What Has Tort Law Got To Do with It? Distinguishing Between Employees and Independent Contractors in the Federal Income Tax, Employment Insurance, and Canada Pension Plan Contexts

Lara Friedlander*

PRÉCIS

La distinction entre employé et entrepreneur indépendant se retrouve dans plusieurs domaines du droit canadien. En dépit des motifs administratifs différents qui justifient cette distinction, la législation semble laisser entendre que le critère permettant de faire la distinction entre un employé et un entrepreneur indépendant aux fins de l'impôt sur le revenu fédéral, de l'assurance-emploi et du Régime de pensions du Canada (RPC) devrait être celui que l'on utilise en *common law* pour établir la responsabilité de l'employeur pour les dommages causés par le travailleur. En fait, malgré les possibilités d'interprétation qui varient selon le contexte, les jugements rendus sur cette distinction dans les quatre domaines précités se confondent en une jurisprudence homogène. L'article porte sur la distinction entre employé et entrepreneur indépendant aux fins de l'impôt sur le revenu fédéral, de l'assurance-emploi et du RPC en vue de déterminer si le critère établi dans le droit de la responsabilité civile délictuelle devrait être utilisé dans chaque domaine ou s'il ne serait pas préférable d'utiliser des critères différents, sous la forme d'une discrétion judiciaire ou de critères très nets fixés dans la loi.

ABSTRACT

The distinction between employees and independent contractors is found in several areas of Canadian law. Despite divergent policy rationales for utilizing the distinction, legislation seems to suggest that the test for distinguishing employees from independent contractors in the domains of federal income tax, employment insurance, and the Canada Pension Plan (CPP) ought to be the test used by the common law to determine vicarious liability of employers for torts committed by workers. Indeed, despite opportunities for context-specific interpretation, the jurisprudence considering

* Of Osler Hoskin & Harcourt, LLP, Toronto, and formerly of the Faculty of Law, McGill University. I wish to thank Kim Brooks, David Duff, the anonymous reviewers of this article, and especially Tim Edgar for their extremely helpful comments, and McGill University for financial support offered through the Individual New Researcher Grant program. All errors are my own.

the employee-independent contractor distinction in these four areas has coalesced into one homogeneous body of case law. This article examines the employee-independent contractor distinction in the federal income tax, employment insurance, and CPP contexts with a view to determining whether the tort law test ought to be used for each area, or whether different types of tests, whether in the form of judicial discretion or bright-line statutory tests, are preferable.

KEYWORDS: EMPLOYEES ■ INDEPENDENT CONTRACTORS ■ UNEMPLOYMENT INSURANCE ■ CANADA PENSION PLAN ■ TAX POLICY

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> [W]hy would anyone think it sensible to give the concept of employee the same meaning in both tort law, where the concept was developed to limit the vicarious liability of employers, and tax law, where the concept is used, . . . among other purposes, to limit the deductibility of employment expenses?[1]

1 Neil Brooks, "Canadian Tax Journal: The Third Decade—1973-1982" (2002) vol. 50, no. 3 *Canadian Tax Journal* 1056-83, at 1066. See also Neil Brooks, "The Responsibility of Judges in Interpreting Tax Legislation," in Graeme S. Cooper, ed., *Tax Avoidance and the Rule of Law* (Amsterdam: IBFD Publications, 1997), 93-129, at 122-24; and David G. Duff, *Canadian Income Tax Law* (Toronto: Emond Montgomery, 2002), 201.

And yet this is indeed the state of the law in Canada.[2] In fact, not only do courts interpreting the federal Income Tax Act[3] apply the tests used in vicarious liability cases to distinguish between "employees" and "independent contractors," but the same tort law tests[4] are applied in the employment insurance and Canada Pension Plan (CPP) contexts[5] as well.

This article questions the application of tort law principles to the distinction between "employees" and "independent contractors" in the federal income tax, employment insurance, and CPP contexts. In each of these four areas of law, the distinction between employees and independent contractors, or between persons operating under a contract of service and persons operating under a contract for service, gives rise to different consequences.[6] In the context of vicarious liability in tort law, employers are vicariously liable for the tortious acts of their employees but generally not liable for the tortious acts of independent contractors. In the federal income tax context, employees are entitled to limited deductions only, are subject to a withholding regime, and are taxed on a cash basis. In both the employment insurance and the CPP contexts, employees are subject to a withholding regime and make contributions on the basis of salary rather than net business income. Independent contractors (with some exceptions) are not covered by the employment insurance system; they are covered by the CPP, but their contributions are based on net business income and are not levied on a withholding basis.

In each of these four areas of law, the differing treatment of employees and independent contractors arises from specific and different policy concerns. For example, with respect to vicarious liability, employers may be considered to be in the best position to prevent future harms caused by employees through organization, supervision, and risk management. In the contexts of employment insurance and the CPP, administrative, compliance, or risk allocation considerations govern withholding and funding options. The distinctions made by the federal income tax

2 With a twist in Quebec, which will be discussed below.

3 RSC 1985, c. 1 (5th Supp.), as amended (herein referred to as "the ITA").

4 As discussed below, the employee-independent contractor distinction is articulated expressly and with a somewhat different application in Quebec civil law.

5 See also Pierre Issalys, *The Pension Appeals Board: A Study of Administrative Procedure in Social Security Matters*, prepared for the Law Reform Commission of Canada (Ottawa: Supply and Services, 1979). For simplicity, this article will not generally refer explicitly to the Quebec Pension Plan, RSQ, c. R-9 (herein referred to as "the QPP"). Generally, and insofar as is relevant to this article, the QPP is very similar to the CPP, infra note 34. Cross-references between the CPP and the QPP will be given where appropriate.

6 Of course, there are other areas of law where the distinction between employees and independent contractors is relevant. I have focused this article on these four areas in reaction to current case law and as a means of restricting the scope of the article. For a recent view of the employee-independent contractor distinction in the labour and employment law context, see Guy Davidov, "The Three Axes of Employment Relationships: A Characterization of Workers in Need of Protection" (2002) vol. 52, no. 4 *University of Toronto Law Journal* 357-418.

regime may also reflect administrative considerations (which may be different from those relevant to employment insurance or the CPP).

Nevertheless, generally the same tests are used to distinguish between employees and independent contractors in each of these four areas of law. The most recent evidence of this is the decision of the Supreme Court of Canada in *671122 Ontario Ltd. v. Sagaz Industries Canada Inc.*,[7] in which precedents in the tort law, income tax, employment insurance, and CPP contexts are used interchangeably. As John Durnford has suggested, "[t]he extent to which the criteria developed in the various fields [such as employment insurance, medicare, government pensions and labour law] . . . is remarkable."[8]

This article examines the distinction between employees and independent contractors in each of these four areas of law for the purpose of determining whether a single test of the distinction ought to be applicable to each area or whether different types of tests (whether in the form of judicial discretion or bright-line statutory tests) are preferable. The first section sets out the common law or statutory location of the employee-independent contractor distinction in the tort, federal income tax, employment insurance, and CPP contexts. The second section attempts to identify the policy rationale for the distinction in each of the four areas. The third section sets out developments in the case law. The fourth section questions whether the tort law test should be used in the federal income tax, employment insurance, or CPP context. The fifth section posits some alternative approaches. The sixth section provides some concluding remarks.

LOCATION OF THE DISTINCTION IN THE FOUR CONTEXTS

Tort Law/Private Law

Vicarious liability in tort law refers to the liability of one person for the tortious acts of another. Generally, it has long been the case that vicarious liability can be imposed on an employer for the acts of an employee committed in the course of employment[9] but that an employer is not vicariously liable for the acts of an independent contractor except in extremely limited circumstances.[10] The distinction between employees and independent contractors in tort law will be reviewed below.

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7 [2001] 4 CTC 139 (SCC).

8 John W. Durnford, "Employee or Independent Contractor? The Interplay Between the Civil Code and the Income Tax Act," in *Mélanges Paul-André Crépeau* (Cowansville, QC: Yvon Blais, 1997), 273-309, at 294.

9 P.S. Atiyah, *Vicarious Liability in the Law of Torts* (London: Butterworths, 1967), 3; R.F.V. Heuston and R.A. Buckley, *Salmond and Heuston on the Law of Torts*, 20th ed. (London: Sweet & Maxwell, 1992), 444; and G.H.L. Fridman, *The Law of Torts in Canada*, vol. 2 (Toronto: Carswell, 1990), 316 and 331.

10 See Atiyah, supra note 9, at part VII; Heuston and Buckley, supra note 9, at 474-80; and Fridman, supra note 9, at 316. Of course, if the independent contractor is an agent of the

The distinction between employees and independent contractors under the Civil Code of Quebec[11] is set out explicitly and is a matter of private law generally rather than of vicarious liability.[12] CCQ article 2085 states:

> A contract of employment is a contract by which a person, the employee, undertakes for a limited period to do work for remuneration, according to the instructions and under the direction or control of another person, the employer.

In contrast, CCQ article 2098 states:

> A contract of enterprise or for services is a contract by which a person, the contractor or the provider of services, as the case may be, undertakes to carry out physical or intellectual work for another person, the client or to provide a service, for a price which the client binds himself to pay.

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employer, the employer may be liable for the torts of the independent contractor as a matter of agency law. See G.H.L. Fridman, *The Law of Agency*, 7th ed. (Toronto: Butterworths, 1996), 315. Here one might say that the principal is not liable vicariously, but rather liable primarily on the basis that the principal acts through the agent.

11 SQ 1991, c. 64, as amended (herein referred to as "the CCQ").

12 Characterization of a person as an "employee" results in the application of chapter VII of title 2 of the CCQ, which includes items such as contract renewal, notice of termination, and non-competition. Chapter VIII of title 2 governs contracts of enterprise or for services. Under the CCQ, an employer will likely, but not necessarily, be liable for torts caused by his or her employee. This is because the existence of an employer-employee relationship is technically not relevant to vicarious liability. Instead, vicarious liability is determined under CCQ article 1463, which states in part, "The principal [a faulty translation of the word "commettant"] is liable to reparation for injury caused by the fault of his agents and servants [together, a faulty translation of the word "préposés"] in the performance of their duties." Whether a person is a "préposé" is a matter of case law. An employee will typically be a préposé, but not always. Jean-Louis Baudouin and Patrice Deslauriers, *La Responsabilité Civile*, 5th ed. (Cowansville, QC: Yvon Blais, 1998), 438. An independent contractor may be a préposé. Ibid. Courts tend to look at a series of factors in determining whether a person is a préposé of someone else. However, the most important factors relate to control: a person will generally be considered to be a préposé of a principal if the principal exercises a sufficient amount of control, direction, and supervision over the person in question. Ibid., at 426-37. Typically, the kind of control, direction, and supervision necessary to establish a relationship of "preposition" is that which allows a principal to decide on the goal or end-product of the work and the way in which the work is to be done. Ibid., at 430. This approach is very similar to the traditional common law "control" test, discussed below.

If CCQ article 1463 does not apply to impose vicarious liability, an employer may still be liable for torts of an employee or of an independent contractor owing to the rules relating to mandate (the CCQ equivalent of agency), just as a principal will generally be liable for the torts of an agent under common law. CCQ article 2164 deals with the liability of a mandator (the civil law equivalent of a principal) for injuries caused by a mandatary (the civil law equivalent of an agent). This article provides, "A mandatary is liable for any injury caused by the fault of the mandatary in the performance of his mandate unless he proves, where the mandatary was not his servant, that he could not have prevented the injury." Again, this kind of liability may be said to be different from vicarious liability in that the acts could be considered to be the acts of the mandator himself or herself. An independent contractor (or an employee for that matter) may or may not be a mandatary, depending on the terms of the relationship.

Further, CCQ article 2099 states:

> The contractor or the provider of services is free to choose the means of performing the contract and no relationship of subordination exists between the contractor or the provider of services and the client in respect of such performance.

It is this element of subordination that is the key distinction under the CCQ between employees and independent contractors.[13]

The Federal Income Tax Act

The distinction between employees and independent contractors under the ITA is fundamental to the calculation of income under that legislation. Income from employment and income from a business are two distinct sources of income under the ITA and are subject to entirely different sets of rules as to calculation: income from employment is calculated under one series of provisions (subdivision a of division B of part I), and income from a business is calculated under another series of provisions (subdivision b of division B of part I). The most significant distinction between these two sets of provisions is the dearth of deductions available for employees as compared with independent contractors. Indeed, the only deductions permitted in respect of the calculation of income from employment are the very limited deductions specifically set out in ITA section 8.[14] In contrast, any outlay or expense may be deducted in computing income from a business so long as that outlay or expense is not prohibited by the ITA; although such prohibitions can be significant,[15] the scope for deductions is much, much larger in the computation of income from a business.[16]

The distinction between employees and independent contractors under the ITA also has consequences for the collection of tax. An employee receiving salary, wages, other remuneration, or certain specific types of benefits is subject to a withholding regime under which the payer is required to withhold tax from such payments and

13 See *Wolf*, infra note 127, at 33, per Décary J. See also François Auger, "Employee and Self-Employed Worker," in *The Harmonization of Federal Legislation with Quebec Civil Law and Canadian Bijuralism: Collection of Studies in Tax Law* (Ottawa: Department of Justice and Association de planification fiscale et financière, 2002), 3:1-82, at 3:32.

14 See, for example, ITA paragraphs 8(1)(b) (legal expenses), (f) (expenses of a salesperson), (h) (travel expenses), and (j) (motor vehicle and aircraft expenses).

15 See, for example, ITA paragraphs 18(1)(a) (the expense must be made or incurred by the taxpayer for the purpose of gaining or producing income from a business or property), (b) (the expense may not be on account of capital unless specifically permitted), and (e) (the amount may not be contingent).

16 For a more thorough comparison of the deductions available to employees and of the consequences of the distinction between employees and independent contractors more generally under the ITA, see Brian J. Wilson, "Employment Status Under the Income Tax Act," in *Income Tax and Goods and Services Tax Planning for Executive and Employee Compensation and Retirement*, 1991 Corporate Management Tax Conference (Toronto: Canadian Tax Foundation, 1992), 2:1-61.

remit such tax to the federal government.[17] An independent contractor is required to pay instalments of tax, which are generally based on the tax payable in the previous taxation year.[18]

The treatment of stock options is another area of the ITA that distinguishes between employees and independent contractors. Employees who receive stock options receive favourable tax treatment under ITA section 7 and paragraphs 110(1)(d) and (d.1).[19]

The ITA gives little guidance regarding the distinction between employees and independent contractors. The only guidance provided is found in the following definitions in ITA subsection 248(1):

> "[B]usiness" includes a profession, calling, trade, manufacture or undertaking of any kind whatever and, except for the purposes of paragraph 18(2)(c), section 54.2, subsection 95(1) and paragraph 110.6(14)(f), an adventure or concern in the nature of trade but does not include an office or employment.
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> "Employment" means the position of an individual in the service of some other person (including Her Majesty or a foreign state or sovereign) and "servant" or "employee" means a person holding such position.[20]

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17 See ITA section 153 and regulations 100 to 108 of the Income Tax Regulations, CRC 1978, c. 945, as amended.

18 Instalments may also be based on estimates of tax payable for the current year or on a combination of tax payable for the two preceding taxation years. See ITA section 156 and regulation 5300. The obligation to pay instalments is not limited to independent contractors but rather is applicable to any individual who meets the relevant threshold as set out in ITA section 156.1.

19 ITA subsection 7(1) provides, generally, that an employee who receives stock options (or options to acquire units of a mutual fund) may postpone an income inclusion until such time as the option is exercised if certain requirements are met. The inclusion may be postponed further, until the disposition of the securities acquired pursuant to the option, if additional requirements are met; see ITA subsection 7(1.1) for options granted by Canadian-controlled private corporations and ITA subsections 7(8) to (16) for options granted by public companies. In many cases, any gain ultimately included in income will be included at capital gains rates (that is, at the rate of one-half of the gain). See ITA paragraphs 110(1)(d) and (d.1). See Daniel Sandler, "The Tax Treatment of Employee Stock Options: Generous to a Fault" (2001) vol. 49, no. 2 *Canadian Tax Journal* 259-319.

Employees and independent contractors are also treated differently in that employees calculate their employment income on a "received" basis whereas independent contractors calculate their income on an accrual basis. See Vern Krishna, *The Fundamentals of Canadian Income Tax*, 7th ed. (Toronto: Carswell, 2002), 181 and 251.

20 Also in ITA subsection 248(1) are the following definitions:

> "[E]mployed" means performing the duties of an office or employment;
> "employee" includes officer; [and] . . .
> "employer," in relation to an officer, means the person from whom the officer receives the officer's remuneration.

The Employment Insurance Act

The distinction between employees and independent contractors is of paramount importance in the employment insurance context. Generally, employees (and their employers) are required to make employment insurance contributions and are therefore covered by the employment insurance system while independent contractors (with some exceptions) are not.

