Defining the difference: employee or independent contractor. The legally-recognized choices of selling one's services today are as an employee in the traditional sense or as a business person who is selling one's services

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There are few matters which give as full expression to our goals, purpose, and sense of accomplishment as the productive work that we do to earn our livelihood. It is not only our source of income, but also our self-actualization of what we want most to do with our lives and of whom we are as human beings. People are more often known by what they do for their life s work than by any other status or activity.

It is not surprising then that despair attends an unsatisfying or uncertain job or the loss of one s job. Ours is a society which places great emphasis on productive output, skill, and economic advancement. Policy makers have maintained that a multitude of social problems would decline if only people could enjoy the fulfilling work that they desire. No wonder governments and politicians today see job creation as one of their main moral imperatives.

The termination of individual employment has been the pre-eminent focus of employment law, much as divorce has been the essence of family law. The second most law-intensive subject in employment is human rights, mostly non-discrimination in the selection and dealing with workers throughout the employment relationship.

Yet the characterization of the nature of the work and worker at the beginning of the relationship is currently becoming the most compelling focus for the law. Most people have heard it said that the old model of lifetime employment where one started young in an organization, rose steadily, and retired with an adequate pension is now left only as fond reminiscence by grandparents. In its place, we find a new model that emphasizes lifelong learning, marketing one s skills and abilities, short-term contract opportunities, ingenuity, retirement planning, the virtual office, niches and core competencies, flexibility, and consulting.

The essential nature of the work relationship is the most important threshold question in the world of work, one which carries considerable legal consequences. This article will describe why it is so critical to know which category you are in and, to the extent you can influence such things, how to structure the relationship to your advantage.

Employee or Business Person Selling Services

The legally-recognized choices of selling one s services today are as an employee in the traditional sense or as a business person who is selling one s services. It is easy to see the service business person as a consultant, but while that is a good example of a service provider in business, it is too limiting. For example, professionals such as lawyers and dentists would not easily fit the generic notion of a consultant. Other occupations such as plumbers and taxi drivers are business people who sell their services. We would not normally refer to them as consultants. Hence, the somewhat more inclusive, if cumbersome, term of service business person.

Like obscenity, employment may be hard to define, but it is easy to recognize when we see it. It usually means the indefinite relationship where the worker (employee) stands by to perform responsibilities on a regular and continuous basis at the request of another person (employer). In return for the employee s dedication and fidelity to the employer s overall purpose, the law implies certain obligations on the part of the employer. These include requiring the employer to give the employee reasonable notice of termination (or full pay in lieu of that), which period furnishes an opportunity for the employee to find alternative work arrangements. This acknowledges the employee s sacrifices for the employer to keep commercial secrets confidential, to apply one s personal skills for the benefit of the employer, to refrain from working for a competitor at the same time, and to be available (usually on a full time basis).

There can, of course, be part time and temporary employment. Nor does it have to be indefinite. It can be for a fixed period of time. The relationship need not be expressed in writing unless it is for a fixed period of time over one year. This type of work relationship developed as employment. Even where the parties did not use the term at the time of making the agreement, the relationship would usually constitute employment by default. In Canada, the employment relationship is a specialized form of contractual relationship. Over the centuries, certain moral expectations arose that had to do with employee incapacity due to illness (Dartmouth Ferry Commission v. Marks, 1903-04), the voluntary provision of group benefits and, especially today, the employer s obligations to share its profits with its workers, and preserve jobs during economic hardship of the employer.

In the last two decades, we have seen a new way grow in which to sell one s services. It has always existed in commercial relations in the sense that we could always buy services like a haircut or a train ride. The change is that many people in less discrete occupations began to offer their services for sale on an individual basis. Ultimately, even employees are individual business people because they seek out and enter into the best business deal for their services. When they find a better deal, they quit and work for a different employer. This was all subsumed under the umbrella of employment. Even the federal Income Tax Act phased out its nominal employment expense deduction , in 1985, under the rationale that employment is not a business on the part of the employee.

Accordingly, these independent service people maintained that their episodic services, frequently of no recognized type and freely replaceable, were their business in the same way as selling consumer products like coffee makers and pork bellies. Under our liberal theory of freedom of contract, they could structure each definable service output as a contract. People who were under-employed or unemployed could go out and sell their services like plumbers making house calls to fix faucets. They were in the service business, and no one would even think of their plumber or hairdresser as an employee.

Another factor encouraged employers to shed employees and take them back as service business people (called independent contractors in law). This was the high cost of government regulation of employment in the form of payroll costs (employer contributions), red tape, and limitations on managerial prerogative in human rights issues (including employment equity) and termination. If independent contractors are a lower legal risk and lower cost alternative to employees, the number of independent contractors was certain to grow.

What is a Contract Worker?

