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EMPLOYMENT CHARACTERIZATION

The Royal Winnipeg Ballet v. MNR: the Growing Significance of Intention in Independent Contractor/ Employee Characterization

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Introduction

The issue of whether an individual providing services is an independent contractor or an employee is important for various reasons, including the following:

- payments to employees are subject to source deductions in respect of income tax,[1] Canada Pension Plan contributions,[2] and Employment Insurance premiums.[3]

In contrast, no source withholdings are generally required in respect of services rendered by an independent contractor who is a resident of Canada;[4]

- payments to independent contractors are generally subject to GST (unless the service being provided is an exempt or zero-rated supply);

- independent contractors can deduct certain expenses that employees cannot;[5] and

- it is generally not possible for an individual who performs employee-like services through a professional corporation to claim the small business tax rate on the first $300,000 of business income.[6]

The importance of the issue notwithstanding, and despite the continuing prevalence of businesses turning to independent contractors to provide skilled professional services, distinguishing between employment and independent contractor status remains a thorny issue, particularly given that there is no legislative test and the vast jurisprudence on this issue fails to provide any sort of bright line test. While each case turns on its unique facts, the *Wiebe Door*[7] test, as confirmed in *671122 Ontario Ltd. v. Sagaz Industries Canada Inc.*,[8] is normally applied. Notably, while *Wiebe Door* did not explicitly include the parties'

intention as a factor, more recent case law, such as *Wolf v. R.*,[9] focused more attention on intention, particularly in situations involving highly skilled professionals.

The factor of common intention took on even greater prominence, and was the source of lively debate amongst the three sitting justices of the Federal Court of Appeal in its recent decision in *The Royal Winnipeg Ballet v. MNR.*[10] The case, which gives a significance to the factor of common intention in cases arising under the common law that it previously did not appear to have, could mark an evolution in the judicial approach to the employee/independent contractor characterization issue.

The Issue

The issue in *Royal Winnipeg* was whether three dancers of the world-renowned Royal Winnipeg Ballet ("RWB") were employees or independent contractors, for the purpose of determining whether RWB was required to pay CPP contributions and EI premiums in respect of the dancers. The legal relationship between the dancers and the RWB was governed by the Canadian Ballet Agreement, which was negotiated between RWB and the exclusive bargaining agent for the dancers. This Agreement established numerous minimum standards with respect to issues such as remuneration, overtime and vacation pay and working conditions. A dancer was also free to negotiate with the RWB for better terms, although the evidence indicated that any such improvements were relatively minor.

The Canadian Ballet Agreement was silent as to independent contractor or employee characterization. However, while there was no written agreement purporting to characterize the legal relationship between the RWB and the dancers, the RWB, the bargaining agent, and the dancers believed that, and acted as though, an independent contractor relationship existed. For example, each dancer was registered for, and charged, GST for their services.

Decision of the Tax Court of Canada[11]

In the course of its analysis, the Tax Court relied on the factors described in *Sagaz*, dividing that non-exhaustive list into two categories: control factors and economic factors, the latter including ownership of equipment, whether a worker hires his or her own employees, degree of financial risks, degree of responsibility for investment management, and opportunity for profit. Finding that the RWB artistic staff assigned the dancer's role and had final say over how a dancer performed, the Tax Court held that the "control" factors indicated an employment relationship. The Tax Court reached a similar conclusion with respect to the "economic" factors, citing the facts that the dancers received a salary with no realistic risk of loss, there was little chance to receive remuneration above the Canadian Ballet Agreement, the RWB covered most expenses, and no opportunities existed to maximize profits within the RWB contract. Notably, the Tax Court rejected the intention of the parties as a factor, noting that it was not mentioned in *Sagaz*and suggesting that its application should be relevant only as a tie-breaker if the usual legal tests did not yield a definitive result. The RWB appealed.

Decision of the Federal Court of Appeal

The Federal Court of Appeal's decision was rendered by way of three separate sets of reasons, with Justice Sharlow writing for the majority, Justice Desjardins writing brief concurring reasons and Justice Evans dissenting.