Under the Employment Insurance Act,[21] a person "employed in insurable employment" is required to pay a premium equal to the person's "insurable earnings" multiplied by the relevant premium.[22] The payment is made by withholding; that is, the person's employer is required to withhold the relevant amount from the person's remuneration and to remit that amount to the government.[23] Withholdings are not required once the person's insurable earnings reach "maximum insurable earnings."[24] An employer is required to pay a premium equal to 1.4 times the premiums required to be deducted from the employee's remuneration.[25] In 2002, the employee premium rate was 2.2 percent and the employer premium rate was 3.08 percent; maximum insurable earnings were $39,000, and therefore the maximum employee premium was $858.00 and the maximum employer premium was $1,201.20.[26]

The distinction between employees and independent contractors arises in the definition of "insurable employment" in EIA section 5(1)(a):

> ["Insurable employment" means] employment in Canada by one or more employers, under any express or implied contract of service or apprenticeship, written or oral, whether the earnings of the employed person are received from the employer or some other person and whether the earnings are calculated by time or by the piece, or partly by time and partly by the piece, or otherwise.[27]

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21 SC 1996, c. 23, as amended (herein referred to as "the EIA"). Previous iterations of this statute include the Unemployment Insurance Act, 1940, SC 1939-40, c. 44; the Unemployment Insurance Act, SC 1955, c. 50; the Unemployment Insurance Act, 1971, SC 1970-71-72, c. 48; and the version of the legislation in the last consolidation of federal statutes, the Unemployment Insurance Act, RSC 1985, c. U-1. The EIA came into effect on July 1, 1996. For more on the development of unemployment insurance legislation in Canada, see Jonathan R. Kesselman, *Financing Canadian Unemployment Insurance*, Canadian Tax Paper no. 73 (Toronto: Canadian Tax Foundation, 1983).

22 EIA section 67. The premium is established under section 66 or 66.1 (depending on the year) and is set by the governor in council or the Canada Employment Insurance Commission (depending on the year) on the recommendation of the minister of human resources development and the minister of finance.

23 EIA sections 67 and 82(1).

24 EIA section 82(2). "Maximum insurable earnings" is defined in EIA section 4.

25 EIA section 68. An employer's premiums may be reduced in certain circumstances. See EIA section 69.

26 See David Sherman, ed., *The Practitioner's Income Tax Act*, 22d ed. (Toronto: Carswell, 2002), xxxvi.

27 The remainder of EIA section 5(1) includes in "insurable employment"

Thus, the notion of a "contract of service"—implying a traditional common law employment relationship—is found here in the "insurable employment" definition rather than in the definition of "employment" itself. The concept of "employment" in the EIA is not defined with any real substance[28] but does, by implication of the definition of "insurable employment," extend beyond a contract-of-service relationship.

The breadth of the term "employment" becomes evident when one examines the provisions of the EIA that clearly contemplate that employment insurance can be extended to the self-employed in certain situations.[29] First, EIA section 5(4)(c) provides that regulations may be made to include in insurable employment

> employment that is not employment under a contract of service if it appears to the Commission that the terms and conditions of service of, and the nature of the work

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(b) employment in Canada as described in paragraph (a) by Her Majesty in right of Canada;

(c) service in the Canadian Forces or in a police force;

(d) employment included by regulations made under subsection (4) or (5); and

(e) employment in Canada of an individual as the sponsor or co-ordinator of an employment benefits project.

EIA section 5(1)(d) could include regulations dealing with employment outside or partly outside Canada and employment by the provinces, foreign governments, or international organizations, for example. See EIA section 5(4).

Under EIA section 5(2), some activities are specifically excluded from "insurable employment," namely,

(a) employment of a casual nature other than for the purpose of the employer's trade or business;

(b) the employment of a person by a corporation if the person controls more than 40% of the voting shares of the corporation;

(c) employment in Canada by Her Majesty in right of a province;

(d) employment in Canada by the government of a country other than Canada or of any political subdivision of the other country;

(e) employment in Canada by an international organization;

(f) employment in Canada under an exchange program if the employment is not remunerated by an employer that is resident in Canada;

(g) employment that constitutes an exchange of work or services;

(h) employment excluded by regulations made under subsection (6); and

(i) employment if the employer and employee are not dealing with each other at arm's length.

28 The EIA does not define "employee" or "employed" (EIA section 2(1)). During the first half of the 1970s, the definition of "employment" was "the act or state of being employed." See section 2(1)(g) of the Unemployment Insurance Act, 1971, supra note 21, and SC 1976-77, c. 54, section 26(4). Unemployment or employment insurance legislation since the Unemployment Insurance Act, 1970 has contained language similar to that found currently in EIA section 5(1)(a) in describing persons actually covered by the legislation. "Employer" is defined in EIA section 2(1) to include "a person who has been an employer and, in respect of remuneration of an individual referred to as sponsor or co-ordinator of a project in paragraph 5(1)(e), it includes that individual."

29 See also *Scheer*, infra note 165, and *Martin Service Station*, infra note 164.

performed by, persons employed in that employment are similar to the terms and conditions of service of, and the nature of the work performed by, persons employed under a contract of service.

Under this provision, a person can be "employed" and yet not work under a contract of service.[30] Thus, the term "employment" clearly refers to an activity or occupation rather than a master-servant relationship.[31]

Second, EIA section 5(5) specifically provides that the Canada Employment Insurance Commission may (with the approval of the governor in council and subject to affirmative resolution of Parliament) make regulations to include in insurable employment the business activities of a person who is engaged in a business (as defined in ITA subsection 248(1)).[32]

Notwithstanding the fact that "employment" in the EIA is broader than a contract of service, the contract of service remains the baseline indicator of employment insurance coverage, given that departures from a contract of service are or must be clearly set out in the EIA or in the regulations made under the EIA.

Employment insurance contributions made by an employer are deductible by the employer under the ITA.[33]

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30 See Employment Insurance Regulations, SOR/96-332 (1996) vol. 130, no. 14 *Canada Gazette Part II* 2192-2254, as amended. For example, regulation 6(d) provides that insurable employment includes a person in a barbering or hairdressing establishment provided that the person provides services that are normally provided by the establishment and that the person is not the owner or operator of the establishment. Regulation 6(e) functions similarly for a person who is a driver of a taxi, commercial bus, school bus, or any other vehicle used by a business or public authority for carrying passengers, where the person is not the owner of more than 50 percent of the vehicle or the owner or operator of the business or the operator of the public authority. Regulation 6(g) includes in insurable employment the employment of a person who is placed in that employment by a placement agency to perform services for and under the director and control of a client of the agency, where that person is remunerated by the agency for the performance of those services.

The substance of this provision was added to the Unemployment Insurance Act, 1940 in 1946, by SC 1946, c. 68, in the form of section 14A. Section 14A was virtually identical to current EIA section 5(4)(c), except that section 14A allowed the commission to act only if the similarity resulted "in anomalies or injustices in the operation of the Act." By the time the new Unemployment Insurance Act was enacted in 1944, this "anomalies or injustices" language had disappeared.

31 *AG Can. v. Skyline Cabs*, [1986] 5 WWR 16 (FCA).

32 There are currently no such regulations. Note that self-employed persons engaged in fishing are covered by the EIA under part VIII of that legislation and the relevant regulations, although they are not considered to be "employed." See Employment Insurance (Fishing) Regulations, SOR/96-445 (1996) vol. 130, no. 20 *Canada Gazette Part II* 2869-80, as amended.

33 ITA section 9. See *Fed. des caisses populaires Desjardins v. R*, [2002] 2 CTC 1 (FCA) ; and *Provigo Distributions Inc. v. The Queen*, 2000 DTC 2112 (TCC). Employee contributions are eligible for a credit under ITA section 118.7.

The Canada Pension Plan

The Canada Pension Plan[34] requires (and always has required)[35] contributions from both employees and independent contractors, but applies quite differently to these two groups. Currently, the two significant distinctions between employees and independent contractors under the CPP are the basis upon which contributions are calculated and the way in which contributions are collected.

Beginning with employees, under the CPP, amounts are required to be withheld and remitted in respect of "remuneration" earned by an "employee who is employed by an employer in pensionable employment."[36] Who is an "employee" for the purposes of these rules? As with the ITA and the EIA (in the definition of "insurable employment"), employees are generally those operating under a "contract of service." Under CPP section 2(1), "employment" is (and has always been) defined in section 2(1) as "the performance of services under an express or implied contract of service or apprenticeship, and includes the tenure of an office."[37] The definition of "business" is generally the same as the definition contained in the ITA. Therefore, again, the treatment of workers under the CPP turns on the distinction between a contract for service and a contract of service.[38]

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34 RSC 1985, c. C-8, as amended.

35 Canada Pension Plan Act, SC 1964-65, c. 51.

36 CPP sections 8(1) and 21(1). See also QPP sections 50 and 59.

37 "Employer" is defined in CPP section 2(1) as "a person liable to pay salary, wages or other remuneration for services performed in employment, and in relation to an officer includes the person from whom the officer receives his remuneration." "Employee" is defined, ibid., merely as including an "officer." "Officer" is defined, ibid., as a person who holds an "office," which in turn is defined as "the position of an individual entitling him to a fixed or ascertainable stipend or remuneration and includes a judicial office, the office of a minister of the Crown, the office of a lieutenant governor, the office of a member of the Senate or House of Commons, a member of a legislative assembly or a member of a legislative or executive council and any other office the incumbent of which is elected by popular vote or is elected or appointed in a representative capacity, and also includes the position of a corporation director." See also QPP section 1.

38 "Pensionable employment" is defined in CPP section 6(1) to mean

> (a) employment in Canada that is not excepted employment;
> (b) employment in Canada under Her Majesty in right of Canada that is not excepted employment; or
> (c) employment included in pensionable employment by a regulation made under section 7.

"Excepted employment" refers to the different types of employment enumerated in CPP section 6(2), including "employment of a casual nature otherwise than for the purpose of the employer's trade or business," employment of a person by the person's spouse or common law partner (unless the remuneration paid to the person may be deducted under the ITA in computing the income of the spouse or common law partner), and employment by a provincial Crown or an agent of a provincial Crown. See also QPP sections 2 and 3.

All employment included in pensionable employment by regulation is already "employment," with one exception, at least on the face of the regulations. Where an individual is placed by a

The amount of the employee's contribution is equal to the product of the "contribution rate"[39] for the year and the lesser of (1) the employee's "contributory salary and wages"[40] for the year paid by the employer, less the basic exemption for the year, and (2) the employee's "maximum contributory earnings" for the year minus certain provincial pension plan contributions.[41] Corresponding contributions are made by the employer, calculated on a similar basis but using a contribution rate that is ordinarily the same as the contribution rate for employees.[42] In 2002, the contribution rate for both employees and employers was 4.7 percent (for a total of 9.4 percent), with a maximum contribution for each of $1,673.20.[43]

Generally, self-employed individuals also are required to make contributions to the CPP. An individual who is resident in Canada during a year for the purposes of the ITA and who has "contributory self-employed earnings" for the year is required to make contributions under a formula unique to self-employed persons that is based on contributory self-employed earnings and is subject to a cap.[44] The maximum contribution for self-employed individuals in 2002 was $3,346.40[45] (exactly equal to the aggregate maximum contribution for employees and employers). "Contributory self-employed earnings" of a person for a year is, generally, the person's "self-employed earnings" for the year, subject to limitations regarding age and disability and certain other factors, similar to those applicable to an ordinary employee, as

placement or employment agency in "employment with or for the performance of services" for a client of the agency, and where the terms or conditions under which the employment or services are performed and the remuneration thereof is paid constitute a contract of services or are analogous to a contract of service, the person who pays the remuneration to the individual (whether it be the client or the agency) is deemed to be the employer of the individual. See section 34 of the Canada Pension Plan Regulations, CRC 1978, vol. IV, c. 385, as amended.

39 Defined in CPP section 2(1) and reviewed pursuant to CPP section 113.1. See also the schedule to the CPP, and QPP sections 44.1 and 50.

40 "Contributory salary and wages" of a person for a particular year is defined in CPP section 12 as the person's "income from pension employment" as calculated under the ITA (that is, income from an employment that is pensionable employment as calculated under the ITA), subject to certain exceptions. The ITA is to be read without reference to subsection 7(8) and paragraph 8(1)(c) but does not include income before the person reaches 18 years of age, during any month that is excluded from the person's "contributory period" under the CPP or under a provincial pension plan by reason of disability or after the person reaches 70 years of age or a retirement pension becomes payable to that person under the CPP or a provincial pension plan. See CPP section 12(1). The remainder of section 12 contains other adjustments applicable in certain circumstances. See also QPP sections 45 and 50.

41 CPP section 8(1). See also QPP section 50.

42 CPP section 9. See also QPP section 52.

43 *The Practitioner's Income Tax Act*, supra note 26, at xxxvi, and the schedule to the CPP.

44 CPP section 10. Certain members of religious sects or divisions thereof may, in certain circumstances, elect not to be subject to CPP section 10. See CPP section 11. See also QPP section 53.

45 *The Practitioner's Income Tax Act*, supra note 26, at xxxvi.

described above.[46] "Self-employed earnings" of a person for a year is equal to the aggregate of the person's net income (that is, gross income less deductions) from all businesses carried on by that person[47] as computed under the ITA, subject to certain adjustments.[48]

The calculation of the retirement benefit paid under the CPP is quite complex.[49] For the purpose of this article, it is merely noted that the amount of the benefit is calculated in large part on the basis of a person's contributory salary and wages or contributory self-employed earnings (as applicable).[50]

CPP premiums paid by an employer are deductible by the employer under the ITA.[51] CPP premiums paid by an independent contractor in respect of self-employed earnings are in part deductible (with respect to the "employer" portion of the contributions) and in part creditable (with respect to the "employee" portion of the contributions).[52]

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46 CPP section 13. See also QPP section 48.

47 Other than a business more than 50 percent of the gross revenue of which consisted of rent from land or buildings. CPP section 14. A person may elect to include in his or her self-employed earnings the amount by which the lesser of the person's contributory salary and wages for the year and his or her maximum pensionable earnings for the year exceeds the aggregate of the person's salary and wages (on which a contribution has been made and such amount as determined by the regulations to the CPP) and the lesser of the person's basic exemption for the year and the amounts deducted federally and under provincial pension plans in respect of the person's basic exemption for the year. CPP section 13. See also QPP section 47 (calculated with reference to the Taxation Act (Quebec), RSQ, c. I-3).

48 Excluded from this calculation are amounts from the performance of services, described in CPP section 7(1)(d), that are included in pensionable employment by regulation made under CPP section 7(1) or a provincial pension plan. Included in this calculation are amounts from employment described in CPP section 7(2)(e) excepted from pension employment by regulation made under CPP section 7(2) or a provincial pension plan (as calculated under the ITA) and certain amounts in respect of "Indians." See CPP section 14.

49 The retirement benefit paid under the CPP is generally equal to 25 percent of "average monthly pensionable earnings." CPP section 46(1). This amount is equal to the person's "total pensionable earnings" divided by the total number of months in the contributory period (up to a cap of 120) or the "basic number of contributory months," whichever is greater. CPP section 48. Generally, the contributory period starts when the person reaches 18 years of age and ends when the person reaches 70 years of age or when the person begins to receive retirement benefits under the CPP, whichever is earlier. CPP section 49. The basic number of contributory months is, generally, 120. CPP section 42(1). The 120-month period serves as a mechanism to average earnings of the final five years of the contributory period. Total pensionable earnings is a relatively complex calculation that begins with the least of three amounts, one of which is the aggregate of contributory salary and wages and contributory self-employed earnings and one of which is a fixed amount that effectively provides a cap on CPP retirement benefits. CPP section 53.

50 CPP section 53.

51 ITA section 9. See also supra note 33.

52 Generally, one-half of CPP or QPP contributions in respect of self-employed earnings is deductible under ITA paragraph 60(e). Sixteen percent (the lowest marginal taxation rate) of the remaining half is eligible for a credit under ITA section 118.7. Employee contributions to the CPP or QPP are also eligible for a credit under ITA section 118.7.

