

YOUR DECLARATION OF INDEPENDENCE

by Craig A. Zawada

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Some businesses have fired all their employees, yet they seem to operate the same as ever. How do they do this? Well, they haven't really sacked all of their workers. Instead, they have converted their employees to independent contractors.

An independent contractor is someone who is providing work or services to another as an independent business unit. In other words, services are performed by an "outside" entity, instead of the company's own employees.

Employers and workers can each benefit from an independent contractor relationship. From the owner's end, there can be advantages through different labour standards rules. There is also a streamlined payroll process. Independent contractors are usually paid by the project, by the piece, or just for a specified term, without any deductions. For an employee, however, the salary/wages are paid, but only after deducting CPP, taxes, and other similar source deductions..

The benefits to the employee are even more attractive. For instance, Canada's *Income Tax Act* permits few deductions from employment income. Anyone running their own business (as an independent contractor) can potentially deduct many more items. Also, the contractor/employee gets all of his or her money, instead of a net amount after source deductions.

With these advantages, why aren't all employment arrangements structured as independent contracting? Because there some disadvantages.

For the worker, there obviously has to be some discipline in paying taxes. Instead of being able to rely on enforced saving through source deductions, the contractor will have to ensure that the money is available by April 30. That can be a tough goal for some.

This problem affects the employer. Canada Customs and Revenue Agency ("CCRA") is well aware of the potential for declining tax collection through independent contractors. They will regularly review arrangements to be sure they are truly independent. If they find otherwise (and if a court agrees), the employer can be liable for the taxes that could not be collected from the employee.

Despite this, many parties still enter into independent contractor arrangements, whether to advance worker relationships, remove ongoing liabilities from the books of the company, or for other reasons. There are some steps that **must** be followed if this is being considered:

- I. **Work within the tests that the courts and CCRA apply.** Unfortunately, no one test is applied to determine whether someone is an employee or contractor. Three of the big ones are:
 - a. *The Control Test.* The court looks to see if the worker is under the control of the employer (things like mandated working hours, ability to make binding decisions, or degree of supervision, to name a few). If the employer simply says "I don't care how you do this task, but have it done in one month", it points more to an independent arrangement.
 - b. *The Integration Test.* The importance of the worker to the overall business is examined here. For instance, reporters are integral to the operation of a

newspaper, and so are more likely to be employees. Conversely, an investment advisor may not be normally hired by a trucking firm, and so is not integral.

- c. *The Combined Test.* Under this, all kinds of factors are considered (including the other tests) to see whether it is more likely that a person is an employee. Some of the items examined are control, ownership of tools (e.g. does a driver supply his or her own truck to a transport company?), degree of financial risk taken, responsibility for investment and management, opportunity to profit, and many more.
 - d. It is impossible to predict which test will be used in a given case, so efforts should be made to meet as many of the criteria as possible.
2. **Observe all formalities.** If existing employees are being converted into contractors, be sure they truly are no longer employees. They must resign in writing, or be dismissed in writing. Records of Employment should be issued. Corporate resolutions authorizing the dismissal or accepting the resignations need to be done up. These kinds of steps are very important, as courts have found against arrangements which were not properly documented.
 3. **Reduce risks.** Businesses need to take steps to ensure the contractor is staying up to date on tax payments. If he or she is not, and the arrangement is later found to be employer/employee, you could be on the hook for source deductions that should have been made, plus penalties.
 4. **Examine all work systems.** Extreme care must be taken to ensure the independent contractors are not treated as if they were employees. A small example: if outside suppliers have never been invited to the company BBQ, consider not having the new independent contractors there either (or invite all your suppliers). This helps ensure that your arrangement will not be seen as a sham, with “business as usual” underlying it.
 5. **Obtain Professional Advice.** This is one area where it is especially dangerous to do it yourself. The rules are too complex, and the consequences too serious, to take any chances.

Despite the risks, there are situations where independent contractor relationships can provide win-win results. The key is to plan carefully, and pay special attention to details.

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