

# Frequently Asked Questions: Employees and Independent Contractors in Ontario

Second Edition



## What is an “employee”?

An employee is someone who has entered into an agreement (whether written or oral) to provide services to an employer. The employer controls how the employee’s services are performed. In exchange for the employee’s services, the employee receives hourly wages or a salary. An employee’s payment is generally not based on the quality of his or her performance.

Full-time employees usually work exclusively for one employer and often have access to benefits (such as health insurance or a pension plan) offered by their employer. An employee usually uses the employer’s tools, office or work space, and resources to complete the work that he or she performs for the employer and is subject to the relevant company policies. An employee reports to his or her employer, and the employee’s performance may be evaluated by the employer.

Employers and employees owe one another many duties. Generally, the duties of the employer are more onerous. This is because the two parties have unequal bargaining power, and the law gives the employee (as the weaker party) greater protection.

## What is an “independent contractor”?

An independent contractor also provides services to another party in exchange for payment. The nature of the independent contractor relationship provides for a greater degree of flexibility. However, an independent contractor provides services as part of the contractor’s own business. The party engaging the contractor has less control over how the independent contractor performs the services than it would have over an employee. Typically, there will be a written contract describing the services to be provided, and other contract terms resulting from negotiations between the parties.

In law, an independent contractor is considered to have equal bargaining power with the party receiving the services. Independent contractors who have previously established a corporation may benefit from certain tax advantages. Independent contractor relationships are governed by commercial law, and not by employment law.

It is not always easy to tell if someone is an employee or an independent contractor. The determination cannot be made by one single and universal test. Instead, one needs to look at the “total relationship” between the parties and ask whether the person who has been engaged to perform the services is really performing them

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*Have a FAQ topic that would be helpful to your business? Let us know.*

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Houser Henry & Syron LLP  
Suite 2701  
145 King St. West  
Toronto, Ontario, M5H 1J8  
t: 416.362.3411  
f: 416.362.3757  
inquiries@houserhenry.com  
www.houserhenry.com

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as part of his or her own business. A central issue is the amount of control the party receiving the services has over the other's activities.

Generally, a true independent contractor will:

- have control over the timing and performance of his or her work;
- own his or her own tools or equipment required to perform the work (e.g. uniform or a computer);
- have a chance of profit and a risk of loss (e.g. receive a fluctuating payment based on actual work done);
- not work full-time for one organization;
- work for (or have the option of working for) more than one organization;
- have the authority to hire his or her own workers;
- have his or her own office or work space; not have vacation entitlements, car allowances, insurance benefits or other benefits from the other party to the contract;
- not be required to report to an organization to show it followed the organization's instructions.

### **What are some differences between employees and independent contractors?**

It is necessary to accurately identify an individual as either an employee or an independent contractor.

Employers owe many duties to their employees and must comply with various laws. For example, an employer is required to comply with Ontario's Employment Standards Act, 2000 (the "ESA"). Among other things, the ESA provides for vacation and holiday entitlement, minimum wages, and protected leaves (such as maternity leave).

If an employer decides to terminate an employee's employment without "cause" (misconduct), he or she must provide the employee with reasonable notice or pay instead of reasonable notice. "Reasonable notice" will be different in each scenario, and will depend on factors such as:

- the character of employment (i.e. is the employee a lower-level employee or a senior manager);
- the employee's length of service;
- the employee's age; and
- the availability of similar employment (having regard to the experience, training and qualifications of the employee).

Minimum notice periods for employee terminations, or pay instead of notice, are established under the ESA. However, courts often award longer notice periods, or pay instead of notice, than the minimums found in the ESA. Even if the employee and employer have included a specific notice period in a written employment contract, there can be circumstances when a court will grant the employee a longer notice period, such as where the employee's relationship

with the employer has changed substantially or where the employee has served the employer for many years.

If an employer imposes unilateral changes on an employee (such as a reduction in pay or a demotion), then the employer may be held to have “constructively dismissed” the employee and may have to pay the employee compensation for terminating the employment relationship. For more on termination of employment, please see our publication “Employee Terminations – Factors to Consider” on our website [Employee Terminations – Factors to Consider \(PDF\)](#).

An employee owes his or her employer duties, including a duty of loyalty. An employee should protect confidential information received in the course of his or her employment. An employee should also avoid competing with his or her employer while employed.

An employer will often be “vicariously liable” for the actions of its employees. For example, if an employee is working and makes a mistake and someone gets injured as a result of that mistake, then the employer may be responsible for the injury. Vicarious liability does not usually apply to the actions of independent contractors.

A person or company’s relationship with an independent contractor is governed by commercial law and the agreement between the parties. While an employer is generally expected to provide an employee with an office or work space, tools and equipment, these things do not need to be provided to an independent contractor, unless the parties agree otherwise.

