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EMPLOYEE OR INDEPENDENT CONTRACTOR? BE AWARE OF THE RISKS

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A. INTRODUCTION

In difficult economic times, charities and not-for-profit organizations may be faced with reduced revenue and may be considering opportunities to reduce their costs by examining alternative employment arrangements.

One alternative is to hire workers on contract and classify those workers as "independent contractors", and not employees. However, organizations must be cautious in classifying workers as either independent workers or employees, as there are potential serious legal consequences arising from an incorrect classification.

An employer has fewer legal obligations when dealing with an independent contractor as opposed to hiring an employee. Apart from the cost of benefits, the hiring of an independent contractor will not trigger the employer's obligations to remit to the government all statutory payroll taxes and deductions. Employers are required to deduct and remit amounts for income tax, Canada Pension Plan ("CPP"), Ontario Employer Health tax and employment insurance ("EI"). For CPP and EI, the employer also has to remit an employer premium. For some businesses, as well as charitable or not-for-profit organizations, this makes hiring an independent contractor rather more appealing.

A potential worker may request that (s)he be classified as an independent contractor for their own financial reasons. They may wish to receive monies without any statutory deductions so as to maximize their

immediate income. Also, as employees are restricted in the types of expenditures they are entitled to deduct from employment income, a classification as an independent contractor would entitle them to deduct all reasonable business expenses from their gross income. While there may be benefits for both the organization and the worker in classifying the worker as an independent contractor, there are serious repercussions if the classification is later found to be incorrect.

1. Consequences of Incorrect Classification

a) Canada Revenue Agency:

An employer who fails to deduct income tax at source, as well as the required CPP contributions and EI premiums, must pay not only the unremitted taxes, but also the employer's share and the employee's share of any premiums owing, plus penalties and interest. The issue of whether a worker is an employee or an independent contractor arises frequently in the Tax Court of Canada. As a result, an improper classification may be costly to the employer, both in terms of not only the premiums, penalties and interest but also the legal fees of defending a challenge by the CRA in the Federal Court.

The CRA has prepared a guide entitled "Employee or Self Employed?"[1] to assist employers and workers in deciding whether the person(s) or individual is or will be considered an employee or an independent contractor. A review of this publication is recommended for any organization considering hiring an individual as an independent contractor rather than an employee.

b) Workplace Safety and Insurance:

What happens if the individual suffers an injury and claims benefits under the *Workplace Safety and Insurance Act* ("WSIA")? Was the person a "worker" within the meaning of that Act? Where it is determined by the Workplace Safety and Insurance Board that independent contractors are really employees under the WSIA, it can charge an organization of being in breach of the WSIA for not remitting premiums for these workers. The consequences of a breach of the WSIA are serious and can lead to:

i) Investigation by the Board;

[1] RC4110 available online at http://www.cra-arc.gc.ca/E/pub/tg/rc4110/README.html.

ii) The charging of the outstanding amount due on the organization's premiums together with interest;

iii) A guilty finding in respect of a provincial offence and the levying of substantial fines.

c) Wrongful Dismissal Claims:

The termination of an independent contractor who later claims to have been an employee may give rise to a claim against the organization for an action for wrongful dismissal, which could include monetary claims for such things as pay in lieu of notice substantially in excess of the minimum requirements of the *Employment Standards Act, 2000* (Ontario) ("ESA"), as well as severance pay under the ESA. Although the written contract between the so-called independent contractor and the organization may provide fewer rights for the contractor in the event of the termination of his or her services, courts will disregard such provisions if it is found that the individual was in fact an employee, as such a contractual term would violate sections of the ESA that prohibit contracting out of the minimum standards of that legislation.

The Ontario Court of Appeal recently awarded a former employee of La-Z-Boy Canada Limited twenty months pay in lieu of notice, finding that the designation by the company of the employee as an independent contractor was not valid: *Braiden v. La-Z-Boy Canada Ltd.*[2] The employee was terminated after 23 years of service with the provision of just sixty days notice under the written contract designating the sales representative an independent contractor. The Court of Appeal held that the facts of the relationship unequivocally pointed to the existence of an employment relationship.

d) Employer's Duties under the ESA.

