

# Employee vs. Contract Worker

Ministry Resources Department



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## I. THE LEGAL TESTS: EMPLOYEE OR CONTRACTOR?

The law essentially recognizes two categories of relationship, employer/employee and contracting party/contractor, and the Courts have developed a series of tests for distinguishing between the two. A thorough preliminary analysis concerning each person is essential to comply with the myriad of statutes - and common law principles - that apply in one way or another. Regardless of a person's description for other purposes within an organization, it is important to determine into which of the legally recognized categories - employee or contractor - the person falls.

From an income tax perspective, the key distinction between an employee and an independent contractor is that an employee earns 'employment income' while an independent contractor earns income from a business. Practically speaking, there are deductions available to a taxpayer in relation to expenses incurred in the course of earning business income that are not available to an employee. From the organization's perspective, an entity that employs an individual has withholding obligations under the Income Tax Act, must deduct and remit employment insurance premiums and Canada Pension Plan contributions. These obligations do not apply in respect of an organization that contracts with an individual for services.

"Employee" is not defined in the Income Tax Act Neither is "independent contractor". Of limited assistance is Revenue Canada Interpretation Bulletin IT-525 (Performing Artists), which states in relation to artists:

"A contract of service [employee] generally exists if the person for whom the services are performed has the right to control the amount, the nature and the direction of the work to be done and the manner of doing it. A contract for services [independent contractor] exists when a person is engaged to achieve a prescribed objective and is given all the freedom he requires to attain the desired result".

The tests currently applied by the Tax Court in distinguishing between independent contractors and employees are summarized in a decision by the Federal Court of Appeal, Wiebe Door Services Ltd. v. M.N.R.:

"Caselaw has established a series of tests to determine whether a contract is one of service or for the provision of services. While not exhaustive the following are four tests most commonly referred to:

- (a) The degree or absence of control, exercised by the alleged employer;

- (b) Ownership of tools;
- (c) Chance of profit and risk of loss;
- (d) Integration of the alleged employees' work into the alleged employer's business".

This "four-in-one" test does not create a strict formula. Rather, it is a guide to be applied in light of specific factual circumstances.

The courts have taken two approaches in applying the four-in-one test. In some instances, the court has specifically laid out the components in the four-in-one test and addressed each issue separately. In other cases, the court has acknowledged the test from Wiebe and then considered all the relevant factors together rather than dividing them into the separate components. Not every component of the test is relevant in every case and the court will decide what weight to give to each factor. Accordingly, there is little certainty for employers and careful scrutiny of each arrangement is necessary to evaluate and subsequently determine the most likely categorization, in light of each component of the test.

## THE FOUR-IN-ONE TEST

**The Control Test** - In the past, the control factor has been given a lot of weight by the courts. The test as set out in an old English case, R. v. Walker states simply that:

"it seems to me that the difference between the relations of master and servant and of principal and agent is this: a principal has the right to direct what the agent has to do; but a master has not only that right, but also the right to say how it is to be done".

[emphasis added]

As a practical matter, the control test may not be very useful in certain circumstances. Indeed, in some cases, the organization may exert greater control over the way in which a particular project is carried out by a true independent contractor than in respect of a senior level employee who operates independently and with little supervision. However, if there are significant elements of control in what is intended to be an independent contractor relationship, there will be a presumption in favour of employment.

From a planning perspective, it is necessary to consider the degree of control to be exerted over a particular individual in connection with a project. If the intention is to create a contractor relationship, the independent contractor must be truly independent in the way in which he or she carries out the job. To the extent possible or appropriate, there must be flexibility in how and when a project gets done. On the other hand, it should be possible to set a deadline for completion of a project, without jeopardizing a contractor relationship.

Two further factors indicating a lack of control and therefore supporting independent contractor status are: one, the ability to subcontract work; and two, the existence of multiple clients for whom the individual claiming contractor status provides services.

The ability to sub-contract work or use a replacement is indicative of an independent contractor relationship. For example, in Cavanagh v. R., the Tax Court found that the ability of the taxpayer to

have somebody else mark the papers that York University had contracted with the taxpayer to grade was a determinative factor in its decision that he was an independent contractor and not an employee.

