MANAGING RELATIONSHIPS WITH INDEPENDENT CONTRACTORS

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INTRODUCTION

During the ‘90s many companies went through a process of downsizing or, as it euphemistically became known, rightsizing. When better times returned many entities did not respond by merely hiring more employees. Instead, the late ‘90s was characterized by a proliferation of independent contractors engaged as consultants, advisors or agents. Often the term used for this was outsourcing or “contract employees”.

Independent contractors have always existed. Lawyers in private practise are perhaps a classical example of the truly independent contractor. Although they work for individuals and corporate entities, a lawyer in private practice would never be considered to be an employee of their client. However, it is possible for lawyers to be employees, especially in the situation where they are “in-house counsel”. The line between a lawyer in private practice and one who is acting as in-house counsel may be easily drawn. That is not always the case however with other individuals ostensibly being hired as independent contractors but acting very much as if they were part of the organization.

There are numerous reasons why both individuals and corporations prefer to characterise their relationship as that of an independent contractor and client as opposed to employer and employee. From the corporation’s perspective, an independent contractor presents far less complications in many circumstances. Income tax deduction at source is not required, CPP and E.I. premiums are not required, the rules under the Employment Standards Act do not apply and although courts are now finding, in many circumstances, that quasi-employment contracts require the same or similar notice, it is possible for companies who engage independent contractors to insist on very short notice provisions in engagement contracts with Independent contractors. Such short notice periods would
be contrary to employment standards legislation and therefore void \textit{ab initio} if the individuals in question were employees.

However, there are pitfalls for both individuals who wish to provide their services as an independent contractor and for corporations or other entities that wish to take advantage of their services.

\textbf{THE LEGAL FRAMEWORK}

Surprisingly, there is no single definition of the term “employee”. In fact an individual who may be found to be an employee for the purposes of one statute will not be an employee for the purposes of another. Often the definitions of employee given in a statute are really very circular in nature. Sometimes an employee is defined as “a person employed by an employer” and the employer is defined as “a person who employs people”. This is probably because common law has long defined employees for various purposes such as master and servant and vicarious liability. It can not be overstated that the purpose for asking the question is in and of itself a factor to consider when determining whether or not a person is an employee within the meaning of the statute or the legal test in question. In 1997 the Supreme Court of Canada made it very clear that it expects courts and tribunals when examining this question to determine whether or not a particular individual has “employee” status to take into account the particular policy objectives of the statute in question \textit{(Pointe Claire v. SEPB Local 57, [1997] 1 S.C.R. 1015)}.

\textbf{THE LABOUR RELATIONS CONTEXT}

This purposeful approach is perhaps best illustrated by the various Labour Relations Acts throughout Canada. An individual who can quite appropriately be treated as an independent contractor for purposes of income tax legislation may well be an “employee” for purposes of labour
relations legislation. Both the Canada Code and the Ontario Labour Relations Act, as well as many other Labour Relations Acts throughout Canada contemplate a “dependant contractor” and consider a “dependant contractor” to be an employee for purposes of the Labour Relations Act.

Perhaps the best example of a dependant contractor as seen by the various Labour Boards throughout Canada is a truck driver who owns his own truck but drives it exclusively or almost exclusively for one engager. Many companies hire drivers in this fashion. Although they are treated as independent contractors for purposes of Income Tax, CPP and Employment Insurance, the terms and conditions of engagements are negotiated collectively and are subject to the terms of a Collective Agreement negotiated pursuant to the provisions of the Canada Code or one of the provincial statutes. The rational for this treatment is perhaps best expressed in the definition section of the Ontario Labour Relations Act. There dependant contractor is defined as follows:

“Dependent Contractor’ means a person, whether or not employed under a contract of employment, and whether or not furnishing tools, vehicles, equipment, machinery, material, or any other thing owned by the dependent contractor, who performs work or services for another person for compensation or reward on such terms and conditions that the dependant contractor is in a position of economic dependence upon, and under an obligation to perform duties for, that person more closely resembling the relationship of an employee then that of an independent contractor.”