There are a number of obligations under the ESA that must be adhered to if the individual working for the organization is characterized as an employee. While an individual who is truly an independent contractor is ineligible for certain ESA benefits, such as overtime pay, pregnancy and parental leave, vacation pay, minimum termination pay and, where applicable, severance pay, these are all benefits available and potentially owing to employees. Therefore, the incorrect characterization of a worker as an independent contractor may result in orders being made by the Ontario Ministry of Labour requiring payment of these various obligations. Also, a failure to

[2] 2008 Carswell Ont. 3442.

provide pregnancy or parental leave where required under the ESA can lead to a discrimination complaint under the *Ontario Human Rights Code* ("Code"). Due to the recent amendments of the Code, individuals now have the resources of the Ontario Human Rights Legal Support Centre to assist them with their applications to the Ontario Human Rights Tribunal.

2. Contractor or Employee?

Given all the risks associated with incorrectly characterizing an employee as an independent contractor, it is important for organizations to be familiar with the manner in which the law distinguishes an independent contractor from an employee. It is also important that the organization seek legal advice if there is any doubt as to whether an individual should properly be hired as an independent contractor or an employee.

Various factors are considered by our courts to decide the issue, including:

- the level of control the payer has over the worker;
- whether or not the worker provides the tools and equipment;
- whether the worker can subcontract the work or hire assistants;
- the degree of financial risk taken by the worker;
- the degree of responsibility for investment and management held by the worker;
- the worker's opportunity for profit; and
- any other relevant factors, such as written contracts.

The CRA publication "Employer or Self Employed?" has a detailed review as to what it considers to be factors which are indicative of either an independent contractor or an employment relationship.

The Federal Court of Appeal recently discussed various tests and the difficulties inherent in applying them in *The Royal Winnipeg Ballet v. The Minister of National Revenue*.[3] In that case, the Tax Court of Canada had ruled that certain dancers engaged by the Royal Winnipeg Ballet for a particular period

[3] 2006 FCA. 87.

were employees and not independent contractors. A majority of the Federal Court of Appeal (Justice Evans dissenting) allowed the appeal and overturned the trial decision.

The court reviewed a number of decisions where the issue had been previously raised, including the leading Supreme Court of Canada case of *67112 Ontario Ltd. v. Sagaz Industries Canada Inc.*[4] ("Sagaz"); and the earlier case of *Wiebe Door Services Ltd. v. M.N.R* [5]; as well as *Wolf v. Canada*[6].

In *Sagaz*, the Supreme Court of Canada enunciated the test for distinguishing between and employee and an independent contractor, stating that:

> The central question is whether the person who has been engaged to perform the service is performing them as a person in business on his own account. In making this determination, the level of control the employer has over the worker's activities will always be a factor. However, other factors to consider include whether the worker provides his or her own equipment, whether the worker hires his or her own helpers, the degree of financial risk taken by the worker, the degree of responsibility for investment and management held by the worker, and the worker's opportunity for profit in the performance of his or her tasks. It bears repeating that the above factors constitute a non-exhaustive list, and there is no set formula as to their application. The relative weight of each will depend on the particular facts and circumstances of the case.

It is important to note that a common theme running through these cases is that the courts will not be bound to the parties' declaration as to the legal character of their contract. However, nor will the parties' stated intentions in their contract necessarily be ignored. In the *Royal Winnipeg Ballet* decision, the majority concluded that the parties' written agreement as to the nature of their relationship, while not conclusive, was a factor to be considered by the court in its determination that, on balance, the facts were consistent with the conclusion that the dancers were self employed.

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[4] [2001] 2 S.C.R. 983; (2001), 204 D.L.R. (4th) 542; 17 B.L.R. (3d) 1; 11 C.C.E.L. (3d) 1; 8 C.C.L.T.(3d) 60; 12 C.P.C. (5th) 1; 274 N.R.366; 150 O.A.C.12; 2001 SCC 59.
[5] [1986] 3 F.C. 553, [1986] 5 W.W.R. 459; (1986), 46 Alta. L.R. (2d) 83; [1986] 2 C.T.C. 200; 87 DTC 5025; 70 N.R. 214 (C.A.).
[6] [2002] 4 F.C. 396; [2002] 3 C.T.C.3; 2002 DTC 6853; 288 N.R.67; 2002 FCA 96.

B. CONCLUSION

To conclude, a well-drafted contract can serve to reduce an ambiguity regarding the status of a worker. From a risk management perspective, organizations should take care to ensure careful drafting of independent contractor agreements to minimize the potential liability of the organization. They also need to make a careful assessment of the position being filled and whether their designation of a worker as an independent contractor or employee would survive a close scrutiny by the CRA and the courts.

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