike can identify the workers who fall within the definition of employee. If a payer wrongly treats an employee as an independent contractor and fails to withhold EWT from that individual's remuneration, the payer would be considered to have failed to fulfil an obligation mandated under the Income Tax Act.

The Income Tax Act defines employee as *“a person who is engaged to provide labour services to another person under a contract of service, a director of a company, a partner of a partnership, and includes a person who is elected or appointed to any office or position, whether temporary or permanent or for a specified term, any person holding a position under a contract of service, and any person holding a position of the State for which the person is remunerated by the State, but does not include an independent contractor engaged by another person to provide services under a contract for services.”*

The above definition has two main broad categories of employees. One category is a set of persons statutorily defined to be employees notwithstanding the relationship or arrangement they have with the payer. For example, a director of the board of a company or member of the parliament would be an employee notwithstanding anything else. However, the other category, “a person providing service to a payer under a contract of service” is not very straightforward to identify.

This guide mainly aims to help you distinguish an employee providing service under contract of service from an independent contractor. An independent contractor is said to provide service to a payer under a “contract **for** service”.

2. Factors to consider

There is no single test to decide the relationship between a payer and worker is that of employer-employee relationship under contract of service or not. In reaching your decision, you must refer to all the factors surrounding the work circumstances and each factor needs to be given its appropriate weight depending on the circumstances of the work.

2.1. Control

Control means the authority, ability, or right of the payer to exercise control over a worker concerning the manner in which the work is done and what work will be done. Control is one of the main factors, which helps to determine whether the worker is an employee under contract of service or an independent contractor.

- a) Indicators showing that the worker is an employee working a contract service
- Worker take instructions from another person i.e usually payer who directs as to how, when and where the work is carried out. The overall work environment between the worker and the payer is one of subordination.
 - The payer can move the worker form task to task and determine the method to be used to do the work.
 - Working hours are specified by the payer
 - Training on how to do your work is usually provided.
 - Workers may provide suggestions to the payer but the payer has the final word.

Example 1: Control

A telecommunication business hires a worker to answer inbound calls in their call centre.

The business has a computer system that automatically routes phone calls to call centre workers based on their knowledge skill set. The call centre worker must answer each phone call according to the business's procedures and scripting.

The call centre worker has five shifts each week, which the business rosters.

The business controls the way the work is done as it directs what, where, how and when the work is done. This indicates that the worker is an employee working under a contract of service for the telecommunication business.

b) Indicators showing that the worker is an independent contractor

- Workers do not have anyone overseeing them. They have the freedom in the way that the work is done, subject to the specific terms in any contract or agreement. The scope and nature of the work is pre-determined and agreed by contractor and worker through a binding contract.
- Workers control their own hours of work in fulfilling the job obligations. Workers maintain discretion and flexibility as how work is completed, although contract may specify some terms and materials used and methods of performance.
- Workers can accept or refuse work from the payer. They can set their own hours of work, as long as they perform the service.

Example 2: Control

A large domestic house builder uses several stylists who create personalised interior solutions for their display homes.

Each stylist is assigned a job to fully fit out and decorate one display home. They liaise with the architect to understand the styling and furnishing needs specific to the intended purchasers of that house. The stylist creates the design and can choose their own suppliers.

The stylists determine how best to complete each job within the agreed budget and timeframe the builder has specified. Each stylist can decide the way the work is done as they are free to exercise their discretion in completing the work.

The above facts indicate the stylists are independent contractors.

2.2. Tools and equipment

Depending on how the provision of the tools and equipment to the workers, can determine that the worker is an employee or an independent contractor. Employees sometimes may provide their own tools and equipment. However, this does not in itself mean that the worker is an independent contractor.

a) Indicators showing that the worker is an employee working under a contract of service

- Most of the equipment for the worker will be provided by the payer.
- If the worker provides all or most of the equipment, tools and other assets required to complete the work, and payer provides them with an allowance or reimburses them for the cost of the equipment, tools and other assets.