The second factor which supports independent contractor status is the existence of other clients. While it is not impossible to be in business with a single client, the courts are influenced by the existence of several clients (or attempts to solicit additional clients) other than the alleged employer. Revenue Canada's position is set out in a recent Revenue Canada Technical Interpretation dealing with an individual who was providing consultative computer services and software products for a single client. Despite many indicia of independent contractor status, such as ownership of tools, lack of control over the way in which the project was to be done, and no participation in the company's benefit plans, Revenue Canada was of the view that the individual, who had a single client, would most likely be viewed as an employee, rather than an independent contractor. The absence of other clients is even more significant where a former employee is classifying himself or herself as an independent contractor whose sole client is the former employer.

**Ownership of Tools** - An independent contractor generally would own his or her equipment and be self-sufficient. On the other hand, an employee will normally rely on the employer's tools or equipment. If the organization provides office space, a desk, secretarial help, a computer and other administrative services, there will be a presumption that an employment relationship exists.

However, even if the worker supplies his or her own tools, other factors may take precedence. In Imperial Drywall Ltd. v. Canada (M.N.R.), the worker provided his own tools - hammer, drill, screw gun, and screws. He also provided invoices, signed an agreement to pay his own share of income tax and CPP, and on a few occasions employed another individual to assist in drywalling projects. However, the contracting organization obtained all the jobs, got the blueprints for sites, made job estimates, and supplied the drywall. The Court questioned whether the individual carried on a business under his own name or one that identified himself as drywalling, whether he had a business telephone listing, whether he advertised and whether he ever hired more than the one employee. In the end, the Court held that the worker was an employee.

An individual providing services to an organization who is responsible for providing his or her own equipment is more likely to be viewed as an independent contractor, assuming other facts do not overwhelmingly support the opposite conclusion. If it is necessary for purposes of the particular project that the individual attend at the organization's premises, care should be taken to provide temporary work space only, so as not to create the impression of a more permanent relationship. The ability of the individual to utilize the organization's 'tools' or facilities should be restricted in the documentation covering the contract.

**Chance of profit/risk of loss** - The courts look to see if the individual has accepted any financial risk. An employee will generally be paid a set rate no matter how the business is succeeding or whether he or she works at a quick or slow pace. An independent contractor will suffer personally if the enterprise is unsuccessful and will have the capacity to make a profit.

The manner in which an individual is paid seems to be gaining significance in some of the recent cases. For example, in Cavanagh, the tutor was paid on the basis of each paper graded. His

submission, which was accepted by the Court, was that for each grading assignment he accepted, he had to calculate the estimated mortality rate in the class. In other words, he had to estimate how many students would remain enrolled until the end of the semester and therefore submit papers to be graded. He could make more or less money on an hourly basis, depending upon the ultimate size of the class. While this profit/loss analysis may appear to be somewhat strained, it was a persuasive factor in the Court's decision that the individual was not an employee, but rather an independent contractor.

On the other hand, payment of a straight hourly rate is indicative of an employment relationship. For example, in E.W. Korpan, among other factors indicative of employment, the Court specifically noted that the casino pitboss was paid a fixed rate of remuneration for his services. Further, in Imperial Drywall, the court was not convinced that an hourly rate gave rise to the possibility of profit or risk of loss. The court stated:

"Someone who just makes out an invoice and then gets paid \$19 per hour is, in my view, very little different from an assembly line worker in a large manufacturing plant who just shows up every day and gets paid \$19 per hour as a skilled worker".

The courts' approach to hourly rates seems to be questionable. Many independent contractors, such as plumbers, electricians, lawyers and accountants have traditionally charged for their services on the basis of a flat hourly rate, regardless of the success or failure of the work performed! However, if the relationship contains other indicia of an employment relationship (such as control by the contracting party, no ownership of tools), the existence of a fixed rate of remuneration will strengthen the presumption that an employment relationship exists.

