Independent contractor misclassification presents serious risks for companies. Treating individuals as independent contractors while they perform the function of a full-time employee is an illegal business practice that many governments are beginning to recognize and penalize companies that make this misstep.

Eurofound conducted a research report on fraudulent work contracting in 28 EU member states, including Norway. According to the report, 79 percent of the national correspondents reported a ‘significant’ fraudulent use of self-employment. Understanding independent contractor misclassification and constantly changing government reforms is key to avoid significant penalties.

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IR35: the UK government’s solution to independent contractor misclassification

The UK government introduced the tax legislation IR35 in the year 2000. This tax legislation aimed to address how contractors were leaving employee roles and forming limited companies, also called Personal Service Companies (PSCs). This was mainly done because working via a PSC enabled contractors to be taxed with all the advantages of a business, rather than as employees.

As per the latest announcement by the UK government, the changes to IR35 will come into effect in April 2021. From then on, workers who don’t meet the criteria for being self-employed will fall inside IR35 rules. And it’s the responsibility of the company to ensure their contractors aren’t misclassified, or face missing taxes, interest and related penalties.

As per the latest announcement by the UK government, the changes to IR35 will come into effect in April 2021. Click To Tweet

Tightening contractor laws across Eastern Europe

What other European countries are revising their independent contractor misclassification laws?

1. Serbia: the independent contractor test

   At the National Assembly, the Serbian government proposed numerous changes to the personal income tax and social contribution laws, which took effect in January 2020. Of the many changes proposed, "the taxation of entrepreneurs engaging in service contracts with one employer" gathered the most attention. It led to the introduction of a new independent contractor test. Entrepreneurs who fail to pass the test will be subject to higher taxation.

   Many software professionals and entrepreneurs are granted the lump-sum taxation status in Serbia. This ensures that income tax and social security contributions are not paid based on real income, but on a statistical average monthly wage. The proposed new independent contractor test will apply to working professionals and entrepreneurs who benefit from the lump-sum taxation scheme as well.

   If they do not pass the independent contractor test, they would be subjected to higher taxation. The test will be applicable to each individual income stream. Workers benefiting from the lump-sum taxation would be required to pay both the lump-sum tax and special income tax on the income that failed the test. This reform is set to affect the Serbian IT industry — by far the largest economy in the western Balkans.

2. Poland: Crackdown by the national labour inspectorate

   Almost 19 percent of people in the Polish economy are self-employed. Poland also ranks fifth among the European Union member states in terms of self-employment share in the total workforce numbers. Workers who provide a high level of skill and expertise while operating in a freelance capacity are also widespread.

In recent years, the National Labour Inspectorate has sought to re-establish the relationship contractors have with companies. The inspectorate has been given the right to ask control questions to employers who post their workers to Poland, and also to Polish companies posting their workers to other EU countries. If no convincing answer is sought, the company is liable to a fine of up to PLN 30,000 by the National Labour Inspectorate.

3. Hungary: The burdensome contractor relationship

   The employment relationship is becoming increasingly burdensome — both administratively and financially — for companies in Hungary. Employers might be tempted to disguise employment relationships as independent contractors — a move which can result in severe financial penalties by courts.

   Hungarian courts use several primary and secondary factors to determine whether the relationship is that of employment, or independent contractors. The major primary factors include personal working obligations,
   regular employee availability, and hierarchy between the parties. Severe financial sanctions may be applied if employees have been disguised as independent contractors.

   Tax authorities, labour authorities, and Hungarian courts have the power to re-classify independent contractor contracts as employment contracts. However, the independent contractor and principal would have to pay
   all contributions and taxes, along with default interests and penalties.

4. Romania: Notorious tax legislations

   The Romanian fiscal code has laid down dependent and independent activities to clearly differentiate employment income from independent contractors. Since 2003, Romanian IT workers have enjoyed zero income tax — a move to boost the

IT sector throughout the country. This led to a decrease in independent contractors within the IT industry. However, as of January 2020, the Romanian government said that the IT industry's zero income tax could soon come to a halt — which could again lead to an increase in the number of independent contractors.

In addition, the Romanian tax system is known to be notoriously complicated. The combination of a complex legal system and more serious penalties for individuals who evade taxes makes compliance even more crucial while contracting in Romania.

The differences in legal status between workers having an employee status versus independent contractors could lead to situations wherein companies use different contracts to suit their own needs, without properly protecting their workers.

Beyond fines and penalties: additional benefits of providing full-time employment

In a world where highly qualified talent is hard to find, companies should focus on providing stability for their employees. The consequences of misclassifying contractors are not limited to the realm of employment law, but more about protecting a crucial organizational asset in the longer run — your workforce.

How Globalization Partners can help solve contractor misclassification troubles

If your company needs to retain a contractor across the European Union, but you're overwhelmed by the intricacies surrounding labor laws, you can get in touch with Globalization Partners. We have a physical, on-the-ground presence around the world and can act as your Employer of Record (EOR) in more than 187 countries.

We can help you establish a capable, legally compliant infrastructure for accounting, legal counsel, HR, and IT. Our comprehensive solution allows you to handle administrative processes in one easy-to-use interface.

If you’re worried whether your contactors are classified properly or not, download our quick guide The Cost of Contractor Misclassification to learn more.

Get in touch with Globalization Partners if you want to retain employees compliantly or have plans to expand internationally.

Book a consultation

