EELA EUROPEAN EMPLOYMENT LAWYERS ASSOCIATION

SUMMARY

2016/30 Members of a Board of Directors are ‘individual contractors’, not self-employed ‘entrepreneurs’ (PL)

<p>The Supreme Court in this case establishes conditions to be met in order for the member of a Board of Directors to qualify as a self-employed “entrepreneur”. In light of these conditions, Directors must be considered to have the status of “individual contractor”, obligating them to pay increased social security contributions.</p>

Summary

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Background

Under the Polish social insurance system, employees are compulsorily insured against certain risks and situations, such as old age, sickness, accidents and unemployment. The system is run by an organisation called Zaklad bezpieczen Spolecznych (ZUS).

In general terms, there are three categories of insured persons: employees, individual contractors (whose status resembles that of employees to a certain extent) and entrepreneurs. The issue in this case concerned the distinction between individual contractors and entrepreneurs. The category of ‘employee’ was not at issue

Essentially, entrepreneurs are individuals who run their own business without being employed. Individual contractors do not run a business, and their status is quite similar to employees, as they are contractually linked in most cases only with one company (under a

'civil' contract, as opposed to an employment contract).

Contributions to the system are paid by all individual contractors and entrepreneurs. Most recipients of services (I will use the term 'employers') deduct a portion of the contribution from their workers' salaries. Roughly speaking, the average contribution paid by an employer (before deduction of worker share if any) lies in the region of 30% of the total gross wage bill.

The contribution owed by an entrepreneur is usually less. This is particularly the case for entrepreneurs with a high level of earnings, for two reasons. First, the contribution for an entrepreneur is a fixed amount. An entrepreneur who earns one million zloty per year pays the same as an entrepreneur with an income of 50,000 zloty per year. Second, the contribution/benefit ratio for employees is unfavourable for high earners. Although benefits increase with contributions, the increment is not proportionate. In other words, there is an element of redistribution, with high earners subsidising lower earners. For these and other reasons, senior managers in many large companies claim entrepreneur status. That way, they pay lower social insurance contributions. In many cases, they purchase private insurance to cover risks, particularly in the area of pension, that are not covered adequately by ZUS.

Members of the Board of Directors of a company (at least, those who are paid) act in two capacities: a corporate capacity and as a provider of services to the company. The latter capacity can take the form of an employment relationship, but it can alternatively take the form of an independent contractor (individual contractor or entrepreneur) relationship.

Facts

The employer in this case (the 'Company') is a mining company. It had a Board of Directors consisting of several members who worked for the Company on a full-time basis (and, therefore, did not perform work for third parties). Each of these directors claimed to be an entrepreneur, having concluded a 'managerial contract' with the Company. In 2012, the Company requested ZUS to confirm that its Board members were not individual contractors, but entrepreneurs, within the meaning of the social insurance legislation. ZUS responded that it saw the Board members as individual contractors, not as entrepreneurs.

The Company applied to the court to overrule ZUS's response. The court of first instance ruled in the Company's favour. ZUS appealed. The Court of Appeal decided to ask the Supreme Court for guidance. It asked the Supreme Court, essentially, whether a member of a board of directors of a company, who has a contract with that company for the provision of services, can benefit from entrepreneur status, allowing them to pay reduced social insurance contributions.

Judgment

The Supreme Court began by establishing that a service provider can only be considered to be an entrepreneur if three conditions have been met:

- the party for whom the work is carried out and not the service provider is liable to third parties for the result of that work (unless the work in question is unlawful);

- the work is performed in the place and at the time directed by the recipient of the service;

- the economic gains and losses generated by the work are for that recipient's account.

Where a contract for the provision of services calls for the service provider to perform services as an independent contractor, for example, where the management of a company is outsourced to a service provider on the basis of a contract, the person in question is an entrepreneur. Where, on the other hand, the service provider's responsibilities do not result from the contract between him and the service recipient, but from the latter's position as a member of the board, the person in question has the status of individual contractor.

Members of a company's board of directors may not act on their own behalf. They do not bear business risks. Where a 'managerial contract' limits the service provider's third party liability exposure and guarantees them a more or less fixed income, it is hard to accept that they run a business risk. This fact in itself prevents them from being entrepreneurs. Moreover, a manager with such a contract acts within the organisational structure of the service recipient, does not bear business expenses and earns an income that is not dependent on business results.

The case is now back in the Court of Appeal to make a final judgment, but it is almost certain what the outcome will be, namely that the directors have the status of individual contractor and will have to pay increased social security contributions.

Commentary

This judgment, which was made public in December 2015, is likely to impact hundreds of senior executives. They will have to pay higher social insurance contributions, in many cases very much higher contributions, without getting much in return by way of increased benefits. It will increase ZUS's revenue, which is under pressure. It is not yet known whether ZUS will attempt to collect arrears in contributions.

Personally, I think the Supreme Court has made the right decision. The managerial contracts

in question were aimed at allowing the individual service providers to pay reduced social security contributions even though their situation did not differ materially from that of regularly employed board members.

