

Define employee/ independent contractor relationship for precise tax payment

As companies seek to reduce their operational costs, consultancy agreements present viable options to fill staffing gaps instead of hiring full-time employees. Consultancy agreements offer more flexibility since businesses can control their costs, contracts durations, terms and conditions among other contractual obligations. Additionally, consultancy agreements reduce company's regulatory burden as an employer.

Prior to contracting for work, it is important that parties understand, among other things, their tax responsibilities and likely consequences of nonadherence to applicable tax laws. Businesses should determine whether the contract being entered is a contract of service or a contract for service. There should be clarity on whether the individual is being engaged to provide services as an independent contractor on their own account, or as an employee? This means defining the working relationship between the individual and the entity contacting for the service.

Employees and independent contractors are taxed differently in Tanzania. Employers withhold and pay taxes up to 30% on employment income and are required to make other employer statutory contributions such as Skills and Development Levy (4%), and contributions to both the Workers Compensation Fund (1%) and the National Social Security Fund (10%). On the other hand, companies are required to withhold tax at the rate of 5% on payment of a service fee to resident independent contractors. Where a misclassification of a contractor by a company occurs and the contractor is later deemed to be an employee, the company is likely to face additional employment taxes, interest and penalties for failing to withhold correct taxes to the TRA.

It is therefore pertinent that businesses understand the difference between an employee and independent contractor. This difference is determined by various factors usually defined by the nature of the working relationship and independence of work performed by the worker.



Below are some of the factors to be considered, to establish whether an individual is an independent contractor or an employee:

- A clear indication of the nature of the working relationship should be described on the contract entered between the parties. The contract should clearly identify the permanency nature of the working relationship. Is there an expectation that the relationship will continue indefinitely rather than for a specific task or period at a determinable fee? Then there could be intent that the contract was to create an employer-employee relationship.
- Are independent contractors provided with benefits usually bestowed to employees like annual leave, sick leave days, medical cover, regular allowances or benefits, and standard hours of work? This could blur the line on the difference between a contractor and an employee.
- To what extent does the principal exert control over the contractor? While both employees and independent contractors perform services under the directive of the principal, only with employees can an employer dictate how the service can be performed.
- Does the principal provide the contractor with essential equipment that is fundamental to the job to be done? Independent contractors generally work under their own terms using their own materials.
- To what extent is the work tied to personal service of the particular person? Is the contractor free to hire someone else to perform the task? Independent contractors are free to engage themselves with other work that can be performed concurrently and regulate their own work plan in terms of work hours and subcontracting or engaging others to assist with the contracted work. Does the contract limit the contractor to perform their work in any capacity?
- Being an independent contractor, is that person free to perform work for other customers?
- And lastly, how is the consideration for that service paid? Is it upon invoicing or via monthly wages?

It is important to note that a contract simply stating that the worker is an employee, or a consultant is not sufficient to determine the status as such. Businesses need to reassess their consultancy contracts to understand how to effectively manage any tax implications that may arise as a result of any misclassification.

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