**Integration** - This test acknowledges that work performed by an employee under a contract of services is done as an integral part of the organization. Under a contract for services, an individual's work, although done for the organization, is not integrated into it, but is only accessory to it. If a worker is doing exactly the same work as an employee, alongside other employees, and the work is part of the core function of the organization, there will be a presumption of employment status. Accordingly, "contracting out" core functions will be more difficult than non-core functions.

The integration test seems to have been persuasive in Chauvco Resources Ltd. v. Canada (M.N.R.). In this case, an individual was hired to replace an employee who was assigned to another project. The company required the individual to sign a contract which stated that she was a "contractor" and liable for her own UI, CPR Workers' Compensation, and Income Tax contributions. The contract stated specifically that the Agreement was not an employment contract.

The Court decided that the individual was an employee despite the agreement. The work done was the same as that of the regular employee who was replaced, the work was done on company premises, with a company computer which was connected to the company network. The work itself was part of the accounting function of the company. She worked the same hours as everyone else, although she was not required to arrange her schedule in this way, and she was paid hourly with no opportunity to make any profit above the hourly rate.

Counsel for the company attempted to argue that the individual was an independent contractor based on the contract, the fact that she was not invited to company events, was not able to

participate in the personal development program of the company and received no pension or benefits. These arguments were rejected and the Court stated that:

"This case is a blatant attempt by the Appellant's to impose terms upon the temporary employee which would amount to contracting out of its obligations under the Unemployment Insurance Act, the CPP, the Income Tax Act, and perhaps provincial legislation as well. This it cannot do".

## **II. CHECKLIST OF PRACTICAL / STRATEGIC CONSIDERATIONS**

It is clear from a consideration of the tests set out above, that there is not a uniform test which can be applied with respect to determining whether an independent contractor or employer-employee relationship exists. However, there are certain general considerations which may assist in an analysis of this issue. The considerations set out below are not exhaustive, and may not be relevant under certain circumstances. It should be noted that they are all designed to assist in the characterization of the individual as an independent contractor.

- Enter into a written contract with the independent contractor. Note that courts will examine the substance of the relationship over the form of the relationship;
- Do not attempt to establish the independent contractor's hours of work;
- Do not pay the independent contractor overtime pay, vacation pay, holiday pay, etc.;
- Attempt to pay the independent contractor on a project basis and/or a fixed fee basis. Try to avoid hourly rate structures;
- Ask the independent contractor to provide an "upfront quote" for the project. Ensure that the quote is inclusive of all expenses;
- Do not pay the independent contractor on the same cycle that employees are paid. For example, pay the independent contractor on a monthly basis or upon completion of pre-determined phases of the project;
- Do not pay the independent contractor unless an account is submitted by the independent contractor;
- Ensure that the independent contractor has a GST number, and that GST is paid on the accounts submitted by the independent contractor;
- Do not provide office services (office space, secretarial, copiers, telephone, fax) to the independent contractor. However, if the independent contractor is permitted to use or have access to office services, ensure that there is a formal billing AND payment structure in place for such services;
- Ensure that the arrangement entered into with the independent contractor provides the independent contractor with the opportunity for profit/loss;

- Have the independent contractor provide proof of adequate insurance coverage;
- Have the independent contractor acknowledge, in writing, that an employment relationship does not exist with the church;
- Do not attempt to direct and control the day to day activities of the independent contractor;
- Do not give the independent contractor a title that is similar to that of a church employee;
- Occasionally allow for a hiatus between contracts with the independent contractor; or, try to avoid long-term relationships with the same independent contractor;
- If the independent contractor is "absent", do not permit church employees to perform the work normally performed by the independent contractor;
- Ensure that the independent contractor provides, or is entitled to provide, services to other unrelated entities;
- Have the independent contractor provide: a business card, listing in the phone book, advertisements, etc.;
- Do not permit the independent contractor to attend regular meetings that the church may conduct with employees;
- Do not permit the independent contractor to participate in any benefits plans offered by, or through the church;
- Do not reimburse the independent contractor for incidental expenses;
- Do not allow the independent contractor to assist other employees with their work, or "fill in" for employees in their absence;
- Ensure that the independent contractor has the authority to subcontract work;

CGR/pjs