Many independent contractor agreements include specific notice periods with regard to terminating the contract. The parties must provide the notice described in the agreement between them, unless they mutually agree that the relationship can be immediately terminated. These notice periods will not generally be extended even if the parties have had a long-standing relationship. If there is no specific notice period in the independent contractor agreement, then one party must provide the other with a “commercially reasonable” notice if the contract is being terminated. What constitutes “commercially reasonable” will vary depending on the industry and the parties’ relationship.

Another difference between contractors and employees is that contractors generally bill for the work they are performing. While some employees may be asked to keep track of the number of hours they work, employees do not submit invoices.

### **What is a “dependent contractor”?**

Similar to independent contractors, people falling into this hybrid category usually have their own businesses and do not have all of the “hallmarks” of employment (e.g. health benefits, vacation entitlements). However, dependent contractors often work exclusively for one company and may perform essential functions for that company.

Unlike independent contractors, dependent contractors usually lose all (or substantially all) of their business if the relationship with the other party ends. To minimize the economic impact of terminating the relationship, courts usually determine that dependent contractors are entitled to longer reasonable notice if the other party intends ends the relationship.

This entitlement to longer reasonable notice is the main difference between independent and dependent contractors. The amount of notice will take into account the time required to find replacement(s) for the business lost. Finding replacement(s) often takes longer for dependent contractors than for independent contractors. To avoid uncertainty upon termination, the parties should enter into a contract that clearly identifies the parties and defines the termination rights, including entitlement to any notice of termination.

Dependent contractors are usually treated as “self-employed” (not employees) for income tax purposes.

### **What are some risks if someone is classified as a contractor, but he or she is actually an employee?**

#### ***Employment Consequences***

Merely calling someone an independent contractor (even if that term is used in a written agreement) or having a separate corporation through which the person is paid does not mean that the person is an independent contractor. Courts will not be bound to the parties’ declarations of the contract; however, parties’ intentions will be considered in making this determination. The objective reality of the employment relationship will be considered above the terms used in the contract when it is determined that it has been mislabeled.

Courts and tribunals will do their own assessment as to whether the person is truly an employee or an independent contractor. This determination is usually based on the degree of control exercised by the party receiving the services. The final assessment will not always be influenced by what the parties label themselves or how a person is paid.

If a person is actually an employee and his or her employment is terminated by the employer without cause, courts and tribunals will generally award that employee reasonable notice (or pay instead of reasonable notice) plus legal costs.

#### ***Tax Consequences***

If a person is incorrectly treated as an independent contractor when she or he is, in fact, an employee, there can be serious tax consequences for both parties.

The Court will generally consider the parties’ intentions when the contract was entered into. However, the Canada Revenue Agency (CRA) can disregard the parties’ intentions if there are other factors that indicate a different type of employment relationship than intended.

Parties can ask the CRA to review the status of a worker. Ideally, this is done at the commencement of the relationship, if there is any doubt as to the worker’s tax status. This is done using Form CPT1. If so requested, the CRA will advise if it regards the worker as an employee or a contractor for the purposes of statutory deductions. Parties should consider making this request to the CRA if they are uncertain as to a worker’s status. If the relationship is an existing or on-going one, obtaining tax advice is recommended before approaching the CRA for a ruling.

An employer must withhold and remit an employee's:

- income tax based on his or her employment; and
- statutory deductions (such as the Canada Pension Plan and Employment Insurance contributions).

If an employer fails to properly withhold and remit these items, the employer can be found liable and be made to pay interest and penalties. Employers must also pay Employer Health Tax in Ontario.

Contractors, on the other hand, are required to make their own remittances to the government. The person or company who received their services will not be liable if the contractor failed to properly remit the required amounts.

The labour provided by employees to their employers is not subject to Harmonized Sales Tax (HST). Contractors charge HST for their services. Contractors should consult with their tax advisors about HST, "input tax credits" and what needs to be remitted to the government.

### ***New ESA Consequences***

The new ESA came into effect November 27, 2017. The new Act gives the Ministry of Labour increased authority to investigate and to punish those who misclassify independent contractors, and the power to do random inspections of businesses for compliance.

It is now the employer's responsibility to prove that an individual who is treated as an independent contractor is not an employee. This means an employer must have solid evidence for its classification of a person as an independent contractor.

If a person is actually an employee, an employer is responsible to provide the employee with his or her entitlements under the ESA, such as vacation pay, notice of termination or severance. In addition, the employer could face fines as high as \$50,000 for an individual and \$500,000 for a corporation if the employer is a reoffender. There is also the possibility of a prosecution and conviction.

Employers must be extra vigilant and proactive when using independent contractors in their organizations. Houser Henry & Syron LLP can help safeguard your organization from misclassifications, allowing you to focus on your business.

\*This article does not deal with employers and employees in the context of a unionized labour force.

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### **About Houser Henry & Syron LLP**

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We understand the needs of mid-sized businesses and their owners and managers and we have the breadth of expertise and the depth of experience necessary to meet those needs. Read what our clients have to say about working with our firm.