POLICY UNDERLYING THE DISTINCTION IN EACH OF THE FOUR CONTEXTS

Vicarious Liability in Tort Law

The policy underlying vicarious liability for torts was reviewed extensively by the Supreme Court of Canada in *Bazley v. Curry*.[53] The court found that there are two main policy concerns in issue relevant to vicarious liability, namely,

> (1) provision of a just and practical remedy for the harm; and (2) the deterrence of future harm.[54]

With respect to the goal of providing a just and practical remedy for the harm, the court noted the underlying concept that employers who advance their own economic interests through the activities of their employees ought to be responsible for the losses incurred by those employees. Vicarious liability is a just remedy in that it holds responsible the party that has created the risk.[55] The court stated:

> The employer puts in the community an enterprise which carries with it certain risks. When those risks materialize and cause injury to a member of the public despite the employer's reasonable efforts, it is fair that the person or organization that creates the enterprise and hence the risk should bear the loss. This accords with the notion that it is right and just that the person who creates a risk bear the loss when the risk ripens into harm. While the fairness of this proposition is capable of standing alone, it is buttressed by the fact that the employer is often in the best position to spread the losses through mechanisms like insurance and higher prices, thus minimizing the dislocative effect of the tort within society.[56]

With respect to the second policy consideration, deterrence, the court stated:

> Fixing the employer with responsibility for the employee's wrongful act, even where the employer is not negligent, may have a deterrent effect. Employers are often in a position to reduce accidents and intentional wrongs by efficient organization and supervision.[57]

The Supreme Court of Canada revisited vicarious liability in *Sagaz* as discussed above. The court cited with approval the following passage from Flannigan:

> This basis for vicarious liability discloses a precise limitation on the scope of the doctrine. If the employer does not control the activities of the worker it is clear that vicarious liability should not be imposed, for then insulated risk taking [by the

53 [1999] 2 SCR 534.

54 Ibid., at 552.

55 Ibid., at 553.

56 Ibid., at 554.

57 Ibid.

> employer] does not occur. Only the worker, authorized to complete a task, could have affected the probability of loss, for he alone had control in any respect. Thus, because there is no mischief where employer control is absent, no remedy is required.[58]

The Supreme Court of Canada in *Sagaz* also stated:

> [T]he main policy concerns justifying vicarious liability are to provide a just and practical remedy for the plaintiff's harm and to encourage the deterrence of future harms. . . . Vicarious liability is fair in principle because the hazards of the business should be borne by the business itself; thus, it does not make sense to anchor liability on an employer for acts of an independent contractor, someone who was in business on his or her own account. In addition, the employer does not have the same control over an independent contractor as an employee to reduce accidents and intentional wrongs by efficient organization and supervision. Each of these policy justifications are [sic] relevant to the ability of the employer to control the activities of the employee, justifications which are generally deficient or missing in the case of an independent contractor. As discussed above, the policy justifications for imposing vicarious liability are relevant where the employer is able to control the activities of the employee but may be deficient in the case of an independent contractor over whom the employer has little control. However, control is not the only factor to consider in determining if a worker is an employee or an independent contractor. . . . [A] reliance on control alone can be misleading, and there are other relevant factors which should be considered in making this determination.[59]

Federal Income Tax Law

The policy rationale underlying the distinction between employees and independent contractors in the income tax context is not quite as clear as the policy rationales underlying vicarious liability articulated by the Supreme Court of Canada. Gwyneth McGregor wrote in 1960:

> It is generally accepted that there is a considerable difference in the tax treatment of employees' expenses and those of the self-employed, and it is often firmly stated—as though it were an axiom—that the principle is and always has been that for income tax purposes income from employment is gross income with no deductions whatsoever, while income from a business, profession or vocation is gross income less the expenses required to produce it.
>
> There is considerable mystery about the origin of this concept. . . . Its justification, as well as its origin, is mysterious, and many attempts have been made to rationalize it; but at the end of it all one is left with the feeling that the thrust is that there is no logic about it and that it has come into being without a perceptible cause—a sort of spontaneous combustion.[60]

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58 *Sagaz*, supra note 7, at paragraph 34, citing Flannigan, infra note 121, at 31-32.

59 *Sagaz*, supra note 7, at paragraph 35.

60 Gwyneth McGregor, *Employees' Deductions Under the Income Tax Act*, Canadian Tax Paper no. 21 (Toronto: Canadian Tax Foundation, 1960), 1.

The policy rationale that emerges from the literature and from various comments by federal government officials seems to be largely one of administrative efficiency. As stated by Eugene LaBrie in 1965,

> [t]he reason for legislation demanding a distinction between income derived from personal services in a business or profession and in an office or employment is a practical one. Administrative convenience requires an employee to pay tax on benefits and expenses that are excluded from the income of a businessman rendering identical services. The vast majority of taxpayers fall into the category of employees and the need to scrutinize all returns and judge the propriety of claimed deductions would, it is said, impose an impossible burden. It is also argued that gross income from offices and employments deserves modification in relatively few situations, an increasing number of which are being taken care of by expanding the exceptions in sec. 5 and sec. 11. This administrative point of view is so prevalent that when Canadian income tax legislation was interpreted at one period as permitting the computation of employment income on a profit basis, it was promptly amended. (See, for example, *Bond v. M.N.R.*, [1946] Ex. C.R. 577, 2 DTC 907, overruled by sec. 6(6) of the *Income War Tax Act*.)[61]

In its comprehensive review of Canadian federal income tax legislation, the Royal Commission on Taxation ("the Carter commission") almost entirely rejected the distinction between employees and independent contractors. The commission found that the distinction was unfair discrimination between the two groups owing to extreme limitations on deductibility of expenses for employees. The commission argued that all reasonable expenses incurred for the purpose of producing income should be deductible.[62]

The commission did concede that "the task of assessment would be enormous if each employee submitted an itemized claim for his or her actual expenses."[63] Indeed, the commission stated that the avoidance of administrative difficulties was the main reason for the distinction between employees and independent contractors. The problematic nature of the distinction between personal and business expenses was already giving rise to litigation in the business income context; this type of litigation would be much more voluminous given the high number of employees in Canada. But the commission offered a twofold response to this problem: (1) offer employees an optional flat deduction in lieu of itemized expenses; and (2) specify in the regulations to the ITA particular (mostly personal) expenses that cannot be deducted. This list would eliminate much of the litigation that could be expected in

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61 F.E. LaBrie, *The Principles of Canadian Income Taxation* (Don Mills, ON: CCH Canadian, 1965), 109.

62 Canada, *Report of the Royal Commission on Taxation*, vol. 3 (Ottawa: Queen's Printer, 1966), 284-85 and 290. The commission highlighted the decision in *J.D. Harbron v. MNR* (1958), 18 Tax ABC 385, in which a journalist who was employed but also did freelance work challenged an assessment denying his deductions against employment income solely for the purpose of publicizing this issue.

63 *Report of the Royal Commission on Taxation*, supra note 62, at 290.

respect of employee expense claims. The ITA would continue to contain a definition of "employment" for limited purposes, including the flat deduction.[64]

The federal government rejected the commission's recommendations, putting forward the following justification:

> [T]he government proposes to make more provision in the law for the expenses legitimately incurred in earning wages or salaries. However, it has reached the conclusion that claims for expenses on the broad basis suggested by the commission would either impose record-keeping on millions of employees or deny them the ability to submit acceptable claims. It would also produce an impossible processing task in tax administration with inevitable long delays in making refunds. Consequently the government proposes that general limits be retained on expenses that can be deducted from employment income but that a general deduction be provided and somewhat greater recognition given to special situations where employees have to live for a period of time at a work site away from home.[65]

Notably, in the 1971-72 tax reform package, the federal government did introduce a deduction for all employees equal to 3 percent of their income, up to a maximum of $150.[66] As Hogg, Magee, and Li note,

> [t]his deduction went some way towards alleviating the unfairness of the prohibition against the deduction of employment-related expenses, and for most employees the deduction was quite generous.[67]

However, after numerous amendments to the ITA to make the employee deduction more generous,[68] the $500 employment credit was eliminated by the 1987 tax reform package. The white paper published to explain the changes stated that the credit was eliminated owing to the enhancement of the basic personal credit.[69] Hogg, Magee, and Li comment that

> [t]he removal of the standard employment expense deduction in 1987 returned the tax system to the pre-1972 state of the law, which the Carter Commission had justly criticized as flouting both equity and neutrality.[70]

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64 Ibid., at 290-91 and 310.

65 E.J. Benson, *Proposals for Tax Reform* (Ottawa: Queen's Printer, 1969), 16.

66 See paragraph 8(1)(a) as enacted by SC 1970-71-72, c. 63.

67 Peter W. Hogg, Joanne E. Magee, and Jinyan Li, *Principles of Canadian Income Tax Law*, 4th ed (Toronto: Carswell, 2002), 104.

68 Under SC 1977-78, c. 1, section 4, the $150 cap was replaced with a $250 cap. SC 1979, c. 5, section 1 replaced the $250 cap with a $500 cap. SC 1984, c. 1, section 3(1) replaced the 3 percent calculation with a 20 percent calculation.

69 Canada, Department of Finance, *The White Paper: Tax Reform 1987* (Ottawa: Department of Finance, 1987).

70 Supra note 67, at 104. Hogg, Magee, and Li also state, ibid., "To be fair, however, allowing an arbitrary standard deduction did achieve only rough justice with a significant revenue loss and this was perhaps why the government removed it."

Employment Insurance

Employment (or unemployment) insurance is intended to protect people at risk of becoming unemployed.[71] This purpose is intimately related to the policy rationale for the distinction between employees and independent contractors:

> The general premise was that only jobs for which there was a risk of unemployment were appropriate for coverage. In this way, there would be reasonable certainty that insurance principles would apply and that the insurance integrity of the plan would not be weakened. There was also the view that care should be taken to ensure that the plan did not attract people from other jobs into insurable employment just to acquire eligibility, thereby distorting the labour force. The practical difficulties of administering the plan were also an important consideration in deciding coverage.[72]

In its 1986 report, the Commission of Inquiry on Unemployment Insurance set out the rationale for excluding independent contractors from unemployment insurance:

> [T]he degree of moral hazard presented by the self-employed is incompatible with Unemployment Insurance. Moral hazard is the risk that an individual may create the conditions which permit collection of benefits. . . . Moral hazard can be minimized but not eliminated entirely.
>
> This argument is most readily applied to artists or professionals who may not have a large capital investment. But when a small business fails and is wound up—especially in cases of forced liquidation or bankruptcy—one could argue that the element of self-control is absent and therefore that the argument of moral hazard is invalid. If, however, Unemployment Insurance were to cover only the risk associated with these extreme circumstances and subject the self-employed to the same premiums as everyone else, one form of inequity would be submitted for another. If the premiums were to differ, then the program in question would no longer be Unemployment Insurance but some other, probably optional, program.[73]

Some commentators have also suggested that the self-employed might be omitted from payroll tax schemes such as the Canadian employment insurance regime because of a fear that the self-employed might simply not comply with the law.[74]

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71 Canada, Committee of Inquiry into the Unemployment Insurance Act, *Report* (Ottawa: Queen's Printer, 1962) ("the Gill report"), 20 and 103. See also Leonard Marsh, *Report on Social Security for Canada* (Toronto: University of Toronto Press, 1975), 93 and 234. For more on the background to and rationale for unemployment insurance, see Harvey S. Rosen, Paul Boothe, Bev Dahlby, and Roger S. Smith, *Public Finance in Canada* (Toronto: McGraw-Hill Ryerson, 1999), chapter 13; and G. Campeau, *De l'assurance-chômage à l'assurance-emploi: L'histoire du régime canadien et de son détournement* (Montréal: Boreal, 2001).

72 Gary Dingledine, *A Chronology of Response: The Evolution of Unemployment Insurance from 1940 to 1980* (Ottawa: Supply and Services, 1981), 9.

73 Canada, Commission of Inquiry on Unemployment Insurance, *Report* (Ottawa: Supply and Services, 1986), 239. See also the Gill report, supra note 71, at 112 and 174-75.

74 Jonathan R. Kesselman, *General Payroll Taxes: Economics, Politics, and Design*, Canadian Tax Paper no. 101 (Toronto: Canadian Tax Foundation, 1997), 88.

The Canada Pension Plan

As seen above, both employees and independent contractors are required to make contributions to the CPP. The difference between these two groups lies not in the requirement to make contributions but rather in the method of collection (contributions from employees are collected by way of withholding and remittance by employers) and in the calculation of the contributions (contributions are measured by reference to employment income for employees and by reference to net business income for independent contractors). These distinctions also appear in the employment insurance context.

There is very little material available with respect to the rationale for the distinction between employees and independent contractors in the context of the CPP.[75] This is not surprising; the consequences of the distinction are much less significant in this context than they are in the income tax and employment insurance contexts.

Nevertheless, there seems to have been a general understanding that CPP contributions ought to be paid by both employers and employees.[76] Speculating on the reasons why a payroll tax such as the CPP would be levied on employers, Kesselman suggests

> 1) the greater political appeal of a tax nominally paid by employers, who are far less numerous than workers in terms of the electoral process . . .
>
> 2) the greater ease of calculating and remitting tax from aggregate payrolls rather than withhold from the paycheques of individual workers, although this difference is minimal when the employer already has to withhold income tax and other levies on workers [this point does not apply to the CPP, which already requires contributions from employees] . . . [and]
>
> 3) a perception that the program to be financed by the payroll tax is a shared obligation for which the employer has some responsibility.[77]

From a principled viewpoint, then, it appears that the primary policy rationale for imposing contribution obligations on employers as well as employees is the perception that employers ought to take some responsibility for financing the CPP. This conclusion is bolstered by the fact that early iterations of the CPP made even more significant distinctions between employees and independent contractors[78] (although

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75 For material on the background to and rationale for the CPP, see Rosen et al., supra note 71, at chapter 14. See also Canada, Department of National Health and Welfare, *The Canada Pension Plan* (Ottawa: Queen's Printer, 1964).

76 See, for example, Canada, House of Commons, *Debates*, February 23, 1965, 11656-57.

77 Kesselman, supra note 74, at 108.

78 Contributions by independent contractors were originally conceived of as being voluntary rather than compulsory. Further, earlier versions of the CPP provided that the contribution rate for independent contractors could never exceed 1 percent of the rate for employees, so as to prevent effective subsidization of independent contractors by employees (because employers would also be contributing to the plan). See Robert M. Clark, "An Economist's View of the Canada Pension Plan," in *Symposium of Views on the Canada Pension Plan* (Don Mills, ON: CCH Canadian, 1964),

it should be noted that there was also an awareness of the administrative difficulties surrounding the collection of contributions from independent contractors).[79]

Concerns regarding the administration of the CPP and the intention that CPP contributions were to be "earnings related,"[80] the fact that unemployment insurance premiums and income tax liabilities were already being withheld from the salaries of employees, and the fact that the net income of self-employed persons was already being calculated for income tax purposes all suggest that it may have been perceived as inevitable that the CPP be designed so that contributions were to be withheld from and calculated on the basis of employees' salaries and that the contributions of the self-employed were to be calculated on the basis of net business income.

THE CASE LAW

In each of the federal income tax,[81] employment insurance, and CPP contexts, the relevant legislation has always specified that an employee (or, in the case of the EIA, a person covered by the legislation) is a person operating under a "contract of service."

Section 13 of the Unemployment Insurance Act, 1940[82] provided that persons in employments specified under part I of the First Schedule to the legislation were covered by the legislation, with the exception of persons in "excepted employment." Paragraph (a) of part I referred to

> [e]mployment in Canada under any contract of service or apprenticeship, written or oral, whether expressed or implied, or whether the person is paid by the employer or some other person, and whether under one or more employers, and whether by time or by the piece or partly by time and partly by the piece, or otherwise.

Under the new CPP, 25 years later, "employment" in paragraph 2(1)(q) was defined as

> the performance of services under an express or implied contract of service or apprenticeship, and includes the tenure of an office.

33-46, at 37. See also Kenneth Bryden, *Old Age Pensions and Policy-Making in Canada* (Montreal: McGill-Queen's University Press, 1974), 154 and 169. Bryden notes, ibid., at 160, that the switch from voluntary to mandatory coverage of independent contractors resulted in part from representations made by the Canadian Federation of Agriculture to the effect that farmers might not take advantage of voluntary coverage.

79 Ibid. See also Judy LaMarsh, "The Canada Pension Plan," in Laurence E. Coward, ed., *Pensions in Canada* (Don Mills, ON: CCH Canadian, 1964), 15-44, at 22.

80 Canada, Department of National Health and Welfare, *Canada Pension Plan—White Paper* (Ottawa: Queen's Printer, 1964), as reproduced in Canada, House of Commons, *Debates*, August 10, 1964, 6635-47, at 6638. For background on the development of the contributory aspect of the CPP, see Bryden, supra note 78, at chapters 6 and 7. See also John Burbidge, *Social Security in Canada: An Economic Appraisal*, Canadian Tax Paper no. 79 (Toronto: Canadian Tax Foundation, 1987), chapter 2.

81 With the exception of the period up to 1948.

82 Supra note 21.

With the introduction of the Income Tax Act (Canada)[83] effective in 1949, and consequent upon the introduction of severe limitations on the deductibility of expenses by employees,[84] came the definition of "employment" as

> the position of an individual in the service of some other person (including His Majesty or a foreign state or sovereign) and "servant" or "employee" means a person holding such a position.[85]

Before 1948, the Income War Tax Act (Canada) contained only a definition of "employed in Canada," which meant

> regularly or continuously employed to perform personal services, any part of which is performed in Canada for salary, wages, commissions, fees or other remuneration, whether directly or indirectly received, derived from sources within Canada.[86]

Given that the concept of a contract of service was or was perceived to be already well established in the common law, it is not surprising that income tax jurisprudence, as well as jurisprudence in the unemployment insurance and CPP contexts, focused on the common law distinction between "contract for service" and "contract of service" or, in other words, attempted to determine whether a common law master-servant relationship existed.[87] Interestingly, before the addition of subsection 6(6) to the Income War Tax Act in 1948,[88] prohibiting the deduction of disbursements or expenses in computing income from an office or employment,[89] and the new and now necessary definition of "employment," it was by no means

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83 SC 1948, c. 52.