There are a number of industries where individuals often work sometimes as employees, sometimes as dependant contractors and sometimes as independent contractors depending on the circumstances.
In the construction industry, it is not at all uncommon for a worker employed by a contractor for much of the time, to perform other work, usually on smaller jobs, which they contract for separately. In this capacity they may employ others to assist them. Thus an individual can be an employee, an independent contractor and even an employer all within the same relatively short time period.

Often the characterization of an individual as an independent contractor or a dependent contractor can have significant ramifications in the unionized construction sector. The designation will determine whether or not individuals are eligible for unionization and therefore whether they “count” when determining eligibility for voting or qualifying for a vote under the certification provisions of Labour Legislation. Under the *Ontario Labour Relations Act* only employees (and that includes dependant contractors) are eligible to take part in a union and collectively bargain. Although there have been no recent cases on point, the old tort of conspiracy would appear to still be available to counter any attempt by truly independent contractors to bargain collectively and to use the threat of withdrawal of services in furtherance of such demands.

Notwithstanding these difficulties, there are a number of sectors where “collective bargaining” takes place between businesses and guilds or “unions” where the status of the individuals involved has never been determined by the *Ontario Labour Relations Board*. The film industry has a number of guilds and “unions” who bargain on behalf of various classifications of persons engaged in film making. The Alliance of Canadian Cinema, Television and Radio Artists (“ACTRA”) bargains with the Canadian Film and Television Production Association (“CFTPA”) and produces an agreement commonly known as the Independent Production Agreement (“IPA”). This agreement is used to determine remuneration and terms of engagement on virtually every firm and television production of any consequence produced in the English language in Canada (except in British Columbia where an independently negotiated alternative agreement with similar terms is in place). Although hundreds
of millions of dollars per year are spent in Canada on actors and actresses engaged pursuant to the terms of the IPA, its status has never been determined by either a court or a competent Labour Board in Canada.

Other agreements in the film industry in Canada are even more questionable. The Director’s Guild of Canada negotiates various “Basic Agreements” either with individual production companies or with producer’s organizations throughout Canada. The various labour relations statutes throughout Canada deny employee status for the purposes of labour relations to persons who have managerial responsibility. Film directors might very well be considered managerial. They are also treated as independent contractors in their relationships with the various producers. Thus the status of the “Basic Agreements” has been and continues to be a legal difficulty for all parties concerned.

In the province of Quebec all of these agreements fall under the Status of Artist Legislation in that province. There is similar federal jurisdiction dealing with artists who work for federal works or undertakings. However, most film and television production in Canada falls under provincial jurisdiction. Other provinces however have no such legislation at this time. Therefore, outside Quebec much of the film industry operates in a legal no mans land and has for many years.

The issue can be important for more than the construction and film industries. A recent case before the Ontario Labour Relations Board dealt with whether or not wholesalers acting for the Toronto Sun were independent or dependent contractors. That case, *Toronto Sun* [1999] O.L.R.D. 504, (February 15, 1999) reviewed in detail the problems that often arise in attempting to characterize individuals as either independent or dependant contractors. Often such individuals have others who work for them. In the Board’s jurisprudence these persons are often called “helpers”. In the Toronto Sun case the Board found that persons under the Act must either be employees or employers but not both. That decision appears to indicate that an individual cannot be an employee for purposes of
the Labour Relations Act if they engage helpers or other employees to assist them in the work they do (although in previous decisions of the Ontario Labour Relations Board in the construction industry, construction workers having no more than one helper were considered dependent contractors and therefore employees).

Some parties have become quite creative in attempting to deal with these issues. The Residential Sector of the construction industry provides some examples. Residential roofing is generally performed by a series of “crews” hired by a general roofing contractor engaged to roof an entire new subdivision. Normally the crews engaged by the roofing contractor have a “crew leader” who enters into a contract with the roofing contractor and arranges for the engagement of the other members of the crew. Usually any equipment which is provided to the crews is provided by the crew leader or the roofing contractor. A wide variety of arrangements between the crew leader and each of the individual helpers on the crew are common. Some are paid an hourly rate, others obtain a percentage of the piece work rate by which the crew as a whole is remunerated. Other crews are more like true partnerships where the various members merely share the total remuneration paid by the roofing contractor.