- Payer is responsible for repair, maintenance or insurance costs of the tools and equipment.

Example 3: Tools and equipment

Ahmed works as a software engineer for a large business. He designs, develops, tests and installs software programs in-house. The business allocates Ahmed working space and computer to develop the applications required for the business.

Ahmed also brings his own laptop and bought additional charger to work along a hard drive. Ahmed then reimburses the charger and the hard drive since these are used for work purpose.

Even though Ahmed brings his own laptop, the business provides majority tools and equipment to perform the particular job.

The facts above indicate that Ahmed is an employee of the business working under contract of service.

b) Indicators showing that the worker is an independent contractor

- The worker provides all or most of the equipment, tools and other assets required to complete the work
- The worker does not receive an allowance or reimbursement for the cost of this equipment, tools and other assets.
- The worker has made a significant investment in the tools and equipment and the worker retains the right over the use of these assets. The worker is responsible for the costs of repairs, insurance, and maintenance to the tools and equipment.

Example 4: Tools and equipment

Ahmed works as a software engineer. He designs, develops, tests and installs software programs in-house for various clients. Ahmed usually works from home and uses his own tools and equipment such as CPU, monitor, hard drive and a laptop just in case he has to visit clients' work environment.

During such visit to the work environment, client usually provide a work station so that Ahmed can work on the project using his own equipment.

Since Ahmed uses his own tools and equipment and for the work being performed, it indicates that Ahmed is an independent contractor.

2.3. Subcontracting of work or hiring of assistants

This factor can help decide a worker's business presence because subcontracting work or hiring assistants can affect the worker's chance of profit and risk of loss.

- a) Indicators showing that the worker is an employee working under a contract of service
- The worker cannot hire helpers or assistants.
 - The worker does not have the ability to hire and send replacements. The worker has to do the work personally.
 - The worker does not have the right to subcontract the work to a third party

Example 5: Subcontracting work or hiring assistants

A hotel industry business hires Adam, a professional construction engineer to oversee its resort renovation projects.

Ahmed is responsible to plan and supervise all the renovations projects undertaken by the resort under the scope set by the management. This includes ongoing projects and upcoming projects as well.

Since Ahmed does not have the right to pass the work to another party and solely responsible for the work set by the business, it indicates that he is an employee of the business working under contract of service.

- b) Indicators showing that the worker is an independent contractor
- The worker does not have to carry out the services personally.
 - The worker has the right to subcontract/delegate the work to another party and pay the costs for doing so.
 - The payer has no say in who the worker hires.

Example 6: Subcontracting of work or hiring of assistants

Azeez enters into a contract with a resort to build two additional water villas.

The contract states the new villas needs to:

- be operational within one year
- Meet the requirements and specifications as per the BOQ

Azeez decides to do all the structural works of the new villas on his own. And to do the interior works he subcontracts the work to a group of interior designers.

Although Azeez has subcontracted part of the work, Azeez is responsible to complete and handover the villas to the resort within the agreed period of time. These facts indicate that Azeez is an independent contractor.

2.4. Financial risk

This factor helps to consider the degree of financial risk taken by the worker. The following indicators can be used to determine whether the worker is an employee or an independent contractor.

- a) Indicators showing that the worker is an employee working under a contract of service
 - The worker will not have any financial risk as they are not responsible for any operating expenses.
 - The working relationship between the worker and the payer is continuous.
 - The payer is legally responsible for the work done by the worker and liable for the cost of rectifying any defect in the work.
 - The payer chooses and controls the method and amount of pay.
 - The worker is not in the position to realize a business profit or loss.
 - The worker have no capital investment in the payer's business.

- b) Indicators showing that the worker is an independent contractor
 - The worker can have financial risk and incur losses because they usually pay fixed monthly costs even if work is not currently being done.
 - The worker hires helpers to assist in the work and pays to the hired helpers.
 - The worker does a substantial amount of work from their own workspace and incurs expenses relating to the operation of that workspace.
 - The worker is hired for a specific job rather than an ongoing relationship.

