

Independent Contractor or Employee?

As owner managers, you know as well as anyone how challenging it can be to stay on top of the administrative requirements that come with running a business. With all of the headaches caused by the seemingly endless piles of paperwork that your business produces it is no wonder why managers often go to great lengths to make their lives simpler. However, as a decision maker, you need to be aware that the easiest solution is not always the best one. One area in particular where following a strategy of simplification can lead to peril is through electing to classify your staff as 'independent contractors' rather than as employees.

From an administrative perspective you may be tempted to classify the people working for your company as independent contractors. This is because, for a company hiring the services of an independent contractor, there is no requirement to remit or file the same payroll source deductions (Canada Pension Plan contributions, Employment Insurance premiums, and Income Taxes) that would be required for remuneration paid to employees.

However, as with most things, when something sounds too good to be true there's a strong chance that it is. From the perspective of the Canada Revenue Agency (CRA), not all service providers can be classified as independent contractors. In order for this classification to be warranted certain conditions must exist in the relationship between payer and service provider. Misapplying this classification can have dire consequences for the payer.

When the CRA determines that a service provider originally classified as a contractor is actually an employee, that employer can suddenly find itself on the hook for all unpaid payroll source deductions (both their share and that of the employee) along with penalties and interest to boot, which over time can amount to a lot! To ensure that your organization does not find itself in such a precarious situation it may be time to re-evaluate the relationship that you have with

your service providers to ensure their classifications are appropriate in the eyes of the CRA.

When assessing the type of relationship that exists between a company and a service provider, you need to look at the following areas:

- Who in the relationship has control?
- Is there is any financial risk incurred on behalf of the service provider as a result of their dealings with your organization?
- Who owns the tools and equipment used on the job?

Control

The biggest difference between an employee and a self employed contractor is that, when you are self employed, you get to be your own boss. This is why, when assessing whether or not a service provider is an independent contractor or an employee, you need to assess who in the relationship controls the work being performed by the service provider. Some useful questions that you can ask to determine where control lies in the relationship include:

- Who in the relationship determines how and when the work is performed?
- Is the service provider given training and oversight by your company or are they largely self sufficient?
- Is the service provider able to work for other clients while engaged by your company?
- Is the overall business relationship between the service provider and the company one of subordination or do both parties operate on equal footing with one another?

Chance of Profit / Risk of Loss

Employment is typically not thought of as a risky prospect. Employees go to work, receive steady remuneration and do not incur any real financial risks along the way. Normally any expenses incurred on the behalf of the employee are reimbursed.

In contrast, independent contractors are self employed which means that they run their own businesses. Like all businesses, independent contractors incur financial risks in order to generate profits.

As such, when differentiating between employed and self employed workers, the CRA looks at the level of financial risk incurred by the service provider as a result of their relationship with the payer company. The expectation is that an independent contractor would incur the same financial risks as would a normal business.

Therefore when evaluating the relationships that exist between your company and its service providers to determine if financial risk is incurred you should establish whether the service providers:

- incur operating expenses in order to generate profit;
- are financially liable for not fulfilling the obligations set out in their contract;
- do not receive any benefits or protection from the payer;
- are hired to perform a specific job rather than as a part of an ongoing relationship
- can hire assistants (to either complete the work or help complete the work), have complete say in who is hired, and pay the associated costs

Questions or comments?
Email us at
office@logankatz.com
or call 613-228-8282 ext 0.

Independent Contractor or Employee?

Who owns the Tools and Equipment?

Another difference between employees and independent contractors in the eyes of the CRA is that while typical employees are not expected to supply their own tools and equipment on the job, independent contractors are. In the eyes of the CRA, what is of particular relevance in this regard is the significance of the investment made in tools and equipment.

The logic that the CRA follows is that if a worker owns the tools and equipment which is both expensive and necessary to the performance of the job, this establishes two things about the relationship that the worker has with the company. For one it establishes that the worker is in control of a significant facet of the work being performed. Secondly, having made a significant investment in equipment implies that the worker has incurred financial risk from the investment. As discussed above, having control and the presence of financial risk are both key determinants when classifying a service provider.

There are also other factors the CRA could consider in their assessment of the relationship between your company/organization and its service providers. For more information, consult the CRA publication **RC 4110 Employee or Self-Employed** at www.cra.gc.ca.

If after reading the steps above you find that the service providers that your company deals with are actually employees in the eyes of the CRA it would be advisable that you make the appropriate remittances and filings and that employment agreements be entered into.

If, on the other hand, you are satisfied that your service providers meet the definition of an independent contractor, there are some things you can do to ensure that your classification stands up to the scrutiny of CRA auditors.

To eliminate any grey areas in your relationship it would be advisable that your company have independent contractor agreements drawn up that include clauses which clearly demonstrate that the service provider exhibits the traits discussed above.

Every independent contractor should issue invoices to your company/organization for their services. Moreover, it is suggested that the independent contractor obtain a business number (BN) and collect GST on the value of their services. The BN should appear on their invoices.

Finally, your company/organization should annually issue T4A slips to all service providers to whom aggregate payments in excess of \$500 were made.

Note that payments made to incorporated entities providing services do not represent any risks for the payer that CRA may challenge the relationship and conclude they are employees. As a result, for greater certainty you may ask that your independent contractor service providers offer their services through a corporation.

Residential Condo Fees and the Home Renovation Tax Credit

If your condominium or co-operative housing corporation has incurred eligible expenses for work done to the common areas, your share of the costs may qualify for the **Home Renovation Tax Credit**. Please contact your condominium association for more details.

Enhancements to Ontario Apprenticeship Training Tax Credit

Pending Royal Assent, the 2009 Ontario Budget proposed enhancements to the Ontario Apprenticeship Training Tax Credit (please see the May 2007 Learning Kurve at www.logankatz.com/publications for more details on the tax credit), effective for expenditures incurred after March 26, 2009, that would:

- increase the 25 per cent ATTC rate to 35 per cent and the enhanced 30 per cent rate for small businesses to 45 per cent;
- increase the \$5,000 annual maximum tax credit to \$10,000;

- extend the ATTC to salaries and wages paid during the first 48 months of an apprenticeship program; and
- make the ATTC a permanent tax incentive.

This 'n That at Logan Katz

New at Logan Katz

Don Armstrong has joined Logan Katz's Financial Reporting Services group. Don will be pleased to provide bookkeeping assistance and bookkeeping software training and support. We look forward to introducing Don to our clients.

Logan Katz in the Community

On October 23rd, Denis Chainé spoke to an audience of more than 40 donors to various Ottawa charities about the tax benefits of planned charitable giving.

Logan Katz was honoured to be a returning sponsor of the *Fundamental Knowledge Exam* at the 6th annual University of Ottawa Accounting Competition held on October 16th and 17th.

Logan Katz is proud to be a contributor once again to the annual *Scotiabank/United Way Charity Auction* to be held on November 4th, 2009.

On Saturday, September 13th, Gary Katz was one of thirty cyclists pedaling 54 kilometres to raise over \$60,000 for the Hillel Lodge Long Term Care Facility.

Logan Katz was a sponsor of *An Evening with Abigail* at the Great Canadian Theatre Company, helping raise \$150,000 for the Ottawa Regional Cancer Foundation in its fight against Breast Cancer.

Tax Planner Guides

The Logan Katz *Personal Tax Planner Guides for 2009-2010* are now available. For a complimentary copy, please contact us or submit your request through our website at www.logankatz.com