After a series of complex hearings, which went on at the Labour Board for several years, (referred to by the Board and many of the participants as “the shingle wars”) the parties have entered into agreements which are called Collective Agreements but are signed by the contractors, the crew leaders, and the union. The crew leaders are treated as both employers and employees in these agreements. They have certain obligations towards their helpers, but also have certain rights under the agreement vis a vi their arrangements with the roofing contractors. It remains to be seen whether the terms of these agreements will be enforced should the matters ever reappear at the Ontario Labour Relations Board.
EMPLOYEES OR INDEPENDENT CONTRACTORS UNDER OTHER STATUTES

Under the *Workers' Safety and Insurance Act*, workers are entitled to disability benefits if they are injured on the job. In exchange for the right to obtain such benefits, the worker is prohibited from suing the employer for negligence. This arrangement is administered by the Workers Safety and Insurance Board (formerly the Workers Compensation Board) as well as the Workers Safety and Insurance Appeals Tribunal set up under the same statute. However, the issue of whether or not a particular individual is covered by the Act, and therefore prohibited from suing or eligible for benefits often turns on whether the person is an independent contractor.

The issues also arise in the context of employment standards legislation. Eligibility to overtime premiums, maternity leave, notice and severance pay, vacation pay and other provisions of the Act depend on status as an employee under such legislation. Some “engagers” have been responsible for a great deal of law on this subject. A long series of cases before the Workers’ Compensation Board, the Workers’ Compensation Appeals Tribunal and the Divisional Court dealt with the status of managers at Becker Store locations. In each case the fundamental issue was whether or not managers of Becker’s stores are employees of Becker’s or independent contractors. There have also been similar cases determined originally by referees appointed under the *Employment Standards Act* and later the judicial review of these decisions.

It is clear from all of these decisions, as well as others that neither courts nor employment related statutory tribunals will allow the terms of a contract, by themselves, to determine whether or not an individual is an employee or an independent contractor.

The distinction between independent contractors and employees was examined in the seminal case *Montreal v. Montreal Locomotive Works Limited et. al.* [1947] 1 D.L.R. 161 (P.C.). The four-fold test set
out by Lord Wright in this judgement remains the basis of analysis in virtually all these cases. Even where the statute in question has a definition for “employee”, the four fold test has been used to enhance that definition. It has been and still is the basis of the analysis by Revenue Canada and by the tax courts in determining the question for purposes of the *Income Tax Act*, the Canada Pension Plan and Employment Insurance legislation.

The four-fold consists of the following areas of analysis:

1. Control;
2. Ownership of the Tools;
3. Chance of Profit; and
4. Risk of Loss

The cases require a factual analysis of the actual relationship between the employee or independent contractor, and the engager. Courts and statutory tribunals will look beyond the wording of the contract and are quite prepared to find that an individual is in fact an employee even when the parties have determined amongst themselves that the relationship is one of engager and independent contractor. It is very important to note that even the most clever contractual drafting will not save the day if the facts don’t hold up under analysis.

The four fold test in *Montreal Locomotive* was further refined by Lord Wright himself later on in his judgement. He suggested that the crucial question to decide is “whose business is it?” The question is whether the party carrying on the business is carrying it on for himself, on his own behalf, or carrying it on on behalf of a superior. Lord Denning in an often quoted case *Stevenson, Jordan and Harrison Limited v. McDonald and Evans* [1992] 1 T.L.R 101 (CA) enunciated a “business integration test”. Under this approach the finder of fact looks to see whether or not the service
being provided (and the individual providing the service) is performed as an integral part of the business or done on behalf of the business but not integrated into it.