84 See the postamble to section 5 introduced in SC 1948, c. 52. Comparable limitations were added to the Income War Tax Act by the introduction of subsection 6(6) in SC 1948, c. 53, section 3(1) (see infra note 88).

85 SC 1948, c. 52, paragraph 127(1)(l).

86 Income War Tax Act, RSC 1927, c. 97, paragraph 2(1)(c). Before these amendments, the Exchequer Court had begun to allow deductions for employees, contrary to the policy of the minister of national revenue. See *Bond v. MNR*, [1946] CTC 281 (Ex. Ct.). The definition of "employment" has not changed significantly since its introduction in 1948.

87 See, for example, *No. 129 v. MNR* (1953), 9 Tax ABC 287. As stated by the Tax Appeal Board in *Guerin v. MNR* (1952), 6 Tax ABC 77, at 87, "it can be seen from this definition that an employment implies, necessarily, an employer-employee or master-servant relationship." See also *D. Di Francesco v. MNR* (1964), 34 Tax ABC 380.

88 Supra note 84. Subsection 6(6) read, "In computing the income from an office or employment, no amount is deductible for a disbursement or expense laid out for the purpose of earning income." A handful of expenses were specifically allowed.

89 Previously, wages, salary, or other fixed amounts, etc., received by a person from an office or employment were merely one of a list of items to be included in income under subsection 3(1) of the Income War Tax Act, 1917, SC 1917, c. 28. Subsection 6(6) was apparently enacted in response to *Bond*, supra note 86. See LaBrie, supra note 61, at 109.

clear that "employee" or "employment" necessarily referred to a master-servant relationship.[90]

In a document entitled *Information for Employers Regarding the Unemployment Insurance Act 1940*, the federal government, stating that employees were considered to be persons working under a contract of service or apprenticeship, elaborated on the meaning of "contract of service" as follows:

> A contract of service is generally understood to be an agreement expressed or implied whereby one person (the employee) agrees to perform services for another (the employer) under the direction of the employer, not only as to the result to be accomplished but also as to the means by which that result is to be accomplished. Under such a contract, the employee is subject to the direction of the employer, not only as to what shall be done, but as to how it shall be done. It is not necessary that the employer actually direct the manner in which the services are to be performed but he must have the right to do so. The right to control hours of work and to discharge for cause are important factors indicating that a contract is a contract of service.[91]

Despite this relatively specific description of the concept of employment (or at least coverage by the Unemployment Insurance Act, 1940), in the early cases distinguishing persons covered by the unemployment insurance legislation from the self-employed, the Umpire did not refer to any case law or any specific tests; these early decisions were entirely fact-based.[92]

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90 In *Harold Hunter v. MNR* (1951), 4 Tax ABC 191, the Tax Appeal Board cited *Tilley v. Wales*, [1943] AC 386, at 393 (HL), for the proposition that employment "necessarily involves service over a period of time during which the office is held or the employment continues. The ordinary way of remunerating the holder or the person employed is to make payments to him periodically." According to the board, a key identifier of employment status was regularity or continuity of service. But see *J.J. Collins v. MNR* (1952), 5 Tax ABC 425, which relied on common law principles to determine whether a musician was an employee or an independent contractor. Note that one of the earliest cases on the meaning of "employed" (though not in the context of subsection 6(6)) actually rejected the master-servant approach: *Might v. MNR*, [1948] CTC 144 (Ex. Ct.); aff'd. without reasons [1949] CTC 41 (SCC). During the relevant period, very generally, the Income War Tax Act provided a more favourable taxation regime for a husband as compared with a single man, so long as the husband's wife did not have a separate income in excess of $660. "Earned income" that was earned "by reason of [the] wife being employed" did not count toward the $660 threshold. In *Might*, the taxpayer's wife practised medicine on her own account. The court found that "employed" in this context meant "being occupied, engaged or at work" rather than being in a master-servant relationship, largely on the basis that the policy of the provision (which, according to the court, was to induce married women to work and thereby alleviate the labour shortage) would be frustrated by a different interpretation.

91 Canada, Unemployment Insurance Commission, *Information for Employers Regarding the Unemployment Insurance Act 1940* (Ottawa: Unemployment Insurance Commission, 1943), 14.

92 See, for example, *Case No. CUB-273* (July 5, 1947) and *Case No. CUB-262* (June 26, 1947) in Canada, Unemployment Insurance Commission, *Selected Decisions of the Umpire: 1943-1948* (Ottawa: King's Printer, 1950), 281 and 270; *Case No. CUB-738* (October 1, 1951) and *Case No. CUB-800* (March 11, 1952) in Canada, Unemployment Insurance Commission, *Selected*

It quickly became clear, however, that courts in the unemployment insurance context accepted that the definition of "insurable employment" reflected the common law notion of master-servant relationship, and that the real issue confronting the courts was to choose among the various tests present in the jurisprudence.[93] This reliance on the common law in defining a contract of service persists to the present day, notwithstanding Supreme Court of Canada cases such as *Abrahams v. Attorney General of Canada*[94] and *Hills v. Canada (AG)*.[95] Those decisions held that the federal unemployment insurance legislation should be interpreted liberally, given that its primary purpose is to protect the unemployed, and therefore presented the opportunity to take a different approach to the contract of service concept.[96]

On the contrary, the jurisprudence in the unemployment insurance, federal income tax, and CPP areas became interchangeable, notwithstanding the different legislative and policy contexts. Indeed, the Pension Appeals Board explicitly rejected any distinction between the income tax context and the pension benefits context in *DiMarco Taxi Ltd. v. Minister of National Revenue*.[97] The board stated:

> [Counsel for the claimant has argued that since] this is not a taxing statute but rather social legislation, [and] thus . . . should benefit all and especially the individual . . . the strict and narrow interpretation normally applied to taxing statutes should not be the rule herein [and further that] it is obvious that this legislation must be given the broad and liberal interpretation treatment. Nonetheless I am satisfied that the common law tests of employer and employee relationships are the proper ones to be applied unless different guidelines are indicated in the statute, and I find no such indication."[98]

Generally, four different kinds of tests used to distinguish employees from independent contractors were applied by the courts and tribunals in the federal income tax, pension, and unemployment insurance contexts. The tests generally emerge from the common law of torts; to the extent that they do not, they seem to

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Decisions of the Umpire: 1949-1953 (Ottawa: King's Printer, n.d.); and *Case No. CUB-1566* (September 2, 1958) in Canada, Unemployment Insurance Commission, *Selected Decisions of the Umpire: 1956-1958* (Ottawa: Queen's Printer, n.d.).

93 See Marc Noël, "Contract for Services, Contract of Services—A Tax Perspective and Analysis," in *Report of Proceedings of the Twenty-Ninth Tax Conference*, 1977 Conference Report (Toronto: Canadian Tax Foundation, 1978), 712-40.

94 [1983] 1 SCR 2.

95 [1988] 1 SCR 513. See also *Canada Pacific Ltd. v. AG (Can.)*, [1986] 1 SCR 678.

96 Note, however, *Granovksy v. Canada*, [2000] 1 SCR 703, at 712, to the effect that the CPP is not social welfare legislation. In *Yellow Cab Co. v. MNR* (2002), 215 DLR (4th) 413, the Federal Court of Appeal refused to adopt a liberal interpretation of the regulations to the EIA (deeming certain persons, such as taxi drivers, to be engaged in insurable employment) notwithstanding *Abrahams*, supra note 94, and *Hills*, supra note 95.

97 (1968), CEB & PGR 5953 (PAB).

98 Ibid., at 5956. See also *Mann and Martel v. Minister of National Revenue* (1968), CEB & PGR 5958 (PAB).

have been perceived as reflecting the broader common law concept of master-servant relationship.[99] The four tests are described briefly here; the reader is referred to other authorities for a more thorough review.[100]

1. *The "control" test.* This is the oldest of the tests used to distinguish employees from independent contractors. The traditional formulation is that found in *The Queen v. Walker*:

   > It seems to me that the difference between the relations of master and servant and of principal and agent is this:—A principal has the right to direct what the agent has to do; but a master has not only that right, but also the right to say how it is to be done.[101]

   The control test was used frequently until the early 1980s.[102]

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99 Recent research suggests that the origins of the non-tax concept of "employment" are much more complex than these tests would suggest. See Judith Fudge, Eric Tucker, and Leah Vosko, *The Legal Concept of Employment: Marginalizing Workers* (Ottawa: Law Commission of Canada, 2002), 8-11. Nevertheless, these tests are the ones that have been applied by Canadian courts in the past.

100 See Robert Flannigan, "Employment Status for Income Tax Purposes" (1988) vol. 36, no. 1 *Canadian Tax Journal* 145-61; Joanne E. Magee, "Whose Business Is It? Employees Versus Independent Contractors," Personal Tax Planning feature (1997) vol. 45, no. 3 *Canadian Tax Journal* 584-603; Noël, supra note 93; and Wilson, supra note 16.

101 (1858), 27 LJMC 207, at 208 (Ct. for Crown Cases), per Baron Bramwell. In this case, Mr. Walker was hired by manure manufacturers to obtain orders for manure from farmers. Mr. Walker was accused of embezzling funds from the manure manufacturers. Apparently, the case for embezzlement could be made out only if Mr. Walker was found to be a servant of the manure manufacturers. The court found that Mr. Walker was an agent rather than a servant. See also *Hôpital Notre-Dame and Théoret v. Laurent*, [1978] 1 SCR 605, in which the Supreme Court of Canada seems to use a similar test in the context of a vicarious liability claim (against a hospital for the actions of a surgeon) under article 1054 of the Civil Code of Lower Canada (now, generally, CCQ article 1463).

102 See *DiMarco Taxi*, supra note 97; *Floors Moderne Limited v. Minister of National Revenue* (1969), CEB & PGR 5963 (PAB); *Skyview Photos Ltd. v. Minister of National Revenue* (1972), CEB & PGR 6097 (PAB); *C.A. Latimer v. MNR*, [1977] CTC 2128 (TRB); *J. Thibault v. MNR*, [1983] CTC 2211 (TRB); *J. Marotta v. The Queen*, [1986] 1 CTC 393 (FCTD); *J.M. Gagne v. MNR*, [1983] CTC 2502 (TRB); *R.J. Haynes v. MNR*, [1980] CTC 2616 (TRB); and *H.L. Molot v. MNR*, [1977] CTC 2170 (TRB) in the federal income tax context. See also Wilson, supra note 16, at 2:14.

Some commentators have stated that "control" has traditionally been measured with respect to four elements: (1) whether the employer has the power to hire or select the person who is providing the services; (2) whether the employer has control over the method of payment and the time when the worker is paid; (3) whether the employer has the right to evaluate the method and performance of the work; and (4) whether the employer has the right to fire or suspend the worker (see Krishna, supra note 19, at 178). However, it seems relatively clear that courts have tended to focus on the Baron Bramwell formulation in determining whether an employer can be said to "control." See Noël, supra note 93, at 724; and *Wiebe Door*, infra note 113, at 203.

2. *The "entrepreneur" test.* This test was developed by William O. Douglas[103] and applied in *Montreal v. Montreal Locomotive Works*, where it was expressed as follows:

> It has been suggested that a fourfold test would in some cases be more appropriate, a complex involving (1) control; (2) ownership of the tools; (3) chance of profit; (4) risk of loss. Control in itself is not always conclusive. . . . In many cases the question can only be settled by examining the whole of the various elements which constitute the relationship between the parties. In this way it is in some cases possible to decide the issue by raising as the crucial question whose business is it, or in other words by asking whether the party is carrying on the business, in the sense of carrying it on for himself or on his own behalf and not merely for a superior.[104]

   As noted by Wilson, this test was not used in Canada until the late 1970s and early 1980s.[105]

3. *The "integration" or "organization" test.* This test was initially articulated by Lord Denning in *Stevenson, Jordan and Harrison, Ltd. v. Macdonald and Evans*[106] and approved by the Supreme Court of Canada in *Co-operators Insurance Association v. Kearney*,[107] a vicarious liability case. The following passage from *Stevenson, Jordan and Harrison* set out the integration or organization test:

> One feature which seems to run through the instances is that, under a contract of service, a man is employed as part of a business, and his work is done as an integral part of the business; whereas, under a contract for services, his

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103 See William O. Douglas, "Vicarious Liability and the Administration of Risk I" (1929) vol. 38, no. 5 *Yale Law Journal* 584-604.

104 [1947] 1 DLR 161, at 169 (PC). The *Montreal Locomotive Works* decision was actually a municipal taxation case. Montreal Locomotive Works was found to be exempt from certain municipal taxes because it was considered to be an agent of the Crown. The Judicial Committee of the Privy Council applied the "entrepreneur" test because the control test was problematic, given "the more complex conditions of modern industry." Ibid., at 169. One might suggest that Douglas's article should have asked why vicarious liability *and* labour law tests are applied in the income tax, employment insurance, and pension plan contexts, given that *Montreal Locomotive Works* was a labour law case; however, I note that the origin of the test used in *Montreal Locomotive Works* is indeed an article on vicarious liability.

105 Wilson, supra note 16, at 2:15. See, for example, *Latimer*, supra note 102; *Marotta*, supra note 102; and *W. Hauser v. MNR*, [1978] CTC 2728 (TRB).

106 [1952] 1 TLR 101 (CA). In this case, the issue was the ownership of copyright in a textbook that was written by a worker while undertaking activities for his employer. If the worker was found to be an employee, the copyright would be owned by the employer, but if the worker was an independent contractor, the copyright would be owned by the worker. Although this case deals with copyright, the discussion of the characterization of the worker as an employee or an independent contractor is clearly rooted in the common law rather than in the interpretation of the copyright legislation.

107 [1965] SCR 106.

> work, although done for the business, is not integrated into it but is only accessory to it.[108]

This test was used in the CPP context for many years, but Canadian courts did not apply it in the federal income tax context until the late 1970s.[109]

4. *The "specific results" test.* This test has not appeared frequently in the jurisprudence.[110] The gist of the test is that an independent contractor is a person who is generally hired to accomplish a specific task.

> On the one hand, a contract of service is a contract under which one party, the servant or employee, agrees, for either a period of time or indefinitely, and either full time or part time, to work for the other party, the master or the employer. On the other hand, a contract for services is a contract under which the one party agrees that certain specified work will be done for the other. A contract of service does not normally envisage the accomplishment of a specified amount of work but does normally contemplate the servant putting his personal services at the disposal of the master during some period of time. A contract for services does normally envisage the accomplishment of a specified job or task and normally does not require that the contractor do anything personally.[111]

The "battle of the tests" continued[112] until some resolution was reached in the watershed case of *Wiebe Door Services Ltd. v. MNR*.[113] In *Wiebe Door*, the Federal Court of Appeal was required to determine whether the taxpayer was properly assessed for the payment of unemployment insurance premiums and CPP contributions. The taxpayer was in the business of installing and servicing doors and carried on these businesses through many door installers. The taxpayer had a specific understanding with each installer that taxes, workers' compensation contributions, unemployment insurance premiums, and CPP contributions would all be the responsibility of each installer, rather than the taxpayer.

The Tax Court of Canada applied the integration test. On the basis that the taxpayer would have been out of business without the installers, the court found

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108 *Stevenson, Jordan*, supra note 106, at 111.

109 See *Rosen v. The Queen*, 76 DTC 6274 (FCTD); *MacDonald v. MNR*, 74 DTC 1161 (TRB); *Whiteside v. MNR*, 77 DTC 239 (TRB); *Mann and Martel*, supra note 98; *Davis Miller Diamond v. Minister of National Revenue* (1969), CEB & PGR 5965 (PAB); *Skyview Photos*, supra note 102; *Comet Realties Ltd. v. Minister of National Revenue* (1972), CEB & PGR 6062 (PAB); and *Vic Sellner Ltd. v. Minister of National Revenue* (1972), CEB & PGR 6062 (PAB). See also *Grolier Limitée v. Ministère du revenu* (1969), CEB & PGR 5970 (PAB), for similar reasoning in the context of the QPP. See also Flannigan, supra note 100, at 158-59.

110 See Flannigan, supra note 100, at 157-58.

111 *Dr. W.H. Alexander v. MNR*, [1969] CTC 715, at 724 (Ex. Ct.). See also *Hauser*, supra note 105, at 2732; and *B.E. Forst v. MNR*, [1982] CTC 2053 (TRB).