- The worker is legally responsible for their work and liable for the cost of rectifying any defect in their work.
- The worker does not receive any protection or benefits from the payer.
- The worker can negotiate the price or unilaterally set the price for services.
- The worker can have capital investment in the business.
- The worker can manage expenses to maximize net earnings.
- The worker advertises and actively markets their services.

Example 7: Financial risk

Mohamed, a specialized flooring service provider installs wood flooring in meeting room of a business. He gives a guarantee of 12 months for its quality and durability.

Two months after using the meeting room, the wooden flooring has started to crack.

As Mohamed guaranteed the work, the business contacts Mohamed and asks him to fix the problem. The business is not required to pay him.

Since Mohamed bears the legal risk for his work and rectification is at his own expense, it indicates that he is an independent contractor.

2.5. Opportunity for profit

Usually when a work is completed, the costs are accounted and the net amounts are calculated to see whether it is a profit or loss. How these are recorded, can give indications as to whether the worker is under a contract of service or under a contract for service.

- a) Indicators showing that the worker is an employee working under a contract of service
- Workers are not financially liable for any losses of the payer's business resulting from any breach of obligations of the contract between the payer and its clients.
 - Workers are not responsible for operating expenses of the payer's business.
 - Workers have no capital investment in the payer's business.
 - Workers are normally not in the position to realize a business profit or loss.

Example 8: Opportunity for profit

A hotel has room attendants clean and vacuum as well as dealing with housekeeping requests.

The room attendants:

- wear a uniform with the hotel's logo and a name badge
- were provided with training by the hotel in how their duties needed to be carried out to meet the hotel's standards
- work specific hours and as part of a team to ensure the rooms are made up before the hotel's check in time
- need to do any duties reasonably asked of them (within their job description) by the hotel.

The room attendants are not operating independently of the hotel as they work within and are part of the hotel and bear any additional cost. The hotel is the single business being operated and the business records the costs and income. There is no opportunity for profit to the worker, and it indicates that the room attendant is an employee of the hotel working under a contract of service

b) Indicators showing that the worker is an independent contractor

- Workers are financially liable if the obligations of the contract are not fulfilled.
- Workers pay the hired helpers.
- Workers may perform a substantial amount of work from their own workspace (i.e. premises that are not provided by the payer), hence they incur expenses relating to the operation of the place (e.g. rental cost and utility bills).
- Workers incur on-going business fixed costs regardless of whether work is currently being performed or not.
- Workers have capital investment in the business.
- Workers can negotiate the price or unilaterally set the price for The goods or services.
- Workers can manage expenses to maximize your net earnings.

Example 9: Opportunity for profit

A hotel offers a range of services to its guests, including in-room spa treatment. The hotel enters into an agreement with a therapist to provide spa treatments for their guests.

If a guest requests a treatment, the therapist would use his or her own table, oils and so on to provide the treatment in the guest's room.

The client may either pay the spa therapist directly or add the cost to their room account, in which case, the hotel takes out a service fee before passing on the net amount to the therapist.

The hotel vets the therapists before allowing them to perform the treatments on their premises, but as specified in their agreement takes no responsibility for any negative outcome for the guest or therapist.

The therapists earn income by performing spa treatments at other hotels and can also visit clients in their own homes. They are free to refuse work the hotel offers.

At the end of the days therapist records total revenue earned and deduct expenses to account the net profit or loss of the work being performed.

These facts indicate that the massage therapists are independent contractors.