The Supreme Court did not refer to EU law, clearly seeing the case as a purely domestic one without an EU dimension. In my opinion this was the right approach, even though the ECJ has delivered many judgments on the issue of whether service provision qualifies as employment or self-employment. In this case, domestic Polish regulations were crucial in determining the outcome of the case.

Comments from other jurisdictions

Croatia (Dina Vlahov Buhin, Schoenherr): According to Croatian law management board members (directors) may perform certain tasks for the employer as employed workers, based on an employment contract and if performing only managerial duties with no employment relationship, they can work solely based a managerial services contract and are consequently regarded as service providers.

Either way, directors must contribute to pension, health, accident and unemployment insurance. The difference between the two is that contributions of directors who are also employees are automatically calculated based on gross salary and paid into the state budget by their employer, while directors who are only service providers are obliged to register with the competent pension and health insurance (provided they are not already registered for some other reason) and pay by pension and health insurance contributions themselves based on a fixed tax base.

The applicable contribution rates in respect of employees are: 20% for pension, 15% for health, 1.70% for unemployment and 0.50% for accident insurance. Service providers must report a monthly taxable income of HRK 8,037 (approximately EUR 1,050) and pay at the same rates (approximately EUR 400) into the state budget. However, if directors (service providers) would, on the basis of a managerial contract, receive remuneration which exceeds the above fixed tax base, the additional amount would be taxed as 'other income' and would be subject again to the above rates. Hence, the amount of approximately EUR 400 represents the minimum amount of directors' contributions, provided that they are not insured on another basis.

By comparing the Croatian and Polish insurance system, we could conclude that self-employed entrepreneurs under Polish law are somewhat similar to Croatian directors performing their managerial duties solely on the basis of a managerial contract, considering that both groups pay contributions at a fixed rate, as opposed to employees who pay

contributions depending on their gross salary. However, under the Croatian tax system, directors on managerial contracts will ultimately be taxed on the same amount as regular employees (i.e. the contributions will be calculated on the total amount of pay they receive including 'other income'). Therefore, from the social insurance system perspective, no distinction need to be made between directors working as employees and service providers.

By this system, the Croatian legislator is trying to prevent unequal taxation between directors who also work as employees of a company and directors who perform their managerial duties for a company solely based on a management agreement – as well as preventing potential evasion of contributions by the latter.

Regardless of this, there is an issue about the minimum contributions that directors as service providers must pay by themselves (provided they are not already insured on a different basis). Such an arrangement may result in a situation where a director receives pay below the fixed tax base of HRK 8,037 (or even does not receive any, especially in situations where a sole shareholder also acts as a director and thus does not want to lose profit by paying out both salary, which is to tax, and profit tax at the end of a business year) but is still obliged to pay contributions in accordance with the fixed tax base. Therefore, in practice it is not uncommon that directors conclude employment contracts with other employers for a minimum statutory salary in order to avoid excessive taxation as directors.

Czech Republic (Natasa Randlová, Randl Partners): A similar problem occurs in the Czech Republic. The total amount of tax, social and health insurance contributions paid by employees and employers is higher than the amount paid by entrepreneurs. Therefore many employees formally act as providers of services to their employers. This applies not only to high income employees but to all employees without regard to income level.

The Czech Labour Code creates the concept of dependent work i.e. work performed within a relationship where the employee is subordinate to the employer, on the employer's behalf, according to the employer's instructions or orders and by the employee personally for the employer. Dependent work must be always performed in an employment law relationship, for salary, at the employer's cost and with it bearing responsibility, within working hours and at employer's workplace or other agreed place. Breaches of this rule may result in a fine, not only on the employer, but also on the individual performing dependent work as an independent contractor.

An interesting point from the Czech perspective is that, according to this Polish decision, members of a board of directors can be employees, or more precisely, must be employees. The case law is quite the opposite in the Czech Republic. Members of a statutory company body

(such as members of a board of directors or managing directors) cannot perform their functions as employees. An employment contract in those circumstances would be deemed invalid.

The Netherlands (Peter Vas Nunes): Until the ECJ's judgment of 4 December 2014 in the case FNV – v – State of the Netherlands (C-413/13), Dutch doctrine held that there are, basically, no more than two categories of service providers: employees and non-employees, the latter being self-employed contractors. The ECJ's judgment in that case shed doubt on this doctrine. In his commentary on the judgment, Zef Even noted that the ECJ's decision "adds a third category": the newly introduced category of "false self-employed service providers" (see EELC 2015-4/ nr 53 page 29). These are employees who act under the guise of self-employed individuals.

Whether there are two or three categories of service providers seems to me to be an academic issue. What is more than academic is where the demarcation line is to be drawn between employees (real or "false") on the one hand and non-employees (whatever they call themselves) on the other. This has been a lively subject of debate amongst Dutch scholars and in countless Dutch judgments ever since 1945, and perhaps even before that. The issue seemed to have subsided somewhat in recent years, until the government introduced new legislation, that became effective earlier this year, that aims to reduce the percentage of workers claiming to be self-employed. This has reignited the debate.