After reviewing the leading cases of *Wiebe Door, Sagaz*, and *Wolf*, Justice Sharlow focused primarily on the intention of the parties in determining their legal relationship. In emphasizing intention, Justice Sharlow was careful to note that "[t]here is ample authority for the proposition that parties to a contract cannot change the legal nature of that contract merely by asserting that it is something else" but that the

parties' intention was important because "in determining the legal nature of a contract, it is a search for the common intention of the parties that is the object of the exercise." Although there was no written agreement that purported to describe the legal relationship between the RWB and the dancers, she noted that "there is no dispute between the parties as to what they believe that relationship to be."[12] This conclusion was, presumably, based on the evidence given at trial and the parties' prior conduct such as the dancers charging GST for their services. Her views as to the appropriate test are succinctly summarized in the following:

> In these circumstances, it seems to me wrong in principle to set aside, as worthy of no weight, the uncontradicted evidence of the parties as to their common understanding of their legal relationship, even if the evidence cannot be conclusive. The judge should have considered the *Wiebe Door* factors in the light of this uncontradicted evidence and asked himself whether, on balance, the facts were consistent with the conclusion that the dancers were self-employed, as the parties understood to be the case, or were more consistent with the conclusion that the dancers were employees.

In briefly reconsidering the relevant factors, Justice Sharlow focused primarily on the control factor, holding that, while the degree of control exercised by the RWB over the dancers was extensive, it was equivalent to the control exerted over a guest artist (who would be an independent contractor), and thus the factor of control could not reasonably be considered to be inconsistent with the independent contractor characterization. She concluded that this was a case "where the common understanding of the parties as to the nature of their legal relationship is borne out by the contractual terms and the other relevant facts."

Justice Desjardins concurred with Justice Sharlow and provided further arguments why, at common law, intention is important in determining the parties' legal relationship. In particular, she noted that, in the difficult task of determining whether a contract is one of service or for service, the trial judge should not be deprived of looking at all of the indicia necessary to assess the "true nature" of the relationship between the parties, and agreed with the approach put forward by Justice Sharlow. Notably, however, she left open the issue of whether "the intention of the parties" is of the same meaning in the common law system as in the civil law of Quebec, leaving this to be decided on a case-by-case basis.

In a vigorous dissent, Justice Evans rejected RWB's contention that the parties' stated intention regarding their legal relationship was determinative in the absence of evidence to the contrary. He noted that cases emphasizing intention, such as *Wolf*, have been at least partially based on articles of Quebec's Civil Code and that such principles do not necessarily transfer to the common law.[13] Justice Evans focused on four main reasons why little weight should be attached to the intention of the parties: (i) intention, he argued, is not relevant for determining the legal characterization of the relationship but is relevant only to giving meaning to the terms of the contract; (ii) the parties' view of the legal nature of their contract is inevitably self-serving; (iii) attributing significant weight to a contractual statement as to intention may disadvantage the party which was in the more vulnerable bargaining position; and (iv) legal characterization should be based solely on the terms of the contract in order to protect the interests of third parties (e.g., a victim of tort). Thus, in the view of Justice Evans, the parties' intention goes to resolving ambiguities and filling in silences but not to its legal characterization. In light of his conclusions on that issue, he held that the trial judge's conclusion was not clearly wrong and accordingly, could not be overturned.

Is Reliance on Intention Suitable?

Undue reliance on the concept of the parties' intention has been criticized as being an unsuitable method of characterizing the legal relationship between parties, particularly since the intentions may vary as between the parties or may be multiple for both. Justice Evans also raises the concern that the parties' so-called intentions may be self-serving. Some comfort with respect to both of these concerns can be taken

from the reasons of the majority in *Royal Winnipeg*which indicate deference to intention should only be given where the parties have a "common intention" and that such common intention will only be respected where the parties have acted consistently with the title they have imposed on their relationship. Justice Evans' concern that a focus on intention may unduly disadvantage service providers may be somewhat reduced to the extent that subsequent case law demands that a worker fully understand the implications of independent contractor status prior to stating such characterization was their intention. Lastly, to the extent the income tax law should be applied consistently in Quebec and in other parts of the country, the decision in *Royal Winnipeg* is a welcome one.

What is perhaps even more noteworthy in the decision is that the prominence of intention may be an indication of the courts' increasing struggle to characterize the role of a skilled professional who does not fit into the *Wiebe Door/Sagaz* test. In fact, Justice Evans notes that *Wiebe Door* has not kept pace with the changing marketplace and that the appropriateness of the test ought to be questioned given the rapid growth of outsourcing. Whether or not focusing on intention of the parties is the answer, it is hoped that the courts will develop a new test that recognizes the market's current need for skilled professionals who operate in a complex, diverse and dynamic economy.