2.6. Entitlement of employment benefits under the Employment Act.

Workers entitlement to employment benefits as specified in the Maldives Employment Act (Law No. 2/2008) can be used as factor to determine whether the worker is an employee under a contract of service

- a) Indicators showing that the worker is an employee working under a contract of service
 - Existence of a written employment agreement which conforms to the Employment Act.
 - The worker is entitled to paid leaves as per the Employment Act.
 - The worker is entitled to remuneration as per the Employment Act.
 - The worker is entitled to working hours as specified in the Employment Act.
- c) Indicators showing that the worker is an independent contractor
 - Absence of a written employment agreement which conforms to the Employment Act.
 - The worker is not entitled to paid leaves as per the Employment Act.
 - The worker's pay does not conform to the rules set in the Employment Act

3. How to decide?

Having established the facts, you must consider whether factors referred to above which are relevant to the case are more consistent with a contract of service or independent contractor. This is not a mechanical exercise but more a matter of reaching a balanced qualitative assessment from all the facts. It is vital that you take a well-considered and rounded view based on the reality of the situation.

Example 10: working for multiple payers

Dr. Raj Kumar, a national of India, is a temporary tax resident of Maldives. He primarily works in a private hospital in Malé. The hospital and Dr. Kumar has a written employment agreement which conforms to the Employment Act. He is also entitled to the employment benefits as per the Employment Act and his working hours at the hospital are set by the hospital.

When he is off-duty from the hospital, he works at several clinics at different times. He does have a written agreement with each of the clinics. His pay is negotiated between the clinic and him, and is paid based on number of consultations. Number of working days and times are also negotiated and fixed. Most of the equipment used in consultation is owned by the doctor. He is not entitled to leaves as per the Employment Act. He can choose not to work any day he wants. He cannot hire own helpers nor can delegate the work to another, and doesn't bear any financial risk. He fully controls the way he does his job at the clinics and there is no supervisor he reports to. There is no opportunity for him to minimize expense to increase net earnings from his service.

Based on the facts, it is straight forward that the doctor is an employee of the hospital working under a contract of service.

However, the relationship the doctor has with the clinics shows mixed attributes. There are more factors indicating that the doctor is an independent contractor, hence it should be concluded that the doctor is an independent contractor working for the clinic.

Example 11: Temporary worker hired for a foreign aid funded project

A Government office hires a project manager, for a project funded by an international donor agency. The project manager is paid by the office from the project fund. The project manager is expected to report to a staff of the office, and the office provides him with a fully equipped work station. His working hours are set by the office same as that of employees of the office.

Given the facts above, the project manager is an employee of the office working under a contract of service. [Note: if the employee qualifies for the exemption specified in 12(j) of the Income Tax Act...

Example 12: crew of a fishing boat

Hassan owns a commercial fishing vessel (dhoani) which engages in tuna fishery. 20 crew members including the captain work on the ship. There are no written agreements between the crew members and Hassan. Crew members are not given benefits as the Employment Act, and are paid from weekly profits of the operation, based on a predetermined ratio. Crew cannot delegate their work, cannot hire their own helpers and their work is directed by the captain. All the equipment and fishing gear on board are provided by Hassan. Crew members bears no financial risks from the operation of the vessel.

Considering all the given facts, it can be concluded that the crew members of the fishing boat are employees of Ahmed working a contract of service.

Example 13: legal service

ASC Pvt. Ltd. hires Mohamed Shahid on a five year contract as the company's attorney to advise the company on legal matters. Under the agreement, Mohamed Shahid is paid MVR 50,000 monthly, and the arrangement includes unlimited document review, consultations, and representing the company in any civil suit. Mohamed Shahid uses his own office for legal work, and has a few paralegals and assistants working for him. At any given time Mohamed Shahid may have 20 such clients.

Considering the facts, it can be concluded that Mohamed Shahid is an independent contractor working for ASC Pvt. Ltd.

Example 14: director of a company

Laxman Fernando is director of ABC Pvt. Ltd, which is a Maldives resident company. Laxman is a resident of Sri Lanka. Laxman is an [statutory] employee of the company as the Income Tax Act says that directors of a company are employees of the company.



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