

Employee or Independent Contractor?



If you hire what you think are independent contractors for short-term or other types of projects, beware. According to a recent survey, most workers who are classified as “independent contractors” should really be treated as “employees.” What’s the difference? You don’t have to pay employment insurance or payroll taxes for independent contractors. Plus, independent contractors aren’t usually entitled to vacation and holiday pay. So, classifying a worker as an independent contractor rather than an employee can save your company thousands of dollars per worker each year.

But be careful with your labels. Misclassifying a worker as an independent contractor can get you into big trouble. If the government decides that the worker is really an employee, it can order you to pay fines and both the employer and employee portions of Canada Pension Plan (CPP) and Employment Insurance (EI) premiums. It can also make you pay interest on unpaid premiums and even demand additional withholdings for tax and workers’ compensation. Adding insult to injury, the workers whom you misclassified as independent contractors may sue you for reimbursement for expenses they thought they could deduct under such status.

With the help of labour and employment lawyers, CRA guidelines and court decisions, we’ll tell you how to determine whether to classify your workers as employees or independent contractors.

Employer Fined for Misclassification

There’s a lot riding on a company’s ability to classify workers the right way. An Ontario cleaning company learned this lesson the hard way. The company let new workers decide for themselves whether they wanted to be treated as employees or independent contractors. This turned out to be a bad idea. The problem was that the working conditions were exactly the same, regardless of the worker’s classification. The only difference was that employees received a lower hourly rate and the company paid their CPP and EI premiums. The company set each worker’s hours and was responsible for finding customers, providing job quotes, and setting each customer’s rate.

After determining that all of the workers were actually employees, the government ordered the company to pay almost \$8,000 in unpaid EI premiums. The company appealed, arguing that some of the workers were independent contractors because they signed an agreement saying so. But the tax court didn’t care about the agreement and upheld the award based on each worker’s **actual relationship** with the company [*Windsor Home Care*

Consider 4 Factors

How do you know whether you should classify a worker as an independent contractor or an employee? Unfortunately, there's no bright-line test. And it doesn't matter if you have a contract that says your worker is an independent contractor, as the Ontario cleaning company in the case above found out. The government looks at the substance of the relationship to determine whether an employer-employee relationship exists. So, what **are** the substantive elements that determine if a worker is an employee or independent contractor? CRA and the courts consider 4 key factors:

1. Degree of Control over Worker

The first factor is the amount of control that an employer has over the worker. Workers who are told where, when and how to do their work are generally considered employees. Generally, the less experience and skill a worker has, the more control an employer is likely to exert and the greater the likelihood that the workers should be considered employees. Questions to ask:

- Who chooses the hours the worker works?
- Who determines the quality of their work?
- Who hires and trains the worker and assistants?
- Does the worker receive consistent pay or fringe benefits?
- Does the worker have other clients or work just for the employer?
- Is the worker expected to report to the employer at the start of each workday?
- Does the worker have the right to refuse or "hand off" certain jobs?

Example: A hospital in a small Saskatchewan city accessible only by air had a hard time finding qualified nurses. Rather than hire full-time nurses, it had to pay premium rates to temporaries who would work two-week stints. It also had to pay the temporaries' travel expenses. The hospital classified the temporary nurses as independent contractors. The government claimed they were employees. The tax court ruled in the hospital's favor. The hospital had limited control over the nurses, it said. The nurses weren't supervised and could refuse jobs whenever they wanted [[Uranium City Hospital v. M.N.R.](#), 2003 TCC 439 (CanLII)].

Strategic Pointer: A worker might be an employee even if an employer doesn't control what they do. What's important is whether the employer has **authority to** control the worker, not whether it actually exercises that control.

2. Ownership of Tools

Most independent contractors own and maintain their own tools. Employees, on the other hand, generally use tools owned and maintained by the employer. When looking at tools, also consider who pays for repairs, insurance, transport, rental and operation (for example, fuel).

Example: A store in Ontario hired two opticians to fit customers' eyeglasses and contact lenses. One optician used all of his own tools. If he needed to perform specialty work, he took it off-site to his own shop. The other optician, who was less experienced, didn't have her own equipment and performed all of her duties at the store. The government said they should both be treated as employees. But the tax court disagreed and held that the optician who used his own tools should be treated as an independent contractor and the optician who worked in the store using the employer's equipment an employee [[Grzymski v. M.N.R.](#), [2005] T.C.J. No. 131].

3. Whether the Worker Bears the Risk of Loss

The extent of workers' financial involvement in the project is another indicator of whether they're an employee or independent contractor. Workers who are paid a straight salary, regardless of whether the project succeeds or fails, are more likely to be considered employees. But if the worker has the chance to make a profit if the project is successful or incur a loss if it fails, you're probably dealing with an independent contractor. **Exception:** Workers who are paid by commission for each piece of equipment they sell are considered employees if they're paid the same amount per unit regardless of whether the employer is making a profit.

Example: A real estate company hired an agent to list and sell real estate in Manitoba. The company paid the agent a commission for each sale instead of a set salary. It also had very little control or supervision over her work. These factors normally suggest independent contractor status. But here the tax court said the agent was an employee because she received the same commission regardless of the company's administrative and advertising costs. The set figure protected her against any risk of loss, the court said [*Yellowhead Realty Ltd. v. M.N.R.*, [2002] T.C.J. No. 498].

4. Integration

Where the relationship between the employer and worker is still unclear, courts turn to the integration test, which looks at where the employer's business fits in with the worker's business. Workers whose activities are integral to the business (for example, grocers or construction workers) are more likely to be considered employees. On the other hand, if the worker's service can be separated from the employer's business (for example, construction workers who work on a project basis), the worker is more likely to be an independent contractor.

Example: A door installation and repair company in Ottawa hired installers each of which ran his own business and paid his own taxes and pension and unemployment insurance contributions. Each installer owned their own truck and tools and was free to accept or refuse calls for work. Nevertheless, the government said that the installers should be treated as employees based on the integration test – the workers were an “integral part” of the company's business and without them, the company would be out of business. In what remains a seminal Canadian case, the court disagreed and said that the integration test was important, but the totality of circumstances – not one single test – was what mattered most [*Wiebe Door Services Ltd. v. M.N.R.* (F.C.A.), 1986 CanLII 6775 (FCA), [1986] 3 FC 553].

How to Differentiate Independent Contractors from Employees

When it comes to classifying a worker as an employee or independent contractor, no single factor is likely to be decisive. Instead, you have to weigh your responses to all of the factors and make a judgment call. A good way to evaluate your responses is to record them in an independent-contractor [questionnaire](#) for each worker. Ask whether the employer:

- Directs and controls where and how the work will be done;
- Provides the facilities and other resources for work to be completed;
- Runs the risk of loss if the project isn't successful; and
- Needs the worker to continue its core business.

If you answer yes to most of these questions, chances are that your worker is an employee, which means you'll have to withhold income tax and pay CPP and EI premiums.