Avoiding employee vs contractor disputes

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The status of a particular worker as an employee (*i.e*. engaged under a contract of service) or an independent contractor (*i.e*. engaged under a contract for service) has many important consequences for both the worker and the employer/hirer, including:

- the obligation on employers to withhold income tax from employee compensation and remit such amounts to tax authorities;;
- premiums under the *Employment Insurance Act*;
- contributions under the Canada Pension Plan;
- provincial labour and employment standards laws (*e.g*., vacation pay, holiday pay, termination pay, etc.) applicable only to employees;
- the Goods and Services Tax (GST);
- the filing of income tax returns (these differ for both parties depending on whether the worker is an employee or not);
- deductions from income (these are greatly limited for employees relative to independent contractors); and
- the tax treatment of stock options (separate rules applicable to employee stock options).

The legal consequences of mis-classifying a worker can be very serious, and particularly in today's economy, there is often considerable uncertainty on this issue. The legal test to determine whether a person is an employee or an independent contractor can be simply stated: essentially, what must be determined is whether the individual is performing services as a person in business on his/her own account.

However, simply stated, the test can be difficult to apply. The totality of the relationship of the parties has to be considered in light of the various factors identified in the case law as being relevant to this determination. Disputes principally arise where relationships have aspects of both employee/employer and independent contractor/hirer relationships, or where the arrangements are not properly understood and/or documented. Such disputes can arise because tax authorities challenge the worker's status, or where the worker him or herself does so (this occurs most frequently where a terminated worker sues the employer/hirer seeking employment-related benefits).

Hirers and workers benefit from having clearly delineated relationships, as well as systems and protocols in place to ensure their arrangements are properly understood and documented. This greatly reduces the chances of disputes with the tax authorities.

What you need to know

- The status of workers as employees or independent contractors has significant tax and employment law consequences for both workers and employers/hirers.
- The status of workers is an issue that generates a significant amount of disputes and litigation. The test can be difficult to apply where relationships are not clearly set out.
- Workers and employers/hirers should understand the issue, structure and document the terms and conditions of their working relationships to achieve the desired legal status, and conduct themselves in practice in a manner consistent with that desired relationship in order to avoid costly disputes and litigation.

Recent jurisprudence

Two recent decisions are a reminder that the issue of worker characterization remains one of the most frequently litigated issues in the Tax Court of Canada, and usefully illustrate how to analyze this question.

WCT Productions MCT Ltd. v. MNR, 2022 TCC 107

On Sept. 22, 2022, Justice Biringer decided the matter of WCT Productions MCT Ltd. (WCT), a case dealing with the status of highly skilled workers engaged by WCT in its business of providing special effects and animatronics for movie and television productions. WCT appealed a determination of the Minister of National Revenue that these workers were engaged in pensionable and insurable employment for purposes of the *Canada Pension Plan and the Employment Insurance Act*.

In her reasons, Justice Biringer describes the two-step process that courts carry out in order to make the determination whether a person is an employee or an independent contractor (in provinces or territories other than Québec):

- *The first step is to determine whether there is common intention or mutual understanding of the parties regarding the nature of their relationship* - To determine the intention of the parties, courts will consider the testimony of witnesses and other evidence. The intention can be determined by a written contract that the parties have entered into or by the behaviour of each party. The parties' intention can also be revealed in documents such as invoices for services rendered, the registration of a worker for GST purposes, and income tax filings by a worker as an independent contractor. A mere declaration of intention is not sufficient.
- *The second step requires analyzing the facts of the case to determine whether the objective reality of the situation supports and is consistent with the parties' intention - The determination of the legal nature of the relationship between the parties must be grounded in "verifiable objective reality"*. The factors to consider in this analysis may vary depending on the circumstances. However the following, known as the Wiebe Door factors, are usually considered relevant:
    - he extent of the employer/hirer's control over the worker;
    - ownership of the tools and equipment used by the worker;
    - whether the worker has the ability to hire helpers; and
    - the extent of the worker's opportunity for profit and risk of loss.[1]

The relative weight of each depends on the facts and circumstances of the case.