112 See, for example, *Speedy Messenger Service v. Minister of National Revenue* (1981), CEB & PGR 6560 (PAB); *Terra Engineering Laboratories Ltd. v. Minister of National Revenue* (1983), CEB & PGR 6635 (PAB); *J. Lafleur et al. v. MNR*, [1984] CTC 2489 (TCC); and *Thibault*, supra note 102.

113 [1986] 2 CTC 200 (FCA).

that the installers were employees. The taxpayer appealed to the Federal Court of Appeal, arguing that the Tax Court of Canada had applied the wrong test.

At the Federal Court of Appeal, Justice MacGuigan for the court began his analysis by noting that the distinction between employees and independent contractors arises more often in tort law or labour law. He commented that the traditional common law test for the distinction was the control test but then reviewed problems inherent in that test. In Justice MacGuigan's view, a contract between an employer and an independent contractor could contain such detailed specifications and conditions that an employer could exert more control over that independent contractor than many employers exert over their employees. Justice MacGuigan also noted that the control test does not work well for skilled professional employees who, owing to the nature of their skills, might be difficult to control.

Accordingly, Justice MacGuigan considered other alternatives. Noting the existence of the entrepreneur test and the integration test, he found that the latter (which was used by the Tax Court) would be decisive only in some cases and could be prone to misuse, particularly if viewed from the perspective of the employer rather than the employee.

In Justice MacGuigan's view, the "best synthesis" of the appropriate tests was to be found in the judgment of Justice Cooke in *Market Invests. v. Min. of Social Sec.*:

> The observations of Lord Wright, of Denning L.J., and of the judges of the Supreme Court in the U.S.A. suggest that the fundamental test to be applied is this: "Is the person who has engaged himself to perform these services performing them as a person in business on his own account?" If the answer to that question is "yes," then the contract is a contract for services. If the answer is "no" then the contract is a contract of service. No exhaustive list has been compiled and perhaps no exhaustive list can be compiled of considerations which are relevant in determining that question, nor can strict rules be laid down as to the relative weight which the various considerations should carry in particular cases. The most that can be said is that control will no doubt always be considered, although it can no longer be regarded as the sole determining factor; and that factors, which may be of importance, are such matters as whether the man performing the services provides his own equipment, whether he hires his own helpers, what degree of financial risk be taken, what degree of responsibility for investment and management he has, and whether and how far he has an opportunity of profiting from sound management in the performance of his task.[114]

Accordingly, the Federal Court of Appeal found that the Tax Court of Canada had erred in using the organization or integration test and referred the matter back to that court for reconsideration.

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114 [1968] 3 All ER 732, at 737-38 (QB). The issue in this case was whether a market researcher was eligible for benefits as an employee under the British unemployment insurance legislation. The British legislation defined an employment as operating "under a contract of service." In the court's summary of several authorities, the most prominent was the *Montreal Locomotive* decision.

Wiebe Door became the leading case on the employee-independent contractor distinction[115] and is accepted by the Canada Customs and Revenue Agency (CCRA) as such.[116]

The jurisprudence came full circle when *Wiebe Door* was substantially adopted by the Supreme Court of Canada in a vicarious liability case in 2001. In *671122 Ontario Ltd. v. Sagaz Industries Canada Inc.*,[117] the primary issue was whether Sagaz Industries Canada Inc. ("Sagaz") was vicariously liable to 671122, formerly Design Dynamics Limited ("Design"), for the actions of Stewart Landow and American Independent Marketing Inc. ("AIM") in connection with a bribery scheme.

The facts in this case were relatively simple. Design had been in the business of supplying synthetic sheepskin car seat covers for 30 years. Canadian Tire Corporation ("Canadian Tire") was Design's largest customer, accounting for over 50 percent of Design's sales. In 1984, Design lost the Canadian Tire account to Sagaz. The trial judge found that Canadian Tire had switched from Design to Sagaz because the head of Canadian Tire's automotive division, Robert Summers, had accepted bribes from Landow and AIM through a corporate intermediary, International Marketing Consultants ("IMC"). Summers, through IMC, received from AIM 2 percent of all sales of synthetic seat covers by Sagaz to Canadian Tire. The trial judge found that Landow and AIM were liable for the tort of unlawful interference with economic relations and assessed damages against them of $1,807,500 plus $50,000 in punitive damages.[118]

Design also sued Sagaz on the basis that it was vicariously liable for Landow's and AIM's actions. The trial judge found that AIM was an independent contractor[119] and that therefore Sagaz was not vicariously liable for AIM's actions. The Ontario Court of Appeal found that Sagaz was vicariously liable to Design in respect of the actions of both Landow and AIM on the basis of the organization test.[120]

The Supreme Court of Canada began its analysis with the decision of the Federal Court of Appeal in *Wiebe Door*, noting the existence of the control test, the entrepreneur test, and the organization or integration test.[121] The court in *Sagaz* held that a "persuasive approach to the issue" is the *Market Investigations* test used in *Wiebe Door*:

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115 See *Moose Jaw Kinsmen Flying Fins Inc. v. MNR*, [1988] 2 CTC 2377 (FCA).

116 See *Interpretation Bulletin* IT-525R, April 24, 2002.

117 Supra note 7.

118 (1998), 40 OR (3d) 229 (Gen. Div.).

119 The trial judge did not make any findings with respect to Landow.

120 (2000), 183 DLR (4th) 488 (Ont. CA). The Court of Appeal cited *Mayer v. J. Conrad Lavigne Ltd.* (1979), 27 OR (2d) 129 (CA), which in turn cited John G. Fleming, *The Law of Torts*, 2d ed. (Sydney: Law Book, 1961) and *Stevenson, Jordan*, supra note 106. At issue in *Mayer* was whether a worker was an employee under the Canada Labour Code, RSC 1970, c. L-1, such that he was entitled to vacation pay.

121 The Supreme Court of Canada also noted a fourth test, called the "enterprise" test, set out by Robert Flannigan in "Enterprise Control: The Servant-Independent Contractor Distinction" (1987) vol. 37, no. 1 *University of Toronto Law Journal* 25-61. The Supreme Court of Canada

> [T]here is no one conclusive test which can be universally applied to determine whether a person is an employee or an independent contractor. . . .
>
> Although there is no universal test to determine whether a person is an employee or an independent contractor, I agree with MacGuigan J.A. that a persuasive approach to the issue is that taken by Cooke J. in *Market Investigations*. . . . The central question is whether the person who has been engaged to perform the services is performing them as a person in business on his own account. In making this determination, the level of control the employer has over the worker's activities will always be a factor. However, other factors to consider include whether the worker provides his or her own equipment, whether the worker hires his or her own helpers, the degree of financial risk taken by the worker, the degree of responsibility for investment and management held by the worker, and the worker's opportunity for profit in the performance of his or her tasks.
>
> It bears repeating that the above factors constitute a non-exhaustive list, and there is no set formula as to their application. The relative weight of each will depend on the particular facts and circumstances of the case.[122]

Applying this approach to the facts at hand, the Supreme Court of Canada held that AIM[123] was an independent contractor. The court relied particularly on the following facts:

- *With respect to whether AIM and Sagaz were separate legal entities*:[124] AIM and Sagaz had different office locations; AIM paid its own costs of conducting business; and AIM could carry on other activities and represent other suppliers so long as it was not competing with Sagaz.
- *With respect to AIM's responsibility for investment and management*: AIM had discretion with respect to time devoted to representing Sagaz or performing in-store services; Landow had discretion with respect to the number of trips he would take to Toronto; and AIM had no authority to bind Sagaz.

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found that Flannigan's enterprise test would impose vicarious liability on an employer because (1) the employer controls the activities of the worker, (2) the employer is in a position to reduce the risk of loss, (3) the employer benefits from the activities of the worker, and (4) the true cost of a product or service ought to be borne by the enterprise offering it. In fact, this is not the enterprise test as set out by Flannigan; rather, this list is merely a justification of the imposition of vicarious liability in the tort context. Flannigan's "enterprise" or "enterprise control" test is, instead, a "substantial reconstruction" of the entrepreneur test. Ibid., at 48. Flannigan sees the entrepreneur test as an elaboration of the control test, and his enterprise test is a further elaboration or reworking of approaches to control. Flannigan considers control of assets to be of paramount importance, but is willing to look at other factors if they are truly indications of control. See ibid., at 41 and 48-51. In Flannigan's view, *Market Investigations* is a rudimentary version of his enterprise test. See ibid., at 59-61.

122 *Sagaz*, supra note 7, at paragraphs 46 to 48.

123 Landow seems to drop in and out of the analysis at this point.

124 It is strange that the court raised this issue, given that the question of vicarious liability arises only in the context of two (or more) separate legal entities.

- *With respect to risk of loss and opportunity for profit*: Landow and AIM worked on commission.
- *With respect to control*: Although Sagaz directed prices, terms, and other conditions of negotiations with Canadian Tire, AIM "was ultimately in control of providing assistance to Sagaz in retaining the goodwill of Canadian Tire. . . . [A]lthough Sagaz controlled what was done, AIM controlled how it was done. This indicates that Landow was not controlled by Sagaz."[125]

The Supreme Court of Canada in *Sagaz*, then, clearly uses the *Wiebe Door* approach to determine vicarious liability in the tort law context, thereby making *Wiebe Door* the leading case for all four contexts under discussion here: vicarious liability, federal income tax, employment insurance, and the CPP. Note that, despite the court's explicit statement that the relative weight of each factor must be determined, the court does not seem to apply its own instruction to the facts at hand; there is no meaningful discussion as to the weight to be accorded to each factor. This is perhaps unsurprising given that courts have been required to weigh each factor since *Moose Jaw Kinsmen*,[126] yet have regularly failed to do so.

One more important jurisprudential development occurred in this area soon after *Sagaz*. This time the Federal Court of Appeal was required to take into account the CCQ in considering the distinction between employees and independent contractors in the context of the ITA. In *Wolf v. The Queen*,[127] the taxpayer, a US resident, was a mechanical engineer who worked in the aerospace industry. He was placed with Canadair Limited ("Canadair") through Kirk-Mayer of Canada Ltd. ("Kirk-Mayer"), a corporation that found workers for Canadair. The taxpayer signed a contract with Kirk-Mayer in January 1990, which included termination provisions. The assignment had a duration of one year but could be extended at Canadair's discretion. The taxpayer worked on a variety of different projects, such as flight test installations. No one supervised the taxpayer once he was given a task. The taxpayer had access to specialized computer equipment that was essential for his work. He did not have his own office or desk but had an identification card that gave him access to some of Canadair's facilities. The taxpayer's contract was renewed, with some gaps, until 1995. The taxpayer received an hourly fee, a per diem if certain conditions were met, pay for statutory holidays, a completion bonus, and a vacation bonus, and was reimbursed for travel costs upon fulfillment of a condition. The taxpayer billed his hours to Canadair with a copy to Kirk-Mayer; Canadair then paid Kirk-Mayer, which in turn paid the taxpayer but deducted Kirk-Mayer's own fees, CPP contributions, employment insurance premiums, and non-resident withholding tax. However, the taxpayer claimed lodging and travel expenses as business expenses; the minister of national revenue disallowed the deductions.

125 *Sagaz*, supra note 7, at paragraph 55, per Major J.

126 Supra note 115.

127 [2002] 3 CTC 3 (FCA).

The taxpayer argued that he was a non-resident of Canada and an independent contractor without a fixed base in Canada, and was therefore exempt from taxation under article XIV of the Canada-US income tax convention.[128] By the time the case reached the Federal Court of Appeal, the Crown had decided not to challenge the finding of the Tax Court of Canada that the taxpayer was not a resident of Canada and conceded that the taxpayer did not have a fixed base in Canada; therefore, the only remaining issue was the taxpayer's status as an employee or an independent contractor.[129]

Justice Desjardins at the Federal Court of Appeal began by citing the relevant portions of the CCQ dealing with employees and independent contractors, including articles 2085 and 2098 (already set out above).[130] Relying particularly on *Hôpital Notre-Dame*,[131] Justice Desjardins held that

> the distinction between a contract of employment and a contract for services under the Civil Code of Québec can be examined in light of the tests developed through the years both in the civil and in the common law.[132]

Therefore, Justice Desjardins moved on to *Sagaz*, quoting the key portions of Justice Major's judgment (reproduced above) approving of the approach in *Market Investigations* and *Wiebe Door*. Justice Desjardins stated,

> These words [of Justice Major] dictate the investigation I must embark on. The factors traditionally developed by the case law have not been discarded. They remain valid, although somewhat reformulated.[133]

Justice Desjardins therefore examined the level of control that Canadair exercised over the taxpayer's activities, the ownership of the equipment used by the taxpayer, whether the taxpayer hired helpers, and whether the taxpayer took the appropriate degree of financial risk and opportunity for profit.

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128 The Convention Between Canada and the United States of America with Respect to Taxes on Income and on Capital, signed at Washington, DC on September 26, 1980, as amended by the protocols signed on June 14, 1983, March 28, 1984, March 17, 1995, and July 29, 1997 (herein referred to as "the Canada-US convention").

129 Presumably, the exemptions for income from dependent personal services in article XV of the Canada-US convention were not applicable to the taxpayer.

130 See the text accompanying note 11, supra. In fact, for three out of the five taxation years in issue, the predecessor to the CCQ, namely, the Civil Code of Lower Canada, was in effect. However, the court took the view that there were no fundamental differences in the relevant provisions as between the two versions of the civil code and therefore referred only to the CCQ.

131 Supra note 101. Note that this case was decided before the CCQ was enacted.

132 Supra note 127, at paragraph 49. As a practical and arguably legal matter, this statement appears to be correct. See Durnford, supra note 8, who notes at 297 and 305 that both civil and common law courts in Canada applied the *Wiebe Door* test.

133 Supra note 127, at paragraph 61.

With respect to the criterion of control, Justice Desjardins found that the taxpayer did indeed have control over how he did the tasks assigned to him, but found that the control criterion should not be given excessive weight in the circumstances, particularly given the degree of specialization required with respect to the particular tasks involved. Justice Desjardins also found that ownership of the tools should be a neutral factor, given that ownership of the tools by Canadair could be compatible with either status.[134] The taxpayer could not delegate his tasks to someone else; Justice Desjardins again did not view this fact as being material to characterization of the taxpayer as either an employee or an independent contractor. Finally, Justice Desjardins considered the financial risk and opportunity for profit associated with the taxpayer's activities. She found that the taxpayer took all the risks of the activities in question since he was not provided with health insurance, pension benefits, job security, union membership, access to educational courses provided to employees, or the opportunity for a promotion.

Justices Décary and Noël reached the same conclusion as Justice Desjardins and seemed to agree generally with her usage of the factors set out in *Market Investigations*, *Wiebe Door*, and *Sagaz*.[135] However, both Justices Décary and Noël specifically relied on another criterion, namely, the intention of the parties. Justice Décary cited CCQ article 1425, which provides that "[t]he common intention of the parties rather than the adherence to the literal meaning of the words shall be sought in interpreting a contract," and CCQ article 1426, which states that "[i]n interpreting a contract, the nature of the contract, the circumstances in which it was formed, the interpretation which has already been given to it by the parties or which it may have received, and usage, are all taken into account." Justice Décary then stated:

> When a contract is genuinely entered into as a contract for services and is performed as such, the common intention of the parties is clear and that should be the end of the search.[136]

Similarly, Justice Noël stated:

> It follows that the manner in which the parties viewed their agreement must prevail unless they can be shown to have been mistaken as to the true nature of their relationship. In this respect, the evidence when assessed in the light of the relevant legal tests

134 This logic seems somewhat circular.

135 Justice Décary did state, however, that "[t]he test, therefore, is whether, looking at the total relationship of the parties, there is control on one hand and subordination on the other." Supra note 127, at paragraph 117. This approach seems to be different from that taken by Justice Desjardins, in that Justice Décary places more emphasis on control and subordination (as per the CCQ) than does Justice Desjardins. The matter becomes even more confused given Justice Noël's statement that his "assessment of the applicable legal tests to the facts of this case is essentially the same as that of [his] colleagues." Ibid., at paragraph 123. However, Justice Noël then appears to support the analysis of Justice Desjardins.

136 Ibid., at paragraph 119.

> is at best neutral. As the parties considered that they were engaged in an independent contractor relationship and as they acted in a manner that was consistent with this relationship, I do not believe that it was open to the Tax Court Judge to disregard their understanding.[137]

Does *Wolf*, then, provide a different civil law test for distinguishing between employees and independent contractors? Unfortunately, the interaction of the three judgments is far from clear. Arguably, *Wolf* merely provides a twist on the common law approach. Both Justices Décary and Noël (although perhaps this is less clear in the case of Justice Décary, who uses the language of control and subordination more consistent with the CCQ) seem to agree with the initial usage of the *Wiebe Door*/*Sagaz* factors by Justice Desjardins and rely on the intention of the parties only as a type of "tiebreaker." Indeed, it seems clear from the decisions by Justices Décary and Noël that the intention of the parties would not prevail if it was inconsistent with the substance of the relationship. Therefore, the combination of the three judgments in *Wolf* suggests (perhaps wrongly) that the *Wiebe Door*/*Sagaz* approach is the correct approach to take even where the distinction between employees and independent contractors is governed by the CCQ, but that, in contrast to the common law context, where the *Wiebe Door*/*Sagaz* approach does not yield a clear conclusion, the intention of the parties should be considered to be a type of "tiebreaker." Further, query whether a "tiebreaker" is required if the court has properly weighed the *Wiebe Door* factors. Indeed, it is difficult to see how a court could compare the intention of the parties to the substance of the relationship if the substance of the relationship depends on how a court chooses to weigh the different *Wiebe Door* factors in the particular context.