None of these tests are definitive in and of themselves. The many cases that have looked at the area evaluate all of the facts and take into account the purpose for the analysis being done (the legislative purpose) and come to a final determination based on the facts. The issue of control is perhaps the most important of the four outlined by Lord Wright in *Montreal Locomotive*. Where an individual is told not only what is to be done but the way in which it shall be done, the means to be employed in doing it and the time and the place where it shall be done is usually considered to be an employee. Where the individual performing the function in question has a greater deal of control over the how, the way, and the where, there is a greater likelihood that the individual will be found to be an independent contractor.

It is important to note that there can be considerable risk involved to both parties if they treat the relationship as one of independent contract and the relationship is later found to be properly one of employment.

**INCOME TAX CONSIDERATIONS**

There are risks for both the individual and the engager if the relationship is not properly characterized.

Firstly, as most people appreciate, an independent contractor has far greater latitude in deducting expenses incurred from earned revenue. Car expenses, in home office expenses, promotional expenses (in part) and many other expenses are eligible for deduction from revenue before declaring income for tax purposes. In addition, most types of business endeavours are eligible for
incorporation and therefore income splitting with one’s spouse or dependants is possible in appropriate circumstances. All of these tax advantages are denied to the employee.

The employer is required to deduct income for tax remittance at source before paying an employee. No similar deduction is required for an independent contractor. In the event the alleged independent contractor is later deemed to be an employee the employer can be liable for the tax that should have been deducted at source. Revenue Canada will in most instances go after the individual first, but the employer remains liable if the tax payer is unable to pay or can’t be found. If the scheme is deemed to have been an attempt to evade tax in which the employer participated, far more serious consequences are possible.

The individual takes the risk of having most of the alleged expenses of business disallowed by Revenue Canada if the individual is found to have been an employee. Although Revenue Canada will often apply the Act prospectively only (if they are convinced the relationship was entered into in good faith) they are not required to do so. Thus significant additional taxes, interest and potential penalties are at risk.

**CANADA PENSION PLAN AND EMPLOYMENT INSURANCE**

Both of these programs are administered by Revenue Canada. The test for independent contractor versus employee is the same as under the Income Tax Act. Under both pieces of legislation, the employer is required to remit an employer’s contribution and to deduct from the employee and remit that employee’s contribution. In the case of CPP, the independent contractor is required to remit twice the amount the employee contributes (in essence equal to the contribution made by both the employer and the employee), but this does not prevent the employer from being liable for payment of both its contribution as well as that of the employee in the event Revenue Canada is
unable to collect from the individual. The Department may seek to enforce the provision prospectively or can elect to seek retroactive payment for up to four years including interest and penalty. [*Canada Pension Plan Act; s. 22(3)*]

In the case of Employment Insurance, no benefits are available for the independent contractor and therefore no contributions are required. However, if the individual becomes “unemployed” and wishes to dispute his status as an independent contractor, he can obtain benefits if it is determined at the various levels of appeal that he was in fact an employee. In such case, the employer may be liable for payment of both the employee’s and the employer’s contribution for a retroactive period which includes all of the current year and up to three previous years including interest and penalty. [*Employment Insurance Act; s. 85(3)*]. If the employer has misrepresented the facts or committed fraud, the three year limitation in the case of this Act, or the four year limitation in the case of CPP does not apply.

It is important to note that the director of a corporation assumes personal liability for both of these payments under the respective Acts for the period when the deductions and remittances should have been made as if they were the employer. In one case in which I was involved, Revenue Canada sought to establish that the corporation involved had engaged employees on construction projects but paid them as independent contractors. The potential personal liability of the directors of that corporation under these two sections exceeded one million dollars.

I would strongly advise caution when advising engagers in this area.

**GOODS AND SERVICES TAX**

Bill C-62 received Royal assent on December 17th, 1990 after great debate. Notwithstanding promises to the contrary, the Act is still in place. It requires virtually all independent contractors who
earn more than thirty thousand dollars per year in total revenue from the business to obtain a GST number. Engagers who use these independent contractors must then pay GST in addition to the contracted amount. They in turn charge GST for their services and the amounts paid out by them to independent contractors can be deducted from the amount they remit to Revenue Canada for the GST charged by them. To obtain this credit, the engager must record and remit to Revenue Canada the GST number of the independent contractors engaged by them together with the amounts paid as GST to such persons or entities.

