

Are you an employee or a general contractor?

Entrepreneurs are joining the marketplace in increasing numbers and with more enthusiasm than ever before. Many people want to work for themselves rather than working for someone else because of the potential to reduce taxable income with an expanded deduction or expense base. As a result, there is a growing reliance on the provision of services as contractors, casual employees or temporary help.

Two areas for concern arise as a result of the relationships that are being created:

1. Is the consultant an employee or independent contractor?
2. What are the tax implications?

Employee or Independent Contractor?

The issue of whether the consultant is an employee or an independent contractor has been discussed and analyzed in numerous articles and cases and is one of pure fact, rather than law. *Wiebe Door Services Ltd. vs. the Minister of National Revenue* (FCA) confirmed that the whole relationship of the parties must be examined to determine whether or not there is an employment relationship.

“The central question is whether the person who has been engaged to perform the services is performing them as a person in business on his own account.” *671122 Ontario Ltd. v. Sagaz Industries* (SCC) The question can be restated as whether the worker was carrying on the business for himself/herself or for the organization/business that would normally be considered the employer. The Courts have determined that there are four tests that must be considered in making the determination:

1. control
2. ownership of tools
3. chance of profit and risk of loss
4. integration

Control

Employment relationships imply supervision over the work. Jurisprudence suggests that the correct question to ask is *not* whether control is exercised but is rather whether a hirer has the right to exercise control over the work. In determining the degree or absence of control, the court will consider whether or not the individual is working mostly on their own, whether they are free to accept or refuse a call or a job, whether or not they are required to work or attend at the “hirer’s place of business”, and whether, in fact, the hirer does exercise some control over the worker. Control is not always conclusive.

Ownership of the Tools

A worker will be considered an independent contractor if the worker owns his own tools, even if the hirer provides special tools. Conversely, if all the tools are provided by the hirer, it would suggest that the worker is an employee. Interestingly enough, in situations where the contractor/employee is using his knowledge base as a major tool, the situation will often be characterized as that of an independent contractor.

Chance of profit/risk of loss

The chance of profit and the risk of loss is assessed by considering factors such as whether or not the worker has financial investment in the business, whether there is a chance of making more money by working quickly and efficiently or by charging a premium, whether the salary might fluctuate depending on the amount of work that exists, and whether he would be required at his own expense to redo the work or correct the work.

4. Integration

Whether the person is employed as part of the business and his work is done as an integral part of the business or whether under contract of his services his work, although done for the business, is not integrated to it but only ancillary to it. The question is would the worker's business exist without the particular hirer. For example, if the hirer is the worker's only client, it would be difficult to find that it is the worker's business. A planning step would suggest that the worker ensure that he/she provides services to a number of clients.

The approach that must be taken is the totality approach. All of the various four tests must be considered. There is no one conclusive test; it is more of a balance of probability of many circumstances.

Will incorporating the business clarify the relationship?

For a person offering services through a corporation, the contract would be between the employer and the corporation. As such, it is the corporation which would be receiving the income and this income cannot, by definition be from employment or office. However, this fact does not mean the distinction between an employee and independent contractor becomes moot!

Where the worker operates through a corporation, the worker will want to avoid being labeled a personal services business. Essentially, a corporation is carrying on a personal services business if (1) the worker can be reasonably regarded as an officer or employee of the person to whom the services were provided but for the existence of the corporation and (2) the worker performing the services (or someone related to the person) owns 10% or more of any class of shares of the corporation. The two exceptions to this rule is whether (1) the corporation employs more than five full time employees (excluding any

specified shareholders or individuals related to specified shareholders) or (2) the services were provided to an associated corporation.

Tax Implications

The determination of whether someone is an employee or an independent contractor has wide tax implications. It will also affect what kind of withholdings must be made on the payments for work done (CPP, EI, income tax); whether the worker is eligible to participate in the hirer's pension plan with consequent tax deductions, and most importantly, what expenses can be claimed as deductions from home.

An employer (using the term loosely) having a contract with an unincorporated independent contractor may still be liable for CPP and EI withholdings or payments notwithstanding the fact that there is clearly an independent contractor relationship between the employer and the worker. Under the CPP and EI regulations, income may be pensionable or insurable, respectively, if the worker is in an employee relationship with a client of the employer. If the contractor has a contract with a "Placement Agency", for example, that Placement Agency must withhold CPP and EI, even if it is clear that the relationship is a contractor, not an employment relationship.

Where a corporation has been utilized, withholding for CPP, EI and income tax will no longer be an issue, but if it is classified as a personal service business, the corporation will be taxed at the top corporate rate, will not be eligible for the small business deduction and will be limited in the business expense deductions.

On the other hand, if the relationship between the worker and the person to whom the services were provided is one of subcontractor (and not employee) or if one of the exceptions mentioned above applies, then the corporation will be able to enjoy the small business deduction, income splitting and deferral, business deductions, etc.

From the employer standpoint, a contract with a corporation will produce very distinct benefits. As a corporation cannot earn income from office or employment, the income paid to the corporation is not subject to withholding for income taxes or withholding or payments of Canada Pension Plan (CPP) or Employment Insurance (EI) premiums.

The consequences of improperly characterizing a working relationship as independent contractor can be quite significant for the hirer including liability under the *Income Tax Act*, *Employment Insurance Act*, the Canada Pension Plan; including interest and penalties as well as under the Workplace Safety Insurance Act. The consequences to the worker include loss of business expense deductions for expenses already incurred.

If the intended relationship is one of an independent contractor then it is imperative that the relationship be structured in the proper manner. It is imperative that a professional assist in that regard.

An employee (as opposed to an independent contractor) normally has tax withheld from pay at source (153(1)(a)); can deduct only specifically permitted expenses (8(2)); must file on April 30 instead of June (150(1)(d)); does not collect and remit GST on earnings; is eligible for Employment Insurance; has the employer pay a portion of EI premiums and CPP contributions; and is taxed on income when it is received rather than when it is earned (5(1)).