SHOULD THE TORT LAW APPROACH BE USED FOR PURPOSES OF FEDERAL INCOME TAX, EMPLOYMENT INSURANCE, AND THE CPP?

Notwithstanding that the test for vicarious liability used by the Supreme Court of Canada in *Sagaz* is taken from the unemployment insurance and CPP case of *Wiebe Door*, we have seen that the tests examined by the Federal Court of Appeal in *Wiebe Door* are typically tests arising in, or indirectly out of, the tort law context.

As discussed above, in the recent case of *Bazley*, the Supreme Court of Canada enumerated the two primary policy concerns implicated in the vicarious liability doctrine: the provision of a just and practical remedy for the harm and the deterrence of future harm. Given those concerns, it is not surprising that the Supreme Court in *Sagaz* supported the entrepreneur test (or something like it, to the extent that the test applied in *Market Investigations* can be considered to be a different test). After all, the entrepreneur test was designed specifically to respond to policy issues raised in the vicarious liability context. As noted by William Douglas in the article

137 Ibid., at paragraph 124.

that first articulated the entrepreneur test, the test is intended to reflect an appropriate allocation of responsibility and liability for risk as between an employer and a worker, specifically with respect to risk avoidance, risk prevention, risk shifting, and risk distribution.[138] Thus, for example, the person who has control over the selection of personnel can reduce risk by selecting competent workers. The person who has ownership of the relevant equipment can reduce risk by purchasing suitable equipment and maintaining it properly, and purchasing insurance with respect to that equipment, the latter, of course, also helping to fund the payment of damages claims. The person who has the risk of loss or opportunity for profit is the person who is best able to shift the costs of risk avoidance and prevention (for example, by passing on the costs of insurance to customers) and who has the greatest interest in avoiding costly litigation and litigation settlements. The owner of a business is in the best position to consider risk management and to fund payments to tort victims.[139]

The *Sagaz* approach to vicarious liability is now the test used to distinguish between employees and independent contractors for federal income tax, employment insurance, and CPP purposes (subject to *Wolf*, which will be discussed again below). This article is not intended to evaluate the utility of the *Sagaz* approach in determining vicarious liability. Instead, the remainder of the article will focus on whether that approach—or whether any tort-law-based test—is an appropriate test to use in these three non-tort-law contexts.

Federal Income Tax

As seen above, the justification for the distinction between employees and independent contractors in the context of Canadian federal income taxation is largely administrative. Put very bluntly, the use of a specific category for employees under the ITA permits the reduction of deductions available to employees. Such a reduction relieves the CCRA from the otherwise overwhelming burden of having to process millions or even billions of expense claims that could otherwise be made by employees each year. Such a reduction in turn allows the use of a withholding system in respect of employee remuneration; arguably, the application of a withholding system (which would apply to gross income) could otherwise be unfair given the potentially large discrepancy between gross and net income.

Is it sensible to use a tort law test in light of this stated goal? Marc Noël (now Justice Noël) suggests that it is:

> [T]he legislator, in referring to "employment," and attaching thereto a number of income tax consequences, was not attempting to create a departure from the civil or common law notion of employment, but rather was attaching to that civil or common law concept a logical set of rules consistent with the economic reality which underlies an employer-employee relationship. For instance, one of the very basic principles

138 Douglas, supra note 103, at 588 and 598.

139 Ibid,. at 601-2. See also Flannigan, supra note 121.

> pertaining to income from employment under the *Income Tax Act* is the rule that no deductions are allowed in computing income from employment, except as specifically provided in section 8 of the Act. This principle is clearly consistent with the fact that, generally, an employee does not have to incur any expenses to earn his salary, the expenses in usual circumstances being borne by the employer. Similarly, an employer pays a salary to his employee and because of the permanency of the relationship, is usually in a position to ascertain with little difficulty the yearly remuneration of any given employee, with the result that, for purposes of convenience, the legislator has by virtue of paragraph 153(1)(a) of the Act, imposed upon an employer who pays a salary or wages to an officer or employee the obligation to withhold at source the tax owed by the employee and remit that amount to the Receiver General of Canada.[140]

Another justification for the distinction between employees and independent contractors, this time apparently advanced by the Canadian taxation authorities, was that expenditures incurred by employees—at least voluntary ones (that is, expenditures not actually required by the employees' employment contracts)—are really personal expenses but that similar expenses made by independent contractors are not.[141] However, as McGregor points out, this position is based on the assumption that employers know better than employees what are valid expenses in connection with a job, or that employers and employees have negotiated for such valid expenses; McGregor correctly observes that neither assumption holds in all cases.[142]

Finally, Flannigan argues:

> If the policy decision behind the adoption of the servant/independent contractor distinction in the income tax context was an arbitrary one, the only task is, in some way, to distinguish objectively a business from an employment. As it happens, the enterprise control test appears to be singularly appropriate for this purpose. The test positively determines whether the worker is receiving business income because it specifically determines whether or not a worker business exists. It answers exactly the question being asked—is the worker receiving business income or employment income?[143]

The explanation offered by Flannigan is unhelpful in the context of this article, given that the policy decision underlying the distinction between employees and independent contractors was not arbitrary—the rationale was articulated as being one of administrative convenience.

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140 Noël, supra note 93, at 717 (citations omitted).

141 See McGregor, supra note 60, at 20-21.

142 Ibid. Note in this respect the *Harbron* decision, supra note 62. McGregor also suggests that an additional reason for refusing employees' deductions but not those of independent contractors is that employees are "neither as vocal nor as powerful (politically)" as independent contractors. Ibid., at 21.

143 Flannigan, supra note 100, at 161. See supra note 121 for an explanation of the enterprise control test.

But what of the rationale offered by Noël? Given the policy rationale for vicarious liability, one would not expect that the tests developed in that area to distinguish between employees and independent contractors would have much relevance to an attempt to delineate the group that has only narrow access to deductions for federal income tax purposes. It turns out, however, that Noël's position has some basis: there is indeed a fair amount of overlap between the tort law distinction and the income tax distinction.

The most obvious example of such overlap is the "ownership of equipment" criterion in the entrepreneur test. A worker who owns equipment used for providing services should be entitled to deductions in respect of the acquisition and maintenance of that equipment. The traditional control test, which is another element of the entrepreneur test, also has some relevance to the availability of deductions for workers. An employer who has control over the way in which a task is accomplished is frequently also the person who will be incurring the expenses related to the accomplishment of the task. In addition, the risk of loss and opportunity for profit from the effective management of a task is related to deductibility; the person who has the risk of loss and enjoys the opportunity for profit is likely to be the same person who makes decisions as to what expenses will be incurred with respect to the particular task. In respect of the integration test, where a worker is integral to an employer's business, the expenses related to that worker's activities are more likely to be incurred by the employer.

Nevertheless, the use of the test in *Sagaz* or any other tort law test for Canadian federal income tax purposes remains problematic for a number of reasons.

First, notwithstanding that employee status under the tort law tests reviewed in this article may correlate to the allocation to an employer of most of the responsibility for employment expenses, the tort law tests are not applied to the income tax context with an income tax rationale in mind. Therefore, if a court applies a tort law test to the income tax context and finds that the characterization of a worker as an employee or independent contractor turns out to reflect the employee's responsibility or need for the deductibility of expenses, such a result will be accidental, although fortuitous.

It could be argued that so long as the tort law test achieves the right result, it is irrelevant whether that result was reached by deliberate reasoning or by lucky accident. One problem with this argument is that it has not been tested; although one can see the theoretical overlap between the tort law vicarious liability tests and an ideal income tax test, the reality of such an overlap is unclear. Another problem is that it seems unrealistic to expect that courts will accidentally reach appropriate conclusions if they are required to apply tests in the absence of a policy context (or, indeed, in the presence of an irrelevant policy context). One example of a situation in which a policy context might have been useful in the application of the *Wiebe Door*/*Sagaz* tests is *Wolf*, where Justice Desjardins found that the taxpayer took all the financial risks associated with the activities in question because he was not provided with health insurance, pension benefits, and job security, for example. The facts considered by Justice Desjardins may have been relevant to the tort context

(actually, they seem very relevant to the employment insurance context) but do not have much bearing on the allocation of deductions between the taxpayer and the employer. This type of problem becomes evident when one examines groups of cases dealing with similar fact patterns (such as university lecturers or teaching assistants)[144] yet producing results based on precedent; presumably these groups of cases would yield outcomes more consistent with economic reality if the courts were able to rely on more clearly articulated tax policy (even if the stated basis for that policy were merely administrative convenience).

Second, although using a tort law test to identify employees does achieve the goal of radically reducing the number of expense claims that would otherwise be submitted to the Canadian revenue authorities, the use of a tort law test for this purpose is inefficient and inequitable. Of course, using the current deduction rules for all individual providers of labour at least formally leaves to the employer the decision as to which expenses should be incurred. As seen above, the assumption that the employer is in a better position than an employee to make such a decision can be strongly refuted.[145] This assumption becomes even weaker when applied to many (although certainly not all) independent contractors in comparison with recipients of their services. However, in many, if not most, cases, as a worker becomes less like an employee and more like an independent contractor, the degree to which the contract between the employer and the worker is negotiated should increase, and therefore the ability of the worker to insist that the employer incur certain expenses is heightened. Notably, none of the different tests used to distinguish between employees and independent contractors focuses on contract negotiations.

Third, the use of a tort law test is problematic in that it creates uncertainty. A tort law test is a creature of case law. Case law changes over time (as seen above in connection with the development of the entrepreneur and integration tests, and finally with *Wiebe Door*, *Sagaz*, and *Wolf*). Case law in the context of vicarious liability is also uncertain because it can be very fact-specific. This type of uncertainty can lead to problems in administering the test, either because it is difficult for the CCRA to audit and assess consistently, or because in the attempt to audit and assess consistently, the CCRA overly simplifies or restricts the relevant case law.[146]

144 Contrast *J.T. Bart v. MNR*, [1991] 1 CTC 2632 (TCC); *R. Talbot v. MNR*, [1992] 2 CTC 2264 (TCC); *Cavanagh v. The Queen*, [1997] 3 CTC 2155 (TCC); and *Lallier v. The Queen*, [2001] 4 CTC 2449 (TCC). Each of these cases addresses the situation of a part-time lecturer or teaching assistant. In virtually all of these cases, the court relies heavily on precedent and typically finds that the lecturer or assistant in question is an employee, without considering whether there may be economic indications suggesting the opposite. An entirely different analysis and an entirely different outcome emerge in *Cavanagh*, which is much more consistent with economic reality but seems to constitute a significant break with the rest of the case law regarding this type of taxpayer.

145 See the text accompanying note 142, supra.

146 This is a somewhat ironic result given that the rationale for the employee-independent contractor distinction in the federal income tax context is to ease the administrative burden on the CCRA.

These problems are compounded when a tort law test such as *Wiebe Door* is applied to particular industries where a general practice has already developed.[147]

Brian Wilson has also noted that the uncertainty surrounding the use of the *Wiebe Door* type of analysis to the determination of employee or independent contractor status could lead to aggressive filing positions, which are risky not only for employers but also for workers. Aggressive filing positions taken in the past have caused the Department of Finance to legislate higher interest costs, higher penalties, and more anti-avoidance rules.[148] Employers may want to treat workers as independent contractors in order to avoid compliance with employment law standards (such as vacation pay and the right to receive notice of termination) and the payment of payroll taxes (including employment insurance and pension plan contributions).[149] It is perhaps not surprising that the CCRA has, at least in the past, considered that, in most cases, workers who identify themselves as independent contractors are actually employees.[150] The incentive for employers to treat workers as independent contractors is discussed further below in the context of employment insurance and the CPP.

Finally, the use of a tort law test, which is a common law test, raises problems in a bijural (common law and civil law) system. Given that the concept of "employment" in the ITA is defined and has been interpreted to have the meaning given to that concept by the private law, the current distinction between employees and independent contractors should be tested on a different basis as between the common law provinces and Quebec.[151] The stated justification for treating employees and independent contractors differently for income tax purposes demands consistent application of one test throughout Canada. Certainly the suggestion that the intention of the parties may be relevant to employee or independent contractor characterization, at least in Quebec, is cause for concern. Therefore, unless the ITA is amended so as to define "employee" by reference to a common law tort definition, support for the use of a tort law test to distinguish between employees and independent contractors is also support for differential treatment as between common law provinces and Quebec.[152]

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147 Wilson, supra note 16, at 2:21-26.

148 Ibid., at 2:21.

149 See Bev Dahlby, "Payroll Taxes," in Allan M. Maslove, ed., *Business Taxation for Ontario* (Toronto: University of Toronto Press in cooperation with the Ontario Fair Tax Commission, 1993), 80-170, at 139-40.

150 Magee, supra note 100, at 590.

151 Indeed, this difference in meaning is now mandated by section 8.1 of the Interpretation Act, RSC 1985, c. I-21, as amended (reproduced in the text below following note 187). The degree to which the common law and civil law tests differ may be disputed, of course. Contrast Auger, supra note 13, at 3:52, with Durnford, supra note 8, at 306-8. See also *Wolf*, supra note 127, at paragraphs 42 to 50, per Desjardins J, and at paragraphs 114 to 116, per Décary J.

152 Notwithstanding the above, as a practical matter, at least (arguably) until the *Wolf* decision, tax courts, particularly in the income tax context, were applying common law tort tests even when

Of course, the distinction between employees and independent contractors in the federal income tax context is important not only with respect to deductions, but also with respect to collection. As noted above, employees are subject to a withholding system whereas independent contractors are subject to an instalment system. As noted by Noël, this difference in collection mechanisms could be viewed as sensible in that it recognizes that the gross salary and wages paid to employees will be a close approximation of the net employment income received by those employees, and therefore the application of a withholding rate to a gross payment of salary or wages would not be particularly unfair. If withholdings are too high, they are refunded after an income tax return is filed.[153] Imposing a withholding regime on gross business income earned by independent contractors may be considered unfair given that the scope for deductions by independent contractors is much greater than that of employees, and therefore there might be a significant difference between gross and net business income. There is a countervailing argument, however. Overpayments of instalments also yield refunds,[154] and therefore an adjustment would be made at year-end to account for any gap between gross and net income. Additionally, the current instalment system may be even less accurate than a withholding system, which applies to current income, given that the basis for instalment payments can be and often is income tax payable in preceding years.[155] Therefore, the distinction between employees and independent contractors in the context of the choice between a withholding and an instalment regime may not be of huge significance.

There may also be some concern from a horizontal equity perspective with respect to tax deferral. While withholdings from salary are imposed upon payment of salary, for independent contractors there may be a gap between the time when business income is received and the time when instalments are due.[156] However,

civil law tests should have been applied. See Auger, supra note 13, at 3:52; Durnford, supra note 8; Pierre-Jean Beauregard, "Interaction du droit civil et de la Loi de l'impôt," in *Report of Proceedings of the Thirty-Seventh Tax Conference*, 1985 Conference Report (Toronto: Canadian Tax Foundation, 1986), 25:1-27, at 25:5. See also Yves Thivierge, "L'évolution jurisprudentielle de la distinction entre employé et travailleur autonome" (1984) vol. 6, no. 1 *Revue de planification fiscale et successorale* 7-34; and Pierre Archambault and Nicholas Kasirer, "Employé et travailleur autonome : Distinction juridique et le problème des sources du droit" (1987) vol. 9, no. 2 *Revue de planification fiscale et successorale* 287-302. The Federal Court of Appeal in *Wolf* used the employee-independent contractor distinction as set forth in CCQ articles 2085 and 2098, rather than the vicarious liability concept as set forth in CCQ article 1463.

153 ITA subsection 164(1).

154 Ibid.

155 Instalments can be calculated on the basis of tax estimated to be payable in the year (see ITA subparagraph 156(1)(a)(i)) but can be, and often are, calculated on the basis of tax payable in the preceding and possibly even the second preceding taxation year (see the remainder of ITA subsection 156(1)).

156 See Soos, infra note 180, at 132, 173, 179-82, and 192.

these gaps in time should not be significant.[157] Further, in some cases instalments may be due before all the income is actually received (given that independent contractors do not report income on the basis of accrual rather than receipt). Accordingly, concerns about possible tax deferral opportunities should be relatively minor.[158]

Employment Insurance

As we have seen, the employee-independent contractor distinction in the context of Canadian federal income tax is intimately related to that distinction in the context of employment insurance. Not only are the same tort law tests used to make the distinction in both contexts, but the result of the use of the same tests is that employment insurance premiums are collected from employees by employers in tandem with income tax withholdings.