Technically, the term contract worker is not helpful in describing the category of work. Both employees and independent service business people are parties to contracts. As pointed out above, employment is a contractual relationship. On the other hand, in common usage it usually refers to the latter category, since most independent business service contracts have an end date on them, while most employment is indefinite in nature.

The law also refers to employment as a contract of services and the independent service business as engaged in contracts for services. While subtle, this terminology helps to explain the difference in intention and nature of the service. A commercial firm might hire another firm to provide a service, without contracting (as in employment) with a particular individual to render that service.

Why is the Distinction Important?

There are a number of reasons why both parties to the work relationship need to know which category they are operating in.

Employment is Regulated by Statute

At the provincial level, employment standards, workers compensation, labour, and occupational health and safety statutes apply exclusively to the employment relationship. Federally, employment insurance, pension plan, and income tax legislation applies in the same way. The business receiving the services needs to know whether to make and remit payroll deductions (entailing monetary and administrative cost). The costs of doing business may also be increased by the need to meet rules about minimum wages, statutory holidays, overtime and vacation pay. There are serious sanctions against a company not making payroll deductions as required, and corporate directors can be held personally responsible for them.

Workers also need to know because deductions will be made from their pay cheques for these things. Workers need to know whether they are eligible for pensions, benefits programs and employment insurance. They need to know whether they are bound by confidentiality and whether they can work for several different organizations at the same time. The federal copyright law states also that creative works generated in the course of employment belong to the employer, unless there is a written contract to the contrary.

Labour legislation permits only employees to unionize and bargain collectively.

Common Law Regulation of Employment

The common law is even more generous to dismissed employees than legislation. Both parties to the service relationship need to know whether reasonable notice has to be given to end the contract. In indefinite employment such notice is required; fixed term non-employment service contracts usually expire on the last day without further notice by either party.

Employer vicarious liability for the wrongful actions of an employee in the course of employment, is not strictly applied to independent contractor situations. While it may be possible to pursue a principal for the wrongdoing of a consultant on some kind of agency basis, success of that action would be much more remote than in an employment relationship.

How to Distinguish an Employee from an Independent Contractor

How can a work relationship be structured as employment or an independent service contract? The answer to this is that this all depends on the circumstances of the specific case. Lawyers are also apt to say,, that the substance of the relationship is more important in characterizing it than the form given to it. In other words, what the parties are really doing is more important than what they say they are doing. In this case, actions speak louder than words.

Interestingly, the leading legal tests to distinguish an employer from an independent contractor arise out of income tax law, which seeks to examine the relationship between the worker and his source of income. The table on page 12 illustrates the legal tests which are applied and the essential differences between the two categories of contracting for services.

Conclusion

When one pays an accountant to complete one s tax returns, a plumber to fix the leaky sink, or a taxi operator to drive somewhere, one never thinks of these people as employees. Likewise, most people and businesses understand when they are parties to employment relationships, if only because of payroll deductions and expectations which will be expressed or understood early in the relationship. This is the historical paradigm distinguishing employees from business people selling services.

The modern uncertainty lies in attempts by both sides to structure an independent contract relationship for mutual advantage such as the minimization of payroll costs, income taxes, and to maximize flexibility and freedom. One can readily see the trade-off advantages to both service provider and recipient to depart from the traditional model of employment. As payroll costs and legal obligations to employees continue to increase, employers will prefer a more flexible out-sourcing structure. As taxes, payroll deductions, and employment uncertainties increase, workers will prefer the same. Even some employees would likely prefer to be able to sell their exclusive full time services to their one employer through their personal services company, but the tax legislation ignores this structure and allows taxation on the basis of employment.

The law always lags behind commercial and social practice. The public regulatory and taxing authorities will continue to expand the definition of employment in order to govern it and tax it. This is the legal all or nothing approach to traditional employment, which is rapidly becoming a remnant of the past. The law s penchant to develop rules to put service providers in distinct categories may be expected to continue for the short term. Meanwhile, service providers and recipients will creatively structure their formal relationships to challenge those categories where to do so is in their own best interests.

This subject is one that is constantly evolving. Alberta is at the forefront of North American jurisdictions where service providers and recipients are experimenting with new forms of exchange of service and money. It is likely that already several hundreds of thousands of service arrangements structured as independent contracts, if they were audited, would be deemed to be employment under the tests identified in the chart. This would lead to them all being liable for payroll costs, taxes and penalties. They would be forced into a legal category that they did their best to escape. One has to question the role of government in structuring such business relationships. If all the government seeks to achieve is minimum standards and revenue, it may have to soon face developing a whole new paradigm to meet these objectives.

While much of the present pre-occupation of the law is on termination and human rights issues, it seems that the very threshold essence of how the sale of services will be governed will bring the world of work and business full circle in the next century.

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