The difficulty with this program is the thirty thousand dollar exemption. It is often very difficult to determine whether or not an independent contractor who you engage has revenue from his position as an independent contractor in excess of thirty thousand per year. This is especially true in the construction industry where as previously discussed individuals are often both employees and independent contractors.

The introduction of the GST had one wholly unintended result: It drove even more of the construction industry into the “off the books” or black market economy. Obviously, any independent contractor who has revenue in excess of thirty thousand in any year must obtain a GST number and charge GST to the end user. This gives a competitive advantage to the small contractor who doesn’t earn thirty thousand per year – he doesn’t have to charge the seven percent GST. The effect on small businesses such as the small construction contractor is obvious. They can’t make more than thirty thousand without charging GST – so they don’t show revenue more than that amount and conduct a large part of their business for cash and without records. Estimates of the amount of untaxed business resulting from the introduction of the GST run into the billions per year. It’s important to note that when GST is not paid, revenue is not recorded and therefore no other tax is paid.
There is one potential advantage of the GST system to an engager of an independent contractor. By insisting that the individual provide you with a GST number, and by then remitting 7% GST to that individual on every account they render, an individual can make it much more difficult for Revenue Canada to question the bona fides of an independent contractor relationship which has subsisted for some time. I have seen several potentially expensive cases with Revenue Canada settled by insuring that all monies paid to all individuals claiming independent contractor status be subject to GST (and thus of course known to Revenue Canada for purposes of calculation of the individual’s Income Tax).

OTHER CONSIDERATIONS

All of us are familiar with the common law rule of employment in Canada regarding reasonable notice. Unless the amount of notice to be given on termination is specifically set out in the contract, the law implies a reasonable notice provision in every contract of employment. Employment Standards legislation sets the minimum amount of notice and/or severance that must be given to an employee but the implied “reasonable notice” required by the common law is in many instances significantly more than the minimums required by the Employment Standards Acts of the various provinces or of the federal government. This rule is in stark contrast to the “employment at-will doctrine” which underlines the law of employment in the United States.

Although the Employment Standards Act, and therefore the minimums as set out in that Act, do not apply to independent contractors, courts have long held that the concept of “reasonable notice” can be implied in many contracts of engagement between an independent contractor and the engager. The Ontario Court of Appeal in 1936 said this about such arrangements:
“There are many cases of an intermediate nature where the relationship of master and servant does not exist but where an agreement to terminate the arrangement upon reasonable notice may be implied.”

“. . .the contract was one which I think could only be terminated upon reasonable notice, reasonable notice would I think, under all the circumstances, be three months (Carter v. Bell & Sons Canada Limited [1936] O.R. 290 Judgement of Middleton, J.A, page 4).”

Many other cases have followed the reasoning in Carter and awarded reasonable notice damages to individuals and even corporation where a “quasi employment” or intermediate relationship exists.

Indeed, in some cases the principal of vicarious liability can also be applied to an independent contractor. In the case 671122 Ontario Limited v. Sagaz Industries Inc. (46 O.R. 3rd, 760) the Ontario Court of Appeal found that the relationship between an independent contractor and his engager was such that the engager was vicariously liable for the acts of the independent contractor. Again the court looked at an “organizational test” to find whether or not the actions of the independent contractor were an integral part of the business of the engager even though the work the independent contractor did was not integrated into such work but only accessory to it. The court makes the following determination (at paragraph 14):

“These authorities indicate that the “organization test” inquires into whether the agent or servant functions as part of the principal’s organization and whether an agent’s work is done as an integral part of the principal’s business. If the answers to these questions is yes
the principal is liable for the tortuous acts of the agent even though, as between themselves, the principal and the agent have chosen to designate the relationship as that of independent contractor.

