EMPLOYEE . . . OR INDEPENDENT CONTRACTOR?

Two or three generations ago, the careers of Canadians followed a fairly predictable path. Following graduation from high school, college, or university, an individual joined a company as a full-time employee and, more often than not, stayed with that company for the remainder of that person's working life, before a retirement at age 65 which was financed, at least in part, by an employer-provided pension.

The ways in which the Canadian workplace has changed over a generation or two are almost innumerable. Full-time permanent employment is now relatively rare, particularly for younger Canadians, and the employer-sponsored defined benefit pension plan is an endangered species. Perhaps the most pervasive difference, however, is the extreme fluidity which characterizes today's workplaces.

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In many companies, there is a relatively small "core" of full-time permanent employees which is supplemented by a changing cast of those who are working on temporary contracts, or perhaps a longer term or renewable contract. Others are seasonal workers, brought in during busy times, or to work on a particular project, or are temporary or permanent part-time workers. Some are perhaps former employees who have been downsized (or are retired) and are now providing services to the company in the capacity of a "consultant", either for a specific project, or on a longer-term basis.

All of these situations raise the question – these days, just who is an employee? That determination may seem to be a purely academic or theoretical one, without practical significance. The reality, however, is that the determination of employment status has significant practical, legal, and financial consequences for both employers and employees. Those individuals who can claim employee status have a significantly broader range of legal and financial rights and benefits. On the other side of the equation, bringing someone into the business as an employee creates a number of financial and legal obligations on the part of the employer. Failure to meet those obligations, particularly on the financial side, usually results in the imposition of penalties and interest.

Generally speaking, the following are true of an individual who is an employee.

- An employee has income tax deducted from his or her pay and remitted to the tax authorities on his or her behalf.
- An employee has Canada Pension Plan contributions and Employment Insurance premiums deducted from his or her pay and similarly remitted to the federal government, together with the CPP contributions and EI premiums which must be paid by the employer. The total of those CPP contributions and EI premiums is used to determine the employee's entitlement to, and amount of, Canada Pension Plan amounts or Employment Insurance benefits.
- An employee can, if his or her employment is terminated other than for cause, usually receive Employment Insurance benefits.
- If an employee's employment is terminated other than for cause, that employee is entitled to notice of termination or to pay in lieu of such notice. The minimum amount of notice required is set by law.
- If the company provides "fringe benefits", such as extended health benefits, or a pension plan, it is usually only employees who are entitled to receive such benefits.

Conversely, an employer has the following obligations in respect of each person who is an employee.

- The employer must deduct income tax, Canada Pension Plan contributions, and Employment Insurance Premiums from the employee's paycheque and must remit those amounts to the federal government on the employee's behalf. The employer is also required to match the employee's CPP contributions dollar for dollar and to remit 1.4 times the amount of the employee's EI premiums. All such payments must be remitted to the federal government on a prescribed schedule and, once remitted, accrue to the benefit of the employee.
- The employer must provide the employee with notice, or payment in lieu of notice, if the employee's employment is to be terminated, unless there is cause for termination. The employer must also follow all other requirements of the employment standards legislation for the province in which the company is located.

It's apparent that, in most cases, the existence of an employment relationship is more to the benefit of the employee than the employer. And so, not surprisingly, in most cases where there is a dispute, it is the would-be employee who is arguing for the existence of an employment relationship, while the "employer" takes the position that such individual is and always was always a self-employed "independent contractor".

Of course, what makes most sense is for both parties to be clear from the outset of the nature of the relationship, and to ensure that the obligations and responsibilities which arise as a result of that determination are followed by both. What follows is a summary of the rules which determine when an employment relationship exists – and when the obligations that such a relationship creates must, as a result, be fulfilled.

It's always the case, no matter the circumstances, that the determination of whether someone is an employee is a fact-specific determination – or, as the Canada Revenue Agency (CRA) states it – "[T]he facts of the working relationship as a whole decide the employment status". And, while there have been innumerable court cases dealing with

the question of just who is an employee, those cases have distilled the test to be applied down to a specific two-part enquiry. The first step of that enquiry asks the worker and the payer (to adopt the terminology used by the CRA) what their intent was when they entered into their working arrangement – whether they intended to create an employer-employee relationship, or whether the worker was entering into a contact to provide services as an independent contractor. Sometimes that intent will be documented in a contract or other written agreement, while in others any agreement between the parties was strictly verbal. In either case, the intentions of both parties, not just one or the other, must be included in the analysis.

Once the intent of both parties is determined, the next step of the test is to look at the day-to-day realities of the working relationship, to assess whether those realities actually reflect the stated intent of the parties. In doing that, the following elements are considered:

- the level of control the payer has over the worker's activities;
- whether the worker provides the tools and equipment;
- whether the worker can subcontract the work or hire assistants;
- the degree of financial risk the worker takes; and
- the worker's opportunity for profit, or risk of loss.

