

Employee vs Contractor – That Is The Question

You might be thinking how you should pay your **next employee or a self-employed contractor**. Dealing with contractors is much easier from the business perspective – you get the work done in exchange for payment and you part your ways. *You are not responsible for source deductions, vacation pay, statutory pay, additional CPP/EI payments, WSIB premiums etc.*

Firing and hiring employees is also much harder from the legal perspective. You will need to set up proper contracts, agreements and disclosures before you can on/offboard an employee.

From an employee standpoint, it might be advantageous to be paid as a self-employed contractor as well. If deemed to be a self-employed contractor, the individual will not need to pay source deductions on the spot and will be able to **deduct related business expenses from the business income**.

On the other hand, the individual will be responsible for the **double amount of Canada Pension Plan (CPP) premiums** and charging, tracking and remitting the HST to the government (if they are invoicing over \$30,000 in the last four quarters for their goods and services).

(With regards to specific contractor tax deductions, please see our long guide on [ultimate list of CRA-approved small business tax deductions](#) for more information on what expenses can be deductible for self-employed contractors).

How Is The Employee vs Contractor Relationship Determined

In the reality, it is neither the employer nor the employee who should determine the status of the worker. It should be dictated by the unique set of circumstances of an individual.

There are multiple factors that the Canada Revenue Agency (CRA) is applying to determine if a small business owner is dealing with an employee or a

self-employed contractor. In short, **if there is a relationship of subordination, control, and no-risk for an individual, then he/she is an employee.**

Contrary to common beliefs, certain factors like an individual working from home or an individual opening a corporation, do not play a role in determining the nature of the relationship.

A CRA auditor would look at the **working relationship in substance** and try to determine the type of relationship based on the given set of facts.

If re-assessed, your business may be responsible for up to **three years back of source deductions**. The individual you worked with will also be denied all the tax deductions and will owe additional taxes plus interest from prior years. Not a nice surprise to have!

So, it is very important to determine the nature of the working relationship prior to proceeding with it. Changing it along the way *may attract more questions from the CRA and even an audit*. We strongly suggest involving a professional accountant if you are not sure about how to proceed.

Let's go over the criteria and the questions that you will need to answer in order to determine if you are dealing with an employee or a self-employed contractor. The factors need to be assessed in aggregate and no single factor should be the major determinant of the relationship.

Will an employee or a contractor set his/her working hours?

The question tries to answer if the relationship has an **element of subordination**. If you are dictating when the individual is coming and leaving the office, then most likely he/she is an employee. If the individual has very little control over when and how the work is done, then it indicates an employee-employer relationship.

Will an employee or a contractor provide similar services to other companies?

A person who is providing similar services to other companies is likely a self-employed contractor. If you are the only “customer” of that individual, then it is very unlikely that they can call themselves a business. However, if the service is provided to multiple customers then there is more likelihood that the individual is indeed running a business and is, in fact, a contractor.

Will an employee or a contractor own his/her tools of trade?

Who will be providing **tools for the individual to do the work**? Tools may include specialized equipment, supplies, laptop, office desk, musical instruments etc. If they are provided by the individual, then it is likely that they are running a business.

This is not a strong factor in determining the status of the individual, since he/she may be working from home by logging into employer’s servers from his/her laptop. But it plays a role on a big picture scale.

Can an employee or a contractor subcontract work to other individuals/companies?

If the answer is yes, then it is likely that there is a business-to-business relationship in place. It would be rare for an employee to be able to subcontract work that was assigned to him/her. Hence, this is a significant factor in establishing the nature of the relationship.

Can an employee or a contractor negotiate the timing and amount of pay?

Usually, most employees are not able to negotiate the timing and amount of payments. On the contrary, a contractor would be able to negotiate the timing

and amount of payments for services provided. Those details can be included in a written contract and invoices provided by the contractor.

Can an employee or a contractor refuse the work and walk away from a job/project?

How much power will the person have in the working relationship? By being able to say 'no' to the project, the individual puts him/herself on the same level with the hiring company. On the opposite side, an employee is usually not able to walk away from the job or project he/she was assigned.

Will an employee or a contractor be responsible for any losses?

In most situations, **an employee is not responsible for any losses incurred as a result of his/her actions.** It is ultimately the company who can get sued as a result of any malpractice or errors. However, in a business-to-business relationship, the contractor can be sued for his/her actions and be responsible for any issues that occurred as a direct result of its actions.

Is there a written contract in place?

The last factor is the **presence of a written contract in place that outlines the nature of the relationship.** The presence of a contract is not a strong factor since it can be carefully crafted by a lawyer to make the relationship make it seem like it is a business-to-business relationship.

An auditor would look into the substance of the working relationship based on the above factors, and would usually disregard the wording of the contract. However, a presence of a contractor can support the case if it leans toward a business-to-business type of working relationship.

Factors that are not important in determining Employee vs Contractor status

There are other factors that do not usually add to the case because they either do not directly relate to it or are easily manipulatable. For instance, it does not matter if the person does have a business number or a corporation (it can in fact play against the taxpayer if their corporation is deemed to be a [personal service business](#)).

Another factor that does not play a role is if the company or the individual have been audited before (not directly related to the issue in question).

Finally, it does not matter if the person works a 2nd job or works frequently from home. He/she may still be an employee based on other factors.

What If You Want to be 100% Sure

If you would like to receive a definitive answer from the CRA, you may submit a [ruling request](#) with all your case facts. The CRA will take some time to review the facts and respond with a definitive answer specific to your situation.

Note that once the ruling has been set it will be guiding your working relationship with the individual going forward. So, please ensure that you submit all the case facts properly (you can go over our and the [CRA list of criteria](#))