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THE PITFALLS OF CLASSIFYING WORKERS AS INDEPENDENT CONTRACTORS

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Canadian companies often seek to shed the label "employee" and simply hire individuals on contract, classifying them as "independent contractors." Often, the "independent contractors" pressure employers to bestow this status for tax reasons.

Employers must withhold and remit payments for employees on account of government agencies such as CRA, CPP and EI. By contrast, companies that hire individuals as independent contractors do not make these deductions or remittances, nor do they provide workers' compensation or other health, insurance or pension-related benefits.

There are, however, potential pitfalls involved in the hiring of independent contractors. Simply applying the label of "independent contractor" does not make it so, and misclassification frequently occurs. Problems can also occur when an individual is considered an employee for one purpose but an independent contractor for another.

The traditional tests applied to determine independent contractor status are based on the following four factors:

- degree of control over the work performed;
- ownership or provision of tools or equipment used in the provision of services;
- chance of profit and risk of loss; and
- degree of integration into the business.

The assessment of these factors is conducted on a case-by-case basis. Often, individuals possess characteristics of both employees and independent contractors, making classification difficult.

Source deductions

When an employee is wrongfully classified as an independent contractor, the employer may be ordered to pay all source deductions that should have been deducted from the employee's wages, including income tax, CPP and EI, along with interest charges and penalties. Since the "independent contractor" was likely paid an amount to compensate for these deductions, and perhaps GST as well, the additional costs are considerable. Under employment standards legislation, a tribunal may order payment of overtime, statutory holiday pay, vacation pay and severance pay, and in some cases, interest and penalties.

Note:

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Workers' compensation

Under workers' compensation legislation, assessments are paid for compensation coverage of a "worker." If a "worker" is misclassified as an independent contractor and sustains a workplace injury, the employer may face liability for unpaid premiums, occupational health and safety penalties, and more importantly, may be required to pay the full amount of the compensation paid to the worker.

Privacy legislation

Privacy statutes may have special rules for the management of personal employee information. These require the safeguarding of personal employee information, and stipulate the length of time an employer must retain such information. The breach of a provincial privacy statute can constitute an offence, and exposes an employer to suits for damages for actual harm.

Notice of termination

Termination or non-renewal of a contract with an independent contractor may result in a wrongful dismissal suit and damages if the individual is later determined to be an employee. Even when the label "independent contractor" is appropriate, it does not necessarily insulate an employer from the obligation to give notice of termination of the contract. Courts have ruled that where the indicia of an independent contractor are present, there may still be an "intermediate" status of dependency that requires notice prior to termination of the contract.

Vicarious liability and insurance

Employers are normally vicariously liable for the tortious acts of their employees, but not for those of independent contractors. Some courts have found employers liable for the acts of independent contractors because of the agency relationship between them. If the company is vicariously liable for the acts of independent contractors, insurance coverage may be inadequate to cover the damage award. Coverage may be an issue if the employment status is not properly declared.

Conclusion

Incorrectly classifying employees as "independent contractors" may have unpleasant financial and legal consequences. A company should not engage individuals as "independent contractors" lightly. All of the relevant factors must be carefully examined to determine the true nature of the relationship.

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