The rationale for distinguishing between employees and independent contractors in the context of employment insurance has already been reviewed. The issue is primarily one of moral hazard—that is, the concern that self-employed persons will abuse an employment insurance system because they can choose whether they are working or not working.[159] This rationale will not be challenged here.[160] Rather, this article queries whether, given this rationale, a tort law test is the appropriate

157 Under ITA subsection 156(1), an individual pays instalments quarterly.

158 Concerns regarding the logic of applying a tort law test to employee or independent contractor characterization are more significant in the context of stock options. It is far from clear that the current tort-law-based distinction between employees and independent contractors should be a basis for providing favourable tax treatment to some service providers and not to others. Favourable treatment with respect to stock options granted by Canadian-controlled private corporations (CCPCs) has been justified on the basis that such treatment allowed smaller companies to attract high-quality employees by offering them non-cash-based compensation taxed at favourable rates. Sandler, supra note 19, at 273 and 296. This rationale is no longer applicable owing to the expansion of favourable tax treatment over the years to stock options issued by non-CCPCs: in 1984, the favourable inclusion rate was expanded to non-CCPC stock options, and in 2000, the delay in inclusion until the disposition of the securities acquired under an option was expanded to non-CCPCs: ITA paragraph 110(1)(d) and subsections 7(8) to (16), respectively. The rationale for expanding favourable stock option treatment to other companies was to provide an incentive to employees to work more productively. Sandler, supra note 19, at 297. For more on this point and other policy rationales for encouraging employee stock ownership, see Robin J. MacKnight, "ESOP's Fable: Gargoyles, Tax Policy, and Employee Ownership in Ontario," in *Report of Proceedings of the Forty-Sixth Tax Conference*, 1994 Conference Report (Toronto: Canadian Tax Foundation, 1995), 22:1-36. Finally, the 2000 amendments to the stock option rules seem to have been enacted in order to slow down the apparent "brain drain" from Canada to the United States. Sandler, supra note 19, at 298. None of these rationales supports a distinction between employees and independent contractors based on a tort law test.

159 As discussed above, there may be other rationales for the restriction of the employment insurance system to employees, but these rationales appear to be secondary at best.

160 Canada is certainly not alone in excluding the self-employed from unemployment insurance schemes. See C. Gillion, J. Turner, C. Bailey, and D. Latulippe, eds., *Social Security Pensions: Development and Reform* (Geneva: International Labour Organization, 2000), 200.

method by which to distinguish employees from independent contractors in the employment insurance context.

Given the concern as to moral hazard, one would imagine that a test used to distinguish employees from independent contractors would focus almost entirely on the degree to which a worker has control over the continued existence of his or her work for a particular employer or client. Indeed, some of the discussion above[161] demonstrates that at the inception of the unemployment insurance system and subsequently, the federal government has perceived that a significant component of the tort law test is control over the termination of work. For example, the 1986 Commission of Inquiry on Unemployment Insurance described the distinction between employees and independent contractors, in the context of unemployment insurance legislation, as follows:

> Insurable employment, as defined in legislation, does not include self-employment. A person is in insurable employment only if he or she works under what is known as a "contract of service." That is the technical term used to describe the conventional employer-employee relationship. That relationship exists when someone other than the worker controls the terms and conditions of employment, including the hours of work, methods of work, and matters related to discipline, hiring and firing.[162]

The current tort law tests, however, do not emphasize the employer's control over hiring and firing to any great extent. Certainly the integration test does not pay any regard to the employer's control over the continued existence of the worker's work. The entrepreneur test may involve some analysis of the degree to which an employer has control over the continuation or termination of a worker's work, particularly since "control" is one of the factors to be considered in applying the test; but this analysis will generally not have a significant effect on the ultimate decision of the court or tribunal. Even the control test itself, which does take into account the employer's power to hire (or fire) the worker, focuses more on the employer's control over the way in which the services in question will be performed.

As noted above, given the policy underlying vicarious liability, it is not surprising—indeed, it is appropriate—that these tort law tests do not concern themselves overly with the employer's control of the continuation or termination of work. However, the result of applying these types of tests in the employment insurance context is that the line between employees and independent contractors is drawn in the wrong place: in some cases, workers who do not have control over their employment will not be covered by employment insurance and (perhaps less commonly) those who do have control will be covered. The rise in short-term contract work over the past few decades[163] only serves to heighten this concern.

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161 See the text accompanying note 91, supra.

162 Supra note 73, at 237. See also Organisation for Economic Co-operation and Development, *The Partial Renaissance of Self-Employment* (Paris: OECD, 2000), 162-63.

163 Magee, supra note 100, at 590.

Indeed, as we have seen, the EIA recognizes this problem to some extent in that regulations under that statute provide employment insurance coverage to certain types of workers, such as taxi drivers and hairdressers, notwithstanding that they might not be considered to be "employees" under the tort law tests. However, it is these very exceptions that illustrate most clearly the disconnection between the purpose of the tort law distinction and the purpose of employment insurance legislation.

The constitutionality of two older versions of these regulations was considered by the Supreme Court of Canada in *Martin Service Station Ltd. v. Minister of National Revenue*.[164] Martin Service Station argued that regulations dealing with self-employed persons (persons outside the common law master-servant relationship) were invalid because such persons were not at risk of being unemployed and therefore such regulations did not deal with "insurance," as required by section 91(2A) of the Constitution Act, 1867.[165] While Justice Beetz acknowledged that "[a] cardinal principle . . . is that the loss of employment which is insured against must be involuntary,"[166] he also stated:

> [I]t does not at all follow, in my view, that self-employed persons can never incur any insurable risk of unemployment or that in enacting s. 26(1)(d) of the Act of 1955 and s. 4(1)(c) of the Act of 1971, Parliament has deviated from the insurance approach. . . .
>
> In order to avoid paying contributions under the Acts, some persons might . . . elect to give their contractual relationships a form other than that of a contract of service. . . . But, even leaving out of account any possible intention to evade the Acts, if conditions become such that those who have a contract of employment to perform a given type of work find themselves unemployed, it is most likely that those who perform the same type of work, although they be self-employed, will also find themselves out of work because of the same conditions. It is mainly to protect the latter against this risk of unavailability of work and involuntary idleness that the Acts are extended. Whether they be self-employed or employed under a contract of service, taxi drivers and bus drivers for instance are exposed to the risk of being deprived of work. This risk is, in my opinion, an insurable one, at least under a scheme of compulsory

164 [1977] 2 SCR 996.

165 Section 91(2A) of the Constitution Act, 1867, 30-31 Vict., c. 3 (UK), allows the federal government to make legislation regarding "unemployment insurance." This section was added by the Constitution Act, 1940, 3-4 Geo. VI, c. 36 (UK). The same regulations were also challenged in *The Queen v. Scheer Ltd.*, [1974] SCR 1046. Scheer Limited, an employer of taxi drivers that was assessed for unemployment insurance contributions, challenged the validity of the regulation on the basis that the relevant legislation (section 26(1) of the 1955 Unemployment Insurance Act, supra note 21) provided only for regulations in respect of "employment"; in Scheer Limited's view, "employment" was a reference to a master-servant relationship, and therefore regulations with a scope that extended beyond master-servant relationships were ultra vires. The Supreme Court of Canada held that the regulations were not ultra vires on the basis that the term "employment" in section 26(1) of the Unemployment Insurance Act referred to a business, trade, or occupation rather than a master-servant relationship.

166 *Martin Service Station*, supra note 164, at 1005.

> public insurance which was never expected to function on a strict actuarial basis provided it generally conformed to the nature of an insurance scheme, including protection against risk and a system of contributions.[167]

Deeming certain categories of workers, such as taxi drivers and hairdressers, to be covered by employment insurance legislation is helpful in alleviating deficiencies in employment insurance coverage caused by the use of tort law tests in this context. However, it does not provide a comprehensive solution and therefore leaves many would-be employees without employment insurance.

These deeming rules also do not provide a comprehensive solution to the allocational effects of the use of the basic tort law test. Excluding the self-employed from a payroll tax such as employment insurance encourages workers and employers to try to shift workers into self-employment. This shift can distort not only the allocation of labour from workers who are clearly employees to workers whose job conditions resemble those of independent contractors, but also the allocation of capital by employers away from products or services that must be produced by employees to products or services that can be produced by independent contractors.[168] We have already noted that a tort law test (particularly one that does not reflect the policy rationale underlying the distinction in the given context) is uncertain and prone to manipulation by employers and employees seeking to avoid employment insurance premium obligations. Aggressive filing positions that allow a shift from employees to independent contractors may have a detrimental effect on the financing of a social insurance system.

Finally, the concerns relating to national consistency apply here as well as in the income tax context. The EIA, a federal statute, should not be applied differently in Quebec as compared with the rest of Canada as a result of differences in the private law. Again, the possibility, raised by *Wolf*, that the intention of the parties is relevant to employee or independent contractor characterization under the CCQ should be cause for concern.

It should not be forgotten, however, that there are administrative advantages to the use in the employment insurance context of the employee-independent contractor distinction that is used for purposes of the ITA. I will return to this point below.

The Canada Pension Plan

As discussed above, the rationale for distinguishing between employees and independent contractors in the context of the CPP does not seem to have been expressed explicitly, but appears to be rooted in the perception that employers ought to take some responsibility for the financing of the CPP. I have also speculated that the distinction may serve administrative purposes, allowing the CCRA to collect CPP

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167 Ibid., at 1004-5. See also *Skyline Cabs*, supra note 31.

168 Kesselman, supra note 74, at 88-89 and 101. See also Lawrence H. Thompson, *Older and Wiser: The Economics of Public Pensions* (Washington, DC: Urban Institute Press, 1998), 80.

contributions from employers and employees in the same way as it collects income tax payments and employment insurance premiums.

Perhaps the lack of precision in identifying this policy rationale is not of great concern, given that the consequences of the distinction are not nearly as significant in this context as they are in the federal income tax and employment insurance contexts. In contrast to the employment insurance context, the self-employed are covered by the CPP. Further, although employee characterization requires contributions from both the employee and the employer, contributions by the self-employed are intended to be equivalent to total employee and employer contributions. Therefore, subject to differences in income calculations, total contributions by the self-employed are intended to equal total contributions in respect of employees.

Employees, however, are treated differently from independent contractors in the context of the CPP in several ways. First, the income upon which contributions are based is different: employees (and their employers) generally contribute to the CPP on the basis of the employee's net employment income, whereas independent contractors contribute to the CPP on the basis of net business income. Using net business income as a base, rather than net income from employment, means that independent contractors are assessed under an income tax while most employees are assessed under something akin to a payroll tax.[169] Concerns expressed earlier with respect to the lack of horizontal equity of this approach in the income tax context apply equally here, except to the extent that CPP contributions are subject to a cap. Additionally, since CPP benefits also are calculated on the basis of net employment or net business income, a reduced contribution base for self-employed workers could result in reduced CPP benefits. Further, since CPP contributions are levied by way of withholding for employees but not for independent contractors, concerns expressed earlier with respect to potential income tax deferral could apply in the CPP context as well.

Are these distinctions sufficiently significant to cause concern over incorrect line drawing? The answer lies primarily in the extent to which deductions are being denied to employees: where significant deductions are being denied to a worker, that worker (and his or her employer) is likely paying more in CPP contributions than would be the case if the worker were an independent contractor, although the cap on contributions and benefits does somewhat mitigate this problem.

Does the use of a tort law test, rather than some other test, reflect the policy rationale (if any) for the distinction between employees and independent contractors in the context of the CPP? With respect to the concept that employers should have some responsibility for financing the CPP, it might be argued that there is a connection to the tort law distinction between employees and independent contractors in that responsibility for the employer portion of CPP contributions might logically be attached to the person whose business is in issue: the argument here is presumably that the person who profits from the expenditure of labour should be

169 Ontario, *Fair Taxation in a Changing World: Report of the Ontario Fair Tax Commission* (Toronto: University of Toronto Press in cooperation with the Ontario Fair Tax Commission, 1993), 480.

the person who pays CPP contributions. A worker benefits from the expenditure of his or her labour whether the worker is an employee or an independent contractor; therefore, the worker should pay CPP contributions. The remainder of the benefit from the expenditure of the worker's labour could be seen to benefit the person for whose business the work is performed. Therefore, the tort law test might be seen to ask, correctly, "Whose business is it?" Yet the tests used to determine whose business it is do not always present a logical distinction for the CPP context. For example, although one can imagine why the location of opportunity for profit and the risk of loss should be relevant to the obligation to pay CPP contributions, it is less clear why control over the manner in which a task is done or the ownership of equipment should be similarly relevant. The integration test also seems to be disconnected from the policy underlying the use of the employee-independent contractor distinction in the CPP context: why should the degree to which a worker is "integrated" into an employer's business be relevant to the allocation of responsibility for CPP contributions?

Further, to the extent that the employee-independent contractor distinction is used as a means to attach some responsibility for CPP contributions to employers, it is far from clear that employers actually bear the costs of CPP contributions. There is substantial evidence suggesting that the incidence of earmarked payroll taxes is independent of the formal allocation of tax between employers and employees; many studies have suggested that employees bear most of the burden of payroll taxation.[170] On the other hand, independent contractors who have real bargaining power in respect of compensation for services may be able to shift their CPP costs to purchasers of services by way of higher fees. Therefore, the line drawn by the tort law tests may have no connection at all to the actual incidence of the costs of the CPP.

There is one clear rationale for using a tort law test to distinguish between employees and independent contractors in the context of the CPP: administrative convenience. The use of the same test for CPP and employment insurance contributions saves compliance and administration costs, and the use of the same test for income tax and CPP contributions allows the CPP to be calculated on the basis of income as

170 Incidence of payroll taxation is not entirely clear; indeed, some more recent studies question whether employees really do bear most of the burden of payroll taxation. Nevertheless, most studies suggest that payroll taxation is largely borne by employees. See Peter Dungan, "The Effect of Workers' Compensation and Other Payroll Taxes on the Macro Economics of Canada and Ontario," in Morley Gunderson and Douglas Hyatt, eds., *Workers' Compensation: Foundations for Reform* (Toronto: University of Toronto Press, 2000), 118-61, at 120-26; Robin W. Boadway and Harry M. Kitchen, *Canadian Tax Policy*, 3d ed., Canadian Tax Paper no. 103 (Toronto: Canadian Tax Foundation, 1999), 330; Gillian Lester, "Unemployment Insurance and Wealth Distribution" (2001) vol. 49, no. 1 *UCLA Law Review* 335-93, at 379-80; Alice G. Abreu, "Taxes, Power, and Personal Autonomy" (1996) vol. 33, no. 1 *San Diego Law Review* 1-77; John A. Brittain, *The Payroll Tax for Social Security* (Washington, DC: Brookings Institution, 1972); and Dahlby, supra note 149, at 130. See also John Macnicol, *The Politics of Retirement in Britain, 1878-1948* (Cambridge, UK: Cambridge University Press, 1998), 219, with respect to the public's perception that employees will not bear the cost of employer contributions.

calculated under the ITA. Particularly given the earlier speculation that administrative convenience may have been one of the reasons for the employee-independent contractor distinction in the context of the CPP, this rationale has some weight.

ALTERNATIVE APPROACHES

It appears that the use of a tort law test is not sensible, from a policy perspective, in either the federal income tax or the employment insurance context, and is only mildly sensible in the CPP context. But are there better alternatives?

Different Tests or the Same Test?

Before identifying one or several alternative tests for any particular context, one must determine whether such test(s) would apply in all three contexts, or whether a separate test (or tests) should be developed for each one.

There are certainly some arguments in favour of a common definition. Perhaps the most convincing argument is that a common definition can reduce legal, administrative, and compliance costs.[171] Collection costs will be reduced to the extent that payroll tax collection is coupled with income tax collection, given that common filings and administrative personnel can be used, as well as a common definition of "income."[172] Compliance and litigation costs will be reduced to the extent that employers and workers have to interpret and litigate one test rather than three. Both CPP contributions and employment insurance premiums are calculated on the basis of income; with a common definition, the definition of "income" under the ITA can be used for the purpose of calculating employment insurance premiums and CPP contributions. Asking an individual to calculate income for EIA and CPP purposes when that individual does not have to perform that calculation for income tax purposes creates additional complexity.[173]

Williams argues that

> [a] common definition ensures that those who claim rights as an employee must also be shown to have paid tax and contributions as an employee. This does much to stop abuse of the system.[174]

This approach may not have much resonance in Canada if one is considering rights under employment standards legislation (which is generally independent of the kinds

171 David Williams, "Social Security Taxation," in Victor Thuronyi, ed., *Tax Law Design and Drafting*, vol. 1 (Washington, DC: International Monetary Fund, 1996), 340-400, at 371; and Kesselman, supra note 74, at 337. See, generally, François Vaillancourt, *The Administrative and Compliance Costs of the Personal Income Tax and Payroll Tax System in Canada, 1986*, Canadian Tax Paper no. 86 (Toronto: Canadian Tax Foundation, 1989).

