



EMPLOYEE **vs** SELF-EMPLOYED Status

This document is a guideline to assist Mortgage Professionals Canada members in determining employment status based on Canada Revenue Agency (CRA) principles. Members are strongly encouraged to check with their accountant or tax professional regarding their individual circumstances.

What does it mean to be self-employed?

Self-employed individuals are considered to operate their own business instead of working for an employer that pays a salary or wage. Self-employed individuals earn income through conducting profitable operations from a trade or business that they operate directly. As a self-employed individual you are required to pay both portions of Canadian Pension Plan (CPP) and remit quarterly tax installments based on your net income. In some cases, depending on your level of income, you may be required to collect and remit HST. Self-employed individuals are made available to further deductions than an employee.

What does it mean to be an employee?

An employee is an individual who is hired to provide services to a company on a regular basis in exchange for compensation and who does not provide these services as part of an independent business. In the case of an employer-employee relationship, employers are responsible for deducting CPP, Employment Insurance (EI), and withholding income tax from remuneration paid. Employees are very limited to the amount of deductions they can use against employment income, and are only permitted to do so if they are required to incur expenses directly related to their role as an employee.

SELF-EMPLOYED

| Advantages | Disadvantages |
|---|---|
| <ul style="list-style-type: none">▪ Not required to pay EI premiums▪ More expenses are tax deductible▪ More freedom to set own working hours▪ Can work for more than one client▪ In first year of operation, income tax is not payable until April following first year-end▪ Opportunity for increased profits | <ul style="list-style-type: none">▪ Cannot collect EI▪ Must pay both employee and employer portions of CPP▪ Not eligible for any benefits unless individual purchases his/her own benefit package▪ Often work longer hours with no additional pay▪ No severance pay if terminated▪ More record keeping required▪ Harder to obtain financing as self-employed individuals often have inconsistent income and pose a greater risk of collection▪ Cost of purchasing and maintaining own equipment▪ Risk of loss▪ Personally liable if contract obligations are not fulfilled, therefore may require liability insurance▪ After first year, usually must make tax installments on a monthly basis▪ Must register to collect and remit HST▪ May require services of bookkeeper and accountant |

EMPLOYEE

| Advantages | Disadvantages |
|---|--|
| <ul style="list-style-type: none">▪ Qualify for EI▪ 50% of CPP premiums are paid by the employer▪ Ability to participate in employee benefits (vacation pay, health care benefits, disability insurance, pension plans, workers compensation)▪ Potential for higher rate of pay for overtime hours▪ More difficult to be terminated and potential to receive severance pay if terminated▪ Minimal record keeping required▪ Often easier to obtain loans, mortgages and credit cards as employees are perceived to have greater income stability | <ul style="list-style-type: none">▪ Must pay EI premiums▪ Very few expenses are tax deductible▪ Less control over working conditions and hours |

How does the CRA determine employment status?

The CRA closely analyzes the distinction between an employee and a self-employed individual. It is vital that the employer ensure the correct employment status is reflected in the conditions of employment. Failure to do so will result in interest and penalties owed by the employer.

When making an assessment, the CRA will typically consider the following factors to determine whether an employment relationship exists. It is important to note that no single factor is decisive in determining the employment status.

1. Control

Control is the ability or right of a payer to exercise control over a worker concerning the manner in which their work is executed. Control determines whether the worker is directed by someone who is in a position to determine what is to be done and how it is to be done. Where such control exists, there is an employer-employee relationship.

2. Tools and equipment

Consideration is given regarding the extent to which the individual owns and provides the tools and equipment necessary to complete the work at hand. Of significant relevance is the investment in the tools and equipment as well as the replacement cost. An individual who has made a significant investment is likely to retain a right over the tools and diminish the payer's control over how the work is performed. The maintenance and replacement costs associated with the investment will also place the individual at a risk of loss.

3. Subcontracting work or hiring assistants

The ability for a worker to subcontract work or hire assistants is a factor that is used to help determine an individual's business presence. The ability to subcontract work plays a role in affecting their chance of profit and risk of loss.

4. Financial risk

Consideration is given to the amount of financial risk undertaken by the worker. Usually employees do not have to bear financial risks as any expenses incurred would be reimbursed by their employer. On the other hand, self-employed individuals inherently bear a financial risk and could potentially incur a loss as they normally carry fixed monthly costs regardless if they are being paid or not.

5. Opportunity for profit

The ability for an individual to realize a profit or incur a loss would indicate that an individual and business relationship exists. Self-employed individuals normally have the ability to realize a profit or incur a loss as they control and accept contracts as they see fit. Contract fees can be negotiated and offered to more than one client. Self-employed individuals will normally incur expenses associated with carrying out the terms of the contract and can either increase their fees and/or decrease their expenses in order to control their bottom line.

Employees may incur expenses directly related to their employment. These expenses would usually be reimbursed by the employer and should not place the individual at risk of incurring a loss.

What to include in a self-employment contract

It is important to outline the terms of the contract with the individual. The following are some examples that may provide the CRA evidence of a self-employed relationship. While it is important to have a contract in place, the CRA will look at all factors when determining employment status on a case-by-case basis. A contract is a legal document and should be created with the guidance of a legal professional.

The following items should be specified in the contract:

- Whether the individual will invoice the employer for services rendered through a registered corporation, partnership or sole proprietorship
- Whether the individual will supply his/her own tools to perform the work
- That the individual will accept the contract for a specified time period, specified project, or at a specified fixed price
- That the individual is permitted to offer his/her services to other clients during the contract period
- That the individual is exempt from adhering to the payer's specific company policy and code of conduct
- That the individual is responsible for directly remitting income taxes and CPP to the CRA
- That the individual is able to subcontract all or part of the work to be performed

