

Employee, or Self-Employed Worker? *Knowing the Difference has Tax Implications*

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In some fields, they're known as freelancers. In others, they're called contractors. Either way, companies often use self-employed workers instead of hiring permanent staff as a means of reducing costs. The line between "employee" and "self-employed" can be a fine one, however, and as accountants we need to clearly understand the distinctions. This way we can help our clients — be they employers or self-employed workers — to avoid unexpected, and adverse, financial consequences.

The Canada Revenue Agency closely scrutinizes the contracting-out of services and may examine each case individually. Employers must ensure that the correct employment status is reflected in the relevant terms and conditions of employment. The following pointers represent the factors that are typically considered by CRA.

Control

An important determinant of employment status is the level of control the employer exercises over the worker. For example, does the employer direct or supervise the work, control how the work is performed, or set required hours? Does the employer determine and dictate the method and amount of pay? Is this income a significant portion of the worker's earnings, or even all of the worker's earnings (indicating economic dependency)? Does the worker require permission to work for other employers and have the freedom to sub-contract or send replacements?

In the case of professional workers who generally require less supervision, the first questions above may be less relevant. The latter questions may carry more weight.

Tools and Equipment

CRA will consider who owns the computers, phones or other equipment used to perform the work, as well as where the work is taking place. A self-employed individual will often perform a substantial amount of the work from their own home or office while an employee usually comes to the employer's location.

Ongoing Expenses

Self-employed individuals incur ongoing fixed costs that are not directly reimbursed by an employer, such as office rent, telephone and internet service. The presence of these expenses helps provide CRA with a more definitive differentiation between "employee" and "self-employed."

Responsibility for Investment and Management

An established business presence may further indicate to CRA that the worker is, in fact, self-employed. Consideration may be given to whether the worker has capital business investments, such as machinery, and whether they hire and pay other individuals. Such

significant investment on the worker's part may be seen as evidence that an employee relationship does not exist.

Opportunity for Profit and Risk of Loss

Employees incur expenses directly related to their jobs, such as automobile and other travel costs. Normally, these costs fall below the employee's level of compensation, and CRA does not consider them as "loss."

Self-employed individuals, on the other hand, face the risk of loss — and also the expectation of profit — because they pursue and accept contracts as they see fit, negotiate the price for services, and may offer services to more than one client at a time. Self-employed individuals usually incur expenses to fulfill the terms and conditions of contracts, and are able to increase their proceeds and/or decrease their expenses in order to increase profit.

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As well as ensuring that the appropriate status is reflected in the terms and conditions of the work, the employer must treat a self-employed individual differently than an employee. A self-employed person should not, for example, receive benefits or attend a staff outing at the company's expense.

Giving work to self-employed individuals can be financially advantageous for employers. They are spared EI and CPP payments, the administrative costs of withholding employee payroll taxes, and, in the event of termination, frequently pricey severance packages. Self-employed workers, for their part, benefit from lower taxes; they are able to deduct many of their expenses.

As long as the lines are clear and correct procedures followed, everyone concerned — including CRA — can be comfortable with the results.

Sidebar

Putting it in Writing

It's important to spell out the terms of the contract with a self-employed individual. The following contract provisions will provide evidence to CRA that a worker is a self-employed contractor and not an employee:

The contractor will:

- Invoice the employer for services rendered in many cases through a registered corporation, partnership, or sole proprietorship
- Supply their own tools to perform the work, including a home office, computer, cell phone, and vehicle
- Accept the contract for a specified limited time, for a specified project, or at a specified fixed price or rate regardless of the time required for project completion.

The contractor is:

- Permitted to offer services to other clients during the contract period
- Exempt from adhering to specific company policies and disciplinary procedures
- Responsible for directly remitting income taxes to the CRA and premiums to EI and CPP
- Able to, with discretion, subcontract all or part of the work to be performed