

Are You a Contractor or An Employee?

Are you an independent contractor or an employee? If this question sends shivers down your spine at tax time, you're not alone. The difference between an employee relationship and a business relationship is not cut and dried and having the Canada Revenue Agency determine that you're an employee after all can have very expensive repercussions for both you and your employer.

Employers like to hire independent contractors. Hiring a contractor means a lot less rigmarole than hiring an employee and can be less expensive, too. Contractors don't get benefit packages or pensions and pay their own CPP/QPP contributions. As an employer of an independent contractor, you don't have to withhold income tax or pay a share of CPP/QPP or EI.

The big tax advantage for the independent contractor, of course, is the potential for tax deductions. Generally, a self-employed person can deduct all reasonable business expenses.

Sounds great, doesn't it? But if a business hires a contractor who is later deemed to be an employee, both parties lose big as unpaid taxes, penalties, interest, CPP and EI premiums will all have to be paid.

Because the employee relationship and the business relationship is one of those gray areas that is constantly in flux, it's important to do what you can to protect your independent contractor status.

First, you need to be aware of the "four-point test" that the Canada Revenue Agency uses to determine which type of relationship exists. ["Employee or Self-Employed?"](#) (RC4110) "sets out a method that should, in most cases, allow payers and workers to determine the nature of their relationship." The method is based on four key points; control, ownership of tools, chance of profit/risk of loss, and integration. Let's look at each of these from the point of view of the contractor.

1. Independent contractor vs. employee: Control

The primary issue here is who's running the ship. Does the employer have the right to hire or fire, determine the wage or salary to be paid, and decide on the time, place, and manner in which the work is to be done? Then an employer-employee relationship exists. Note that "if the employer does not directly control the worker's activities, but has the right to do so, the notion of control still exists."

On the other hand, in a business relationship, the worker decides how the work will be performed. As a contractor, then, it's important that you maintain the right to decide where, when and how the work will be done. If it comes to the test, and you can show that you were the person responsible for planning the work to be done, choosing the hours of work, and/or setting the standards to be met, for example, you'll have a much better chance of being deemed a contractor rather than an employee.

2. Independent contractor vs. employee: Ownership of tools.

An obvious point, one would think; a contractor would supply his own tools. However, because it's customary for employees to supply their own tools in some trades (think of painters and garage mechanics, for example), the cost of using the tools is a much better indication, according to the Canada Revenue Agency. "When workers purchase or rent equipment or large tools that require a major investment and costly maintenance, it usually indicates that they are self-employed individuals, because they may incur losses when replacing or repairing their equipment."

What else does the Canada Revenue Agency take into account when examining the independent contractor vs. employee situation and what can you do to protect your tax status as a contractor?

The previous page of this article discussed two elements that the Canada Revenue Agency uses to determine whether a person is an independent contractor or actually an employee; control and ownership of tools. There are two other elements of the independent contractor vs. employee situation that are part of the Canada Revenue Agency's "four-point test".

3. Independent contractor vs. employee: Chance of profit/risk of loss.

In this case, whether you're involved in an employer-employee relationship or a business relationship depends on your financial involvement. Do you have a chance of making a profit? Do you run the risk of incurring losses due to bad debts, damage to equipment or materials, or delays? Do you cover the operating costs? If these three things are true, you're a contractor, not an employee.

4. Independent contractor vs. employee: Integration.

This appears to be a further attempt to divine the intention of the parties involved. The Canada Revenue Agency states, "Where the worker integrates the payer's activities to his own commercial activities, a business relationship probably exists... Where the worker integrates his activities to the commercial activities of the payer, an employer-employee relationship probably exists." Exactly how one would determine such integration is not laid out. "Employee or Self-Employed?" seems to treat this point as a summary category calling for a review of the other three.

It would seem to me that one obvious way of "proving" integration to your own commercial activities would be to have multiple clients. The contractor who only has one client makes it too easy for others to perceive his relationship with that client as an employer-employee one.

Also, as a contractor, to protect yourself, you should always enshrine your relationship with each employer in a contract, focusing on the first three points of this four-point test. "Having a carefully crafted written agreement setting out the intentions of the parties may offer some protection if one of the parties subsequently changes his or her mind and argues that the relationship is not what it was purported to be," says Anthony Strawson, (CMA, LLB, BComm), in "[Employee or Independent Contractor](#)". It will also help stave off being "recategorized" by the Canada Revenue Agency.

In summarizing the case law on the independent contractor vs. employee situation, Mr. Strawson points out that the issue is not clear cut, and that while there appears to be a trend towards a more flexible interpretation of the business relationship of a contractor and an employer, the final determination of whether a person is an independent contractor or an employee will always depend on the individual facts and circumstances of the case.

Some employers seem to view incorporation as “proof” of independent contractor status – to the point that they will only do business with incorporated contractors. While being incorporated could conceivably be one point of evidence showing an arm’s length relationship between a contractor and employer, it isn’t proof of a business relationship in itself.

As a contractor, it behooves you to take what measures you can to ensure that your status as an independent contractor is clearly defined. If you have and are still uncertain about whether you’re actually an employee or an independent contractor, discuss the issue with your professional advisor and/or contact [the Canada Revenue Agency](#).