172 Kesselman, supra note 74, at 117.

173 Williams, supra note 171, at 382.

174 Ibid., at 371.

of legislation being reviewed here), but could have some impact if one is considering the various types of beneficial treatment claimed by employees under the ITA (for example, with respect to stock options) or the EIA (with respect to eligibility for benefits).

Nevertheless, a common definition may not be the best approach. Given the diverging policy rationales for each context, a test that works in one context may be inappropriate for another. This is particularly true when comparing the ITA and the EIA. Additional administrative convenience may not be worth the costs of drawing the line in the wrong place in respect of employment insurance coverage. Perhaps the risks of drawing the line in the wrong place might be less significant when comparing the EIA with the CPP, particularly given that (1) the concept that employers should take some responsibility for CPP contributions may overlap with the concept that employers should take some responsibility for employment insurance and (2) the incidence of payroll taxation is likely at least somewhat removed from the formal allocation of those taxes.

It might also be the case that the administrative convenience of using a common definition (particularly for all three contexts, as opposed to a common definition for employment insurance and CPP contributions only) is overstated. Employers would have to incur the cost of tracking which workers were employees for which purpose; however, other than the cost of changing systems (which would not be insignificant), it should not be too costly to track the status of an employee for two or three different purposes rather than for just one.

The fact that employment insurance premiums and CPP contributions are currently calculated on the basis of the income tax definition of "income" does not pose significant problems either. One can use the income base under the ITA for all purposes, whether that income is considered to be "employment income" for some purposes and "business income" for other purposes. A person who is considered to be an employee for purposes of the EIA or CPP yet an independent contractor for income tax purposes could still have his or her employment insurance premiums or CPP contributions calculated on the basis of employment income as calculated under the ITA. If it is fair to deny deductions to that worker for income tax purposes, presumably it is also fair to deny deductions to that worker for purposes of the EIA and CPP. However, it would be a relatively simple matter to ask workers to add back deductions allowed under the ITA when calculating employment insurance or CPP contributions if so desired from a policy perspective. A person who is considered to be an employee for income tax purposes but not for purposes of the EIA or CPP could also continue to use the ITA calculation of employment income as a basis for employment insurance and CPP deductions; where a worker incurs such significant deductions that it is unfair to levy employment insurance premiums or CPP contributions on the basis of employment income (that is, income calculated with few deductions), that person should be considered to be an independent contractor for all purposes and not just for the CPP and EIA. From a collection perspective, withholdings for employees are actually deducted on the basis of gross employment income; if withholdings exceed taxes payable, the employee receives a refund. So

long as refunds are available, there is no reason why the same system cannot be used for workers who are independent contractors for tax purposes but not for employment insurance or CPP purposes. If there is some concern that this system might be too harsh from a cash flow perspective for workers with significant deductions (and again these workers should be considered to be independent contractors under the ITA for policy reasons), a lower withholding rate could be applied.

It should be noted that, because of various deeming rules described above in the EIA and CPP contexts, it is already the case that a person may be an employee for EIA and/or CPP purposes but not for income tax purposes.

Litigation costs could rise if two or three different tests were to be litigated, rather than just one. It is possible, though, that a particular test may be litigated less frequently if it is a bright-line test or if it is based on a more purposive approach to the relevant legislation.

Before leaving this question—whether the same test or different tests should be used for the four areas of law discussed here—we might consider whether it is possible to use one test, namely, *Wiebe Door*, yet apply it differently in the different context by simply weighing the various factors of the test differently, as mandated by *Moose Jaw Kinsmen* and *Sagaz*.[175] The problem with this approach is twofold. First, Canadian courts either are incapable of weighing these various factors or simply refuse to do so; this can be seen clearly in *Sagaz*, as well as in *Wolf* to a lesser extent. Second, even if one aspect of *Wiebe Door* is weighted more heavily than another, the *Wiebe Door* test still misses the relevant policy rationales, particularly with respect to employment insurance.

Removing the Distinction Entirely

Taking the income tax context first, many commentators have decried the distinction between employees and independent contractors. Hogg, Magee, and Li note:

> What are the policy justifications for taxing a taxpayer who earns $50,000 a year under a contract of service differently from a taxpayer who earns $50,000 a year under a contract for services? The discriminative treatment of employees obviously violates the principle of equity by failing to tax equal incomes equally. It also violates the principle of neutrality by creating a tax incentive to earn income in the form of business income rather than employment income.[176]

Similar concerns were voiced by LaBrie, who also mused about providing a mechanism to allow taxpayers to ignore the distinction between employees and independent contractors:

> It is submitted that this approach, leading as it does to groundless distinctions, in turn magnified by modern high and steeply progressive rates, serves to undermine popular

175 I thank one of the anonymous reviewers of this article for this suggestion.

176 Hogg et al., supra note 67, at 103.

> confidence in the income tax, particularly at times when there is no generally admitted national crisis to lead taxpayers to ignore their differences. Also, one may question the extent that the alleged administrative difficulty is real or insurmountable. We may ask how the cost of administering the present system of itemized treatment for employee income would compare with the cost of a more liberal approach. Consider also the possibilities of shifting part of the cost to the taxpayer, for example by providing an election to compute salaried income on a profit basis on condition that returns be prepared by a registered accountant. At all events, the present arrangement is conducive toward a strict interpretation and narrow meaning of offices and employments, thereby relieving against any clearly demonstrated hardships resulting from the itemized computation of income in sec. 5 by merely adding to the cares of an allegedly overburdened administration.[177]

I have already noted the administrative problems that might be involved in treating all workers as independent contractors. It might also be argued that it would be too difficult to treat all workers as independent contractors because such an approach might necessitate accrual-basis taxation, which could present some challenges and increase the compliance burden for employee-like workers.[178] But does removing the distinction necessarily equate with the treatment of all workers as independent contractors? Perhaps not. Burns and Krever argue that a service provider who is compensated for providing labour generally incurs few deductible expenses, whether that service provider is considered to be an employee or an independent contractor for tort law purposes.[179] For Burns and Krever, any such service provider should be treated as an employee for tax purposes regardless of tort law characterization.

Intuitively, the position taken by Burns and Krever rings true. But even if they are mistaken, and some labour providers do incur significant expenses, presumably those expenses can easily be added to the list of deductions permitted for employees under section 8 of the ITA. The ITA already includes provisions such as paragraph 8(1)(f), which provides deductions for, effectively, travelling salespersons. Indeed, as one might have hoped, the most obvious sorts of deductions that would be claimed by any labour provider are generally already included in section 8. For example, ITA paragraph 8(1)(i) provides deductions not only for the deduction of union and professional dues, but also for office rent or salary to an assistant (if the payment of

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177 LaBrie, supra note 61, at 109-10. See also Noël, supra note 93, at 736: "Where an individual must incur expenses to earn income, whether this income be in the form of salary or in the form of a fee, there is no reason from an economic standpoint to prevent this individual from deducting, in the computation of his income, the expenditures incurred for the purpose of gaining such income."

178 This argument may be weak. For most employees, the only relevance of accrual-based accounting would be in respect of pay periods extending over year-ends and delays between pay periods and pay receipts stretching over year-ends.

179 Lee Burns and Richard Krever, "Individual Income Tax," in Victor Thuronyi, ed., *Tax Law Design and Drafting*, vol. 2 (Washington, DC: International Monetary Fund, 1998), 495-563, at 509-10.

such expenses by the employee was required by the contract of employment) and for the cost of supplies that were consumed directly in the performance of the duties of the office or employment (again, only if the payment of such expenses by the employee was required by the contract of employment).

Withholding could be used for all types of workers. Indeed, Soos recommends the introduction of a withholding system for fees for services.[180] She argues that such fees are compensatory and therefore similar to wages. To the extent that inequity could be caused because withholdings occur on a gross basis (and therefore do not take deductions into account), withholding rates could be reduced or adjusted, or refunds (including interim refunds) could be offered.[181] The use of a withholding system for persons currently covered by the instalment system should increase compliance and efficiency.[182] Some may argue that it is simply impractical to expect all service recipients to withhold and remit amounts being paid for services. However, the use of a withholding system for independent contractors is not foreign to the ITA; withholdings are already used by the ITA in respect of non-residents providing services in Canada.[183] Furthermore, a withholding and remittance type of system is currently used in the context of the goods and services tax (GST). As in the context of the GST, exceptions from withholding and remittance obligations could be made; for example, exceptions or waivers could be offered for small businesses or individual taxpayers, or for individuals or entities whose payments for services do not exceed a particular monetary threshold.

It may be possible to eliminate the distinction between employees and independent contractors in the CPP context as well. First, if employees really do bear the cost of the CPP contributions formally made by employers, the elimination of the obligation of employers to pay CPP contributions should not matter. However, employers probably do bear at least some of the cost of their own CPP contributions. Accordingly, it might make sense to eliminate the distinction between employees and independent contractors in the context of the CPP such that employers make CPP contributions in respect of both employees and independent contractors. Given available information regarding incidence, one would expect that the cost of employer CPP contributions in respect of independent contractors would be borne by independent contractors in any case. Further, if it is correct to say that one would ideally allocate the responsibility for the employer portion of CPP contributions to the person who enjoys the opportunity for profit and has the risk of loss, where that

180 Piroska Soos, "Self-Employed Evasion and Tax Withholding: A Comparative Study and Analysis of the Issues" (1990) vol. 24, no. 1 *UC Davis Law Review* 107-93, at 131.

181 Ibid., at 132, 173, 179-82, and 192.

182 Ibid., particularly at 125-29. See also Williams, supra note 171, at 359. See further Kesselman, supra note 74, at 338; and Thompson, supra note 168, at 76-80, for a similar sentiment in the context of pensions.

183 ITA regulation 105. A definition of "employee" might still be desirable in the stock option context, but I leave this topic for another article.

person is the worker, he or she can adjust fees to compensate the employer for the obligation to make CPP contributions. Finally, an increase in the contributions to the CPP that would come out of a switch from a net basis to a gross basis of contributions for independent contractors might be welcome given concerns regarding the financial health of the CPP.[184]

I note also that the elimination of the distinction between employees and independent contractors may have the advantage of administrative simplicity.

Bright-Line Tests

Weisbach argues that line drawing between concepts such as employees and independent contractors in the income tax context should be done by reference to efficiency.[185] He argues that traditional policy approaches are not particularly useful with respect to line drawing, which, by definition, occurs in respect of borderline cases. Rather, Weisbach argues, line drawing should be based on efficiency rationales, particularly the avoidance of "deadweight loss" that can occur when people change their behaviour in response to tax rules. In his analysis, Weisbach emphasizes that the degree to which people will change their behaviour in response to tax rules—and therefore potentially create deadweight loss—is, of course, a function of elasticity of the relevant demand curve.[186]

Theoretically, legislators ought to be able to draw a bright line—perhaps with respect to hours worked, duration of work, or type of employment, or a combination of such factors—that minimizes deadweight loss. The problem with this approach is that elasticity of demand changes over time and between professions, geographic locations, and employers. Therefore, an efficient line would be a line that is constantly adjusted. This kind of adjustment would be expensive to research and would cause significant uncertainty.

Furthermore, it is not clear that traditional policy approaches to employees and independent contractors are without use. Indeed, although I have tried to argue here that the application of the vicarious liability test to the federal income tax distinction between employees and independent contractors is misconstrued, I have acknowledged that even this misconstrued approach sometimes yields appropriate results and have argued that a more tax-policy-oriented approach would yield much

184 See, for example, Newman Lam, James Cutt, and Michael Prince, "The Canada Pension Plan: Retrospect and Prospect," in Keith G. Banting and Robin Boadway, eds., *Reform of Retirement Income Policy: International and Canadian Perspectives* (Kingston, ON: Queen's University, School of Policy Studies, 1997), 105-34, at 112 et seq.; and Michael Hoffman and Bev Dahlby, "Pension Provision in Canada," in Richard Disney and Paul Johnson, eds., *Pension Systems and Retirement Incomes Across OECD Countries* (Cheltenham, UK: Edward Elgar, 2001), 92-130, at 107.

185 David A. Weisbach, "Line Drawing, Doctrine, and Efficiency in the Tax Law" (1999) vol. 84, no. 6 *Cornell Law Review* 1627-1681, at 1649-63. See also David A. Weisbach, "An Efficiency Analysis of Line Drawing in Tax Law" (2000) vol. 29, no. 1, part 1 *The Journal of Legal Studies* 71-98.

186 Weisbach, "Line Drawing, Doctrine, and Efficiency," supra note 185, at 1656.

more sensible results. Indeed, Weisbach's assertion that line drawing between employees and independent contractors is arbitrary would presumably lose some of its power if courts were to move toward a more tax-policy-oriented approach.

Nevertheless, there may be some merit to a bright-line test. Legislators and economists may be able to use empirical data to locate a bright line that characterizes workers in an appropriate fashion (in the view of policy makers) given the different elasticities identified above. Past audit experience would be a key guide in this respect. Although bright-line tests are prone to manipulation, they at least provide certainty and some transparency. Moreover, the stricter the test (and therefore the more people covered by the employee characterization), the less room there is for manipulation. A bright-line test would also provide a test that is consistent nationwide. Bright-line tests may be different in the income tax, employment insurance, and CPP contexts; it has been suggested that the use of different bright-line tests could in itself restrain the manipulation of the employee-independent contractor categories.

Different Case-Law-Based Tests

A third alternative is to develop new or return to older case-law-based tests, which would be tailored to the specific policy concern in each area. For example, case law in the income tax context might focus on the potential for deductions (and therefore the inequity caused by deduction denial caused by employee characterization). In the employment insurance context, courts might return to a focus on control, particularly control over hiring and firing and over job duration. I note that the concern typically expressed in connection with the control test—that a control test is inappropriate in respect of skilled workers, who should control the manner in which they accomplish a task—is not relevant here. Finally, in the context of the CPP, courts might focus on the opportunity for profit and risk of loss as a basis for allocating responsibility for the employer to make CPP contributions.

The disadvantage associated with using different types of tests, noted above, is that litigation costs could rise as a result of having to litigate two or three different types of tests.

More targeted, policy-oriented case law tests offer some significant advantages. First, case law that develops out of specific policy objectives should offer more certainty than the current jurisprudence. Second, such an approach should offer less opportunity for manipulation of the categories, particularly if different tests are used for federal income tax, employment insurance, and CPP purposes. Third, revamping case law tests would not require a wholesale restructuring of federal income tax, employment insurance, or CPP legislation, which would be required if the employee-independent contractor distinction were eliminated or if the Weisbach line-drawing approach were adopted. In comparing a change in case-law-based tests with the elimination of the employee-independent contractor distinction, shifting the orientation of the case law would also shift compliance burdens, but not to the same extent as eliminating the employee-independent contractor distinction. In comparing a change in case-law-based tests with the Weisbach line-drawing

approach, targeted and policy-based case law tests should result in reasonable categorizations and, moreover, would not require detailed and constantly changing legislation. Indeed, the requirement (typically ignored) that courts weigh the different *Wiebe Door* factors is already a step in this direction.

CONCLUSION

Currently, the tort law test for vicarious liability (with some alteration for contracts governed by the CCQ) is used to distinguish between employees and independent contractors in the federal income tax, employment insurance, and CPP contexts. Yet there seems to be little basis in policy for doing so; the policy rationale for the employee-independent contractor distinction is different in each of these contexts. One would therefore have imagined that the test distinguishing between employees and independent contractors would be different in each of these contexts.

Ordinarily, the possibility of changing such deeply entrenched definitions would be remote, particularly given that the legislation in each of the federal income tax, employment insurance, and CPP contexts seems to mandate a master-servant analysis. However, recent developments may trigger renewed interest in these issues. In 2001, section 8.1 was added to the Interpretation Act.[187] This section provides:

> Both the common law and the civil law are equally authoritative and recognized sources of the law of property and civil rights in Canada and, unless otherwise provided by law, if in interpreting an enactment it is necessary to refer to a province's rules, principles or concepts forming part of the law of property and civil rights, reference must be made to the rules, principles and concepts in force in the province at the time the enactment is being applied.

Accordingly, as a result of section 8.1, where a definition in federal legislation refers to a "contract of service," the term "contract of service" will be interpreted differently depending on whether the common law or the civil law is the legal regime in issue. The prospect of this differential treatment may cause legislators to review the definition of "employment" under the ITA and the CPP and the definition of "insurable employment" under the EIA so as to achieve uniformity across Canada. Perhaps such a process will include a fresh look at the policies underlying these definitions and provide Canadian courts with an opportunity to develop more clearly focused case law.

187 Supra note 151.