As in most jurisdictions, the basic criteria for employment are threefold: personal service provision, pay and subordination. The third element has yielded the most case law. The ECJ has ruled repeatedly on these criteria, including in cases where the service provider was a member of a board of directors. It is worth recalling what the ECJ had to say on this subject in 2010 in the Danosa case (C-232/09), in which the member of a Board of Directors of a Latvian company was dismissed during pregnancy (reported in EELC 2010-5). The ECJ held as follows:

"The essential feature of an employment relationship is that, for a certain period of time, a person performs services for and under the direction of another person, in return for which he receives remuneration [...]. The sui generis nature of the employment relationship under national law is of no consequence as regards whether or not a person is a worker for the purposes of EU law [...]. Formal categorisation as a self-employed person under national law does not exclude the possibility that a person may have to be treated as a worker for the purposes of Directive 92/85 if that person's independence is merely notional, thereby disguising an employment relationship within the meaning of that directive [...]. It follows that [...] neither the way in which Latvian law categorises the relationship between a capital company and the members of its Board of Directors nor the fact that there is no employment

contract between the company and the Board Members can determine how that relationship falls to be treated for the purposes of applying Directive 92/85. As is clear from the observations submitted to the Court, it is not disputed in the present case that Ms Danosa provided services to LKB, regularly and in return for remuneration, by performing the duties assigned to her, under the company's statutes and the rules of procedure of the Board of Directors, as sole Board Member. Contrary to the assertions made by that company, it is irrelevant in that regard that Ms Danosa was herself responsible for the establishment of those rules. On the other hand, those observations differ on the question whether between Ms Danosa and LKB there exists the relationship of subordination, or even the degree of subordination, required under the case-law of the Court of Justice relating to the concept of 'worker' within the meaning of EU law in general and Directive 92/85 in particular. LKB maintains, as do the Latvian and Hellenic Governments, that, in the case of members of the Board of Directors of a capital company, there is no relationship of subordination as required under the case-law of the Court of Justice. LKB and the Latvian Government argue that, as a general rule, a Board Member such as Ms Danosa performs his or her duties on the basis of a contract of agency, independently and without instructions. They state that the relationship between, on the one hand, the members of a capital company and/or, where appropriate, the supervisory board and, on the other hand, the members of the Board of Directors, must be based on trust, which means that it must be possible to terminate the working relationship between the parties if ever that trust is no longer forthcoming. The answer to the question whether a relationship of subordination exists within the meaning of the above definition of the concept of 'worker' must, in each particular case, be arrived at on the basis of all the factors and circumstances characterising the relationship between the parties. The fact that Ms Danosa was a member of the Board of Directors of a capital company is not enough in itself to rule out the possibility that she was in a relationship of subordination to that company: it is necessary to consider the circumstances in which the Board Member was recruited; the nature of the duties entrusted to that person; the context in which those duties were performed; the scope of the person's powers and the extent to which he or she was supervised within the company; and the circumstances under which the person could be removed. First of all, […] an examination of those factors in the case before the referring court shows, first and foremost, that Ms Danosa was appointed sole member of LKB's Board of Directors for a fixed period of three years; that she was made responsible for managing the company's assets, directing the company and representing it; and that she was an integral part of the company. It has not been possible to tell, from the reply given to a question raised by the Court during the hearing, by whom or by what body Ms Danosa had been appointed. Next, even though Ms Danosa enjoyed a margin of discretion in the performance of her duties, she had to report on her management to the supervisory board and to cooperate with that board. Lastly, according to

the documents placed before the Court, a member of a Board of Directors may, under Latvian law, be removed from his or her duties by a decision of the shareholders, in some circumstances following suspension from those duties by the supervisory board. […] While it cannot be ruled out that the members of a directorial body of a company, such as a Board of Directors, are not covered by the concept of 'worker' as defined in paragraph 39 above, in view of the specific duties entrusted to them, as well as the context in which those duties are performed and the manner in which they are performed, the fact remains that Board Members who, in return for remuneration, provide services to the company which has appointed them and of which they are an integral part, who carry out their activities under the direction or control of another body of that company and who can, at any time, be removed from their duties without such removal being subject to any restriction, satisfy prima facie the criteria for being treated as workers within the meaning of the case-law of the Court, as referred to above."

The issue of whether the member of a Board of Directors qualifies as an employee came up again in 2015 in the cases of Balkaya (C-229/14), which concerned Directive 98/59 on collective redundancies, and Spies von Bullesheim (C-47/14), which concerned Regulation 44/2001 on the jurisdiction and the recognition and enforcement of judgments in civil and commercial matters. In both cases (reported in EELC 2015-4), the Board member in question was held, at least potentially, to be an employee, even where the national legislation in question determined that members of a Board of Directors do not qualify as such.

Subject: Employment status

Parties: Not identified

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