Level of control

In most workplaces, the employer exercises a significant degree of control of its employees, especially when it comes to employees at less senior levels. The employer requires the employee to be at the employer's premises on specific days of the week and for a specific number of hours. While many companies have adopted "flex-time" or other similar policies, it's still the case that the employee must work the required number of hours within the framework imposed by the employer. As well, even if the work schedule is part-time or irregular, the employee is required to make themselves available for a certain number of hours each week, or on certain days of the week. The employer also determines what work will be assigned to the employee and, generally, how that work is to be carried out. While salary negotiations can take place, it's the employer who ultimately determines the employee's remuneration.

By contrast, while an independent contractor may in some cases use the business's premises for work-related purposes, he or she is usually free to work wherever he or she chooses, and is not required to be at the business premises for a certain number of hours each week. Generally, independent contractors work without supervision, negotiate with the business with respect to the work they will take on, and are free to turn down work if they choose to.

Ownership of tools and equipment

Aside, perhaps, from the need to purchase a company uniform for some positions, employees are rarely required to own or provide the tools and equipment needed to perform their work. Whatever their position, employees work in a workspace owned or rented by the employer and do their work using computers or machinery or equipment owned by the employer. Where repairs or upgrades to that equipment are required, or training is required for the employees who use that equipment, it's the employer who arranges for and pays for those repairs or upgrades, or that training. As well, such training takes place during the employee's normal work hours.

That's not usually the case for independent contractors, especially as they do not, in most cases, work out of the business premises. Such independent contractors acquire, pay for, insure, and maintain whatever equipment is needed to carry out their work, and usually provide for and pay for their own workspaces. If there is a need for training to upgrade skills, that training is undertaken at the independent contractor's expense and on his or her own time.

As well, in the relatively unusual situations in which an employee – generally a skilled tradesperson like an auto mechanic – owns his or her own specialized tools, the courts have held that fact alone does not lead automatically to the conclusion that that person is not an employee. Rather, the ownership of tools must be considered in the context of that individual's overall working arrangement.

Right to subcontract work or hire assistants

It goes without saying that an employee never has the right to hire another person to assist or help that employee with his or her work, or to subcontract that work to another person. He or she is invariably expected to perform assigned work duties personally, and if assistance is to be provided, it will come from another employee hired, supervised, and paid by the employer. Independent contractors, on the other hand, are free to hire whomever they see fit to assist them in their work, on either a temporary or permanent basis. The cost of paying for such assistance is then the responsibility of the independent contractor.

Financial risk – chance of profit/risk of loss

The financial risk undertaken by an individual – specifically, his or her opportunity to realize a profit (or his or her exposure to the risk of a loss) is an important indicator of whether an employment relationship exists. Employees work for a set remuneration, whether that remuneration is based on annual salary, an hourly wage, a commission structure, or a piece-work rate. While employees in the last three categories can see their remuneration fluctuate up or down, depending on the number of hours worked, the volume of sales generated or the amount of piece-work produced, that fluctuation is not the same as profit or loss. Profit is earned when revenue exceeds expenses and losses realized when the converse is true. For employees, revenue and expenses are not part of the calculation, since they aren't liable for the expenses which must be incurred in order for them to carry out their work and their remuneration is not tied directly to the profit which their work generates for the employer.

As well, when and if the employer is in a loss position (in other words, revenue from sales of goods or services doesn't cover the employer's costs, including employee remuneration, of producing those goods or services), the remuneration provided to employees doesn't change. The converse, of course, is also true – when an employer's profits increase, that profit increase accrues to the employer and/or the shareholders of the business, and isn't directly reflected in the employee's compensation.

While employers can and do provide employee raises where the business is doing well, or even "profit sharing" based on the business's profit position, that again is not the same as a chance of profit. There is no obligation on an employer to provide such raises or profit-sharing, and when they occur, the amount and terms of both are determined solely by the employer.

The nature and degree of financial risk undertaken by an independent contractor is very different. Such individuals generally enter into an agreement for a specific amount of revenue to be paid for specific services which they agree to provide, usually within a set time frame. The revenue amount agreed on represents the contractor's best estimate of what it will cost him or her to create and deliver

those services, plus a profit margin. Should that cost estimate turn out to be an underestimate, such that the profit margin is diminished, or even that the agreed-upon revenue does not cover the contractor's costs, that reduced profit or that loss must be absorbed by the contractor. And, of course, the converse is also true – should the projected costs be less than anticipated, the increase in profit accrues to the contractor's benefit.