What is clear from all the cases is that there is a considerable grey area between employee and independent contractor. If you are called upon to advise a potential employee, employer or independent contractor, you must examine the totality of the relationship in the light of the various tests that have been proposed by the courts. If the case is one that is “on the line” I strongly recommend that the risks of inadvertently referring to the relationship as one of independent contractor to both the employer and the potential independent contractor be clearly outlined. Having said this there are some way in which you can assist the parties to ensure that their “independent contractor” relationship is upheld by the courts or relevant statutory tribunals. They are as follows:

1. Ensure that there is a written contract between the independent contractor and the engager. Set out the service to be provided and the remuneration to be paid for the service.

2. Indicate if possible, that the service to be provided to the engager is not exclusive. In other words, set out those areas where the independent contractor will not be able to provide similar services to a competitive entity, but will allow the independent contractor to provide services to others who are not competitors whenever his or her services are not required by the engager.

3. Set out the material and expertise which the independent contractor will be required to independently bring to the task at hand. The more the resources of the independent
contractor and his independent expertise are required, the better the chance the independent contractor status will be upheld.

4. Indicate where the work will be performed. If the work will be performed exclusively on the premises of the engager, unless the work is of an exclusively service nature (i.e. service on the facilities themselves), the more difficult it will be to sustain the independent contractor status. However, it is possible that certain jobs clearly performed by an independent contractor will necessarily be performed at least in part on the premises. Management consultants and even lawyers are often required to attend on the premises in order to provide their service.

5. Set out in the written contract the term in which either party may terminate the arrangement and any obligations which will survive the termination of the contract. When setting out the termination provisions, take into account the termination provisions in the Employment Standards Act or other relevant legislation in case, notwithstanding your clients’ best efforts, the relationship is deemed later to be an employment relationship. In such case, if the termination provisions are not at least the minimum requirements under the Employment Standards Act, the termination provisions will be void ab initio.

6. The chances of success with respect to an independent contractor are better if the independent contractor is an incorporated entity. The incorporated entity can then agree to provide the services of its principal on terms more clearly set out. Make sure that the principal of the incorporated entity is also bound by the confidentiality and non-compete provisions of the contract where required.
7. Ensure that the independent contractor has a GST number and that GST payments are made on the receipt of invoices sent out by the independent contractor on a pre-arranged regular basis.

8. Ensure that the independent contractor is indeed providing a skill or service which he or she is in the business of providing, preferably not only to this engager, but to others. Where an individual has a history of providing similar services to various engagers, the chances of that person being found to be an independent contractor are considerably better than in the case where a particular individual is only providing and has only provided services to one engager.

9. Consider having payment made on a per job or per diem basis. Where the remuneration is made on a per job basis, it might be useful; to consider timelines for completion of the job and penalties or reductions in payment should the job not be delivered in a timely fashion. The chance of profit and risk of loss are important elements in a determination of independent contractor status.

10. If you are acting for the engager, you might consider requesting an indemnification clause in the agreement in the event that revenue Canada were later to determine that the relationship was one of employment and not that of an independent contractor. Absent such a provision, there may be no independent right to obtain indemnification for tax not deducted, EI, or CPP contributions.

CONCLUSIONS

As this paper was being written, Bill 147 received Royal accent. That Bill contains a completely redrafted Employment Standards Act for the province of Ontario. It is interesting to note that although the definitions of employee and employer included in the Act have changed slightly, in my
view those changes will not assist anyone required to make the determinations as discussed in this paper.

Although there is a considerable area of grey between the terms employee and independent contractor, it has been my experience that courts or statutory tribunals will not disturb an arrangement which has been honestly reached by the parties and which does not attempt to circumvent the requirements of the *Employment Standards Act*, the *Income Tax Act*, or other relevant legislation. Where there is some doubt as to whether or not the relationship is that of an independent contractor or an employee, the safest course is to treat the relationship as that of an employee.

There’s an old expression which sums this up in a decidedly non-legal fashion.

“If it looks like a duck and it quacks like a duck, it probably is a duck.”

Substitute the word employee and you have as good a test as any.