Justice Biringer found that while WCT and the workers did not have a written contract, the evidence established that the parties had a common intention or mutual understanding that the workers were engaged as independent contractors. Also, on balance, the Wiebe Door factors supported the independent contractor status. In particular, Justice Biringer appeared to find especially persuasive the facts that workers were free to work for other businesses at any time and that WCT did not guarantee the workers any minimum number of hours or projects. As such, she concluded that the workers were independent contractors and allowed WCT's appeal.

***Kassem Mazraani v. MNR*, 2022 TCC 109**

On Oct. 4, 2022, Justice Smith issued his judgment in the matter of Kassem Mazraani. Mr. Mazraani worked as an insurance sales agent for Industrielle Alliance, Assurances et Services Financiers Inc. Following his termination, he sought a determination as to whether he was engaged in insurable employment for purposes of the *Employment Insurance Act.* The Minister thought not. He appealed the issue before the Tax Court of Canada. Mr. Mazraani's appeal was heard over a five-day period. Industrielle Alliance, Assurance et Services Fincancies Inc. was an intervenor in the case.

Justice Smith noted that where the applicable provincial law is that of Quebec, the relationship between the worker/hirer must be analyzed in light of Quebec civil law and consideration must be given to the relevant provisions of the *Civil Code of Québec*[2]*,* which provide as follows:

- In interpreting a contract, the following will be taken into account:
    - The common intention of the parties to the contract, rather than adherence to the literal meaning of the words
    - The nature of the contract
    - The circumstances in which the contract was formed
    - The interpretation already given to the contract
    - Usage
- Under a contract of employment, the employee undertakes to do work for remuneration under the direction or control of the employer.
- Under a contract of enterprise or for services, the contractor or provider of services is free to choose the means of performing the contract and no relationship of subordination exists between him/her and the client.

As Justice Smith points out, "once the court has addressed the subjective intention of the parties, it must then review the 'verifiable objective reality' of the relationship". In the analysis, the factors with the greatest impact are the *Wiebe Door* factors.

Mr. Mazraani had signed a contract that clearly provided he was an independent contractor. Moreover, after undertaking an objective reality of the workplace, the Court concluded that the he was engaged in a "contract of enterprise", since he "was free to choose the means of performing the contract" and, in connection with such performance, there was no "relationship of subordination". As such, Justice Smith dismissed the appeal.

Avoiding disputes

Workers and employers/hirers should have a clear understanding of both the importance of correctly characterizing the working relationship (i.e., employer/employee or business/independent contractor) and the tax and labour law consequences that result from that characterization. Counsel experienced in this area can help in a variety of ways, in order to avoid costly disputes and litigation:

- identifying the tax, labour and employment law implications for both parties of the different legal relationships;
- explaining the factors that, in the particular circumstances, are likely to be most relevant to making this determination in the particular circumstances;
- drafting the legal documentation that sets out the relevant terms and conditions of the desired legal relationship, so as to achieve that result; and
- assessing potential exposure for existing risks with the current workforce of the business, along with strategies to mitigate those risks

All of this is properly done within a confidential lawyer-client relation that creates privilege over the discussion and resulting work product, and is much more cost-effective than responding reactively to an unexpected challenge from tax authorities, provincial employment standards regulators or disgruntled ex-workers. While worker classification disputes are occurring with increasing frequency and inherently involve significant uncertainty, getting ahead of the issue and proactively managing it is a prudent course of action.

For more information on avoiding employee vs contractor disputes, please reach out to one of the Key Contacts listed below.

[1] Wiebe Door Services Ltd. v. M.N.R., [1986] 3 F.C. 553, which was later approved by the Supreme Court of Canada in 671122 Ontario Ltd. v. Sagaz Industries Canada Inc., 2001 SCC 59.

[2] See sections 1425, 1426, 2085, 2086, 2098, and 2099 of the *Civil Code of Québec*.

By

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