Once the overall circumstances of a particular work relationship are analyzed in light of these factors, it's possible to assess whether the realities of that relationship support the intent of the parties. At the end of the day, it's those realities which will be determinative of whether an employment relationship exists, and where the indicia of an employment relationship do exist, the rights and obligations that result from such a relationship will follow. The corollary of that fact is it's not possible for the parties (even where both agree about doing so) to transform what is clearly an employment relationship into an independent contractor situation simply by stating in an agreement that the person is not an employee. That strategy has been attempted many times, and such agreements will not be upheld by the courts where the objective facts confirm the existence of an employment relationship. While there's nothing wrong with stating in a work contract that one party to the contract is not an employee, it's critical that the work arrangements agreed to and followed align with that stated intent.

To that end, it's helpful to document in the work contract just what those arrangements are. Specifically, the contract can specify, with respect to the four factors outlined above, the respective rights and responsibilities of the parties. In that regard, inclusion of the following clauses in a contract will help to establish that the person involved is an independent contractor and not an employee.

- The contract provides that the person is not required to work at the premises of the business to which services are provided.
- The contract requires the person to acquire and maintain, at his or her own expense, any equipment (e.g., computer hardware and software) needed to provide the services contracted for.
- The contract specifies that the person is required to invoice the business with respect to services provided, following which payment will be made, on the terms outlined in the contract. It is also helpful to specify that the person will, if required by law, charge harmonized sales tax/goods and services tax with respect to services rendered.
- The contract specifies that the person will be solely responsible for payment of income taxes on amounts invoiced and paid, and that no deductions will be made by the business for income tax, Canada Pension Plan contributions, or Employment Insurance premiums.
- The contract specifies that the person will not be entitled to any of the benefits provided to employees of the business.

Business owners or human resources managers who are aware of the factors that go into determining when an employment relationship exists are better able to avoid the pitfalls which can arise to derail the intentions of the parties with respect to the nature of any given work arrangement. Put more positively, that knowledge allows both parties to structure the work relationship to produce the desired characterization of that relationship.

Even with that knowledge, however, there are situations in which it can be very difficult to make that determination with any degree of confidence. Take, for example, an employee who has retired or been downsized from full-time employment but who continues to provide many or most of the same services to his or her former employer, as a consultant or independent contractor. There are legitimate reasons why an employment relationship can evolve into a consultancy or independent contractor arrangement. But, there are also instances in which employers have simply sought to recharacterize an existing employee as an independent contractor, when there is no actual substantive change in their work responsibilities or working conditions. In such circumstances, the CRA will likely question whether there has in fact been a change and should it decide that there has not, the employer will be liable for a failure to

withhold and remit source deductions (income tax, CPP contributions, and EI premiums) and, often, interest and penalties will be levied on those unremitted amounts. It has also happened that after a period of time, a worker brings legal action arguing that he or she was at all times an employee, and that the employer is responsible for the payment of CPP premiums or (especially) EI contributions, often so the former worker can make a claim for EI benefits.

Especially in situations where there is doubt about the status of a particular worker, or the work arrangement is likely to be a longer-term one (and definitely when both are the case), it's worthwhile to obtain a ruling from the CRA with respect to an individual's employment status. Such a ruling can be sought by either party.

Obtaining a ruling isn't difficult – the business can do so online, through the CRA's "Request a CPP/EI Ruling" service in My Business Account on the Agency's website. Alternatively, either the business or the worker can request a ruling by sending a letter or a completed Form CPT1, Request for a Ruling as to the Status of a Worker Under the Canada Pension Plan and/or the Employment Insurance Act, to their Tax Services Office. The CPT1 form can be found online at www.cra-arc.gc.ca/E/pbg/tf/cpt1/README.html, or can be obtained by calling the CRA's Individual Income Tax Enquiries Line at 1-800-959-8281. A listing of the CRA's Tax Services Offices is available at www.cra-arc.gc.ca/cntct/tso-bsf-eng.html.

When the ruling is issued, and either party disagrees with the decision, he or she can appeal further. Information on how to do so can be found on the CRA website at www.cra-arc.gc.ca/E/pub/tg/p133/p133-12e.pdf.

While it's obviously best to seek a ruling with respect to an individual's employment status as early in the working relationship as possible, such application can be made (by the business or the worker) any time prior to June 30 of the year following the year to which the question relates. So, for example, if the work in question takes place in 2017, the ruling request must be made by June 30, 2018.

The time and effort required to ensure the correct characterization of the employment status of a particular worker can seem unreasonable, and the criteria involved vague and difficult to assess, and that can certainly be the case. Notwithstanding, the need to make such a determination is a function of the commercial realities of today's labour market. Not only does each workplace include individuals working under a variety of work arrangements, it's perfectly possible for two people who are doing the essentially the same work to have a different legal status (and different rights) with respect to that work. And, since the negative financial consequences of a failure to properly determine the employment status of each worker and to fulfill any resulting obligations will fall on the business owner, it is well worth doing some up-front work to avoid those consequences.