Conclusion

Royal Winnipeg is noteworthy as marking a potential evolution in the judicial approach to the independent contractor/employee characterization issue. While not displacing the *Wiebe Door* test, it clearly adds a new dimension: that of the parties' intention. In particular, the Tax Court has now been directed to start its analysis at the classification intended by the parties and to then apply the traditional tests to see if the actual relationship is consistent with that intention. It remains to be seen how future Tax Court decisions will be impacted by this decision.[14] In particular, the strong dissenting view indicates that the relevance of intention is, and will remain, a subject of debate.

Given the adverse tax consequences that can result from a future characterization of an independent contractor relationship as being one of employer-employee, both the hirer and the worker will generally be highly motivated to achieve as much certainty as possible with respect to the nature of the relationship. While *Royal Winnipeg* illustrates that intention can be demonstrated, even in the absence of an explicit legal agreement, in attempting to achieve certainty on the issue, it is prudent for the parties to enter into a written contract which explicitly manifests the parties' intention and agreement that the relationship be one of independent contractor. Based on *Royal Winnipeg*, such an intention may go a long way towards establishing an independent contractor relationship, absent evidence that the agreement does not accurately represent the true relationship or is a sham.

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[1] Paragraph 153(1)(*a*) of the Income Tax Act, R.S.C. 1985, c. 1 (5th Supplement), as amended, hereinafter referred to as the "Act." Unless otherwise stated, statutory references in this article are to the Act. Failure by the employer to do so will result in liability for interest (subsection 227(8.3)), and penalties (subsection 227(8)), as well as potential liability on the part of directors (section 227.1).

[2]Sections 8, 9 and 21 of the *Canada Pension Plan Act* (the "CPP Act"). Failure by the employer to do so will result in liability for the whole amount that should have been remitted (including the employee's contribution, subject to limited rights of set-off) (CPP Act subsection 21(2)), interest (CPP Act subsection 21(6)), and penalties (CPP Act subsection 21(7)), as well as potential liability on the part of directors (CPP Act section 21.1).

[3] Sections 67, 68, and 82 of the *Employment Insurance Act*(the "EI Act"). Failure by the employer to do so will result in liability for the whole amount that should have been remitted (including the employee's

premium, subject to limited rights of set-off) (EI Act subsection 82(4)), interest (EI Act subsection 82 (8)), and penalties (EI Act subsection 82(9)), as well as potential liability on the part of directors (EI Act section 83).

[4] Regulation 105 to the Act mandates 15% withholding from payments made to service providers who are non-residents of Canada.

[5] Deductions of expenses by employees are severely curtailed by section 8.

[6] Such an "incorporated employee" should generally be seen to be carrying on a "personal services business," as defined in subsection 125(7), and hence not be eligible for the small business deduction ("SBD"). The SBD currently reduces the federal corporate income tax rate applied to the first $300,000 of qualifying active business income of a Canadian-controlled private corporation to 12%. The 2006 Federal Budget proposed to increase the small business limit to $400,000 as of January 1, 2007 and proposed an aggregate 1% reduction in the tax rate, to 11.5% in 2008 and 11% in 2009.

[7] 87 D.T.C. 5025 (F.C.A.). *Wiebe Door*, which propounded what has come to be known as the "total relationship" test, is well-known and has been discussed in the literature on numerous occasions. Pursuant to the total relationship test, the court is to conduct a broad-based examination of the total relationship between the parties. All the relevant factors, including control, ownership of equipment, the degree of management and responsibility, chance of profit and risk of loss are to be examined and carefully weighed.

[8] [2001] 2 S.C.R. 983.

[9] (2002), 288 N.R. 67 (F.C.A.).

[10] 2006 F.C.A. 87.

[11] 2004 T.C.C. 390.

[12] This suggests that where, after the service relationship has terminated, the parties disagree as to the proper characterization (e.g., where the worker subsequently makes a claim for wrongful dismissal or applies for employment insurance benefits), intention will not be a factor in the analysis.

[13] Somewhat surprisingly, Justice Evans did not refer to other common law cases where the issue has arisen such as, for example, *Sara Consulting and Promotions Inc. v. MNR*, [2001] TCJ No. 773 (QL).

[14] At the time of writing, *Royal Winnipeg*had been considered is a few cases arising under the Quebec Civil Code. The only case to be heard under the common law, *Freeway Technologies Inc. v. MNR*, 2006 T.C.C. 176, did not consider the factor of intention because there was no common intention.

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