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EMPLOYEE OR SELF-EMPLOYED WORKER? THE COURT OF APPEAL OF QUÉBEC RULES

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with the collaboration of Martin Bédard [1]

THE COURT OF APPEAL OF QUÉBEC RECENTLY RULED ON THE CRITERIA FOR DISTINGUISHING BETWEEN AN EMPLOYMENT AGREEMENT AND A CONTRACT FOR SERVICES IN THE CASE OF *BERMEX INTERNATIONAL INC.* V. *AGENCE DU REVENU DU QUÉBEC.* [2]

It is worth noting that regardless of the fact that the parties labelled their agreement as a contract for services or an agreement with a self-employed worker, such a description is not binding on a court.

The courts have developed certain criteria for analysing an individual's legal status in order to determine whether he or she is an employee or a self-employed worker.

Among these criteria, the relationship of subordination, that is, whether a person carries out work under the direction or control of another person, has always been a determining factor.

But what if an individual is not, strictly speaking, "under the direction or control of another person",[3] due to the fact that he or she is the one running the business?

This was the question the Court of Appeal was called upon to answer.

This is an interesting decision because the Court adopted a liberal interpretation of the relationship of subordination by taking into account the degree of integration of the worker into the company, a criterion derived from the common law.

In this article, we will benefit from the collaboration of Mtre Martin Bédard, an expert in tax law, to provide a brief overview of the tax implications which may arise from erroneously labelling the relationship between the parties.

THE FACTS

This article addresses the appeal from a decision of the Court of Québec dismissing the contestation by four companies of notices of assessment issued by the Agence du revenu du Québec (the "Agence"). At the heart of the dispute over whether an actual relationship of subordination existed, and ultimately whether the individual in question was an employee rather than a self-employed worker, was the status of the principal director and officer of the appellant companies.

The appellants, Bermex International ("Bermex"), Finition Chez Soi ("Finition") and Confortec 2000 ("Confortec") carry on business in the furniture industry. These three companies are controlled by Groupe Bermex Inc. ("Groupe") and the voting shares of Groupe are held by Gestion Richard Darveau Inc.

Richard Darveau is a chartered accountant as well as the principal director and officer of the three appellant companies. He describes himself as a business management consultant.

Following a tax assessment of the four companies, the Agence concluded that Mr. Darveau was not a self-employed worker but rather an employee of the companies. Accordingly, the Agence was of the view that the management fees paid to Mr. Darveau were to be considered employment income and as such, they should be included in the companies' payroll.

For the years 2003, 2004 and 2005, the management fees paid to Mr. Darveau were $800,000, $900,000 and $900,000 respectively. For his part, Mr. Darveau declared these amounts as business income on his personal tax returns.

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[2] 2013 QCCA 1379.

[3] Article 2085 of the *Civil Code of Québec*.

THE LOWER COURTS

Bermex, Finition, Confortec, and Groupe unsuccessfully contested the notices of assessment issued by the Agence.The assessments were upheld.

The Court of Québec also dismissed the appeal of the assessments filed by the companies. It concluded that the assessments were presumed to be valid [4] and that the appellants had the burden of [translation] "demolishing" [5] this presumption, something they failed to do.

Below is a non-exhaustive list of the facts arising out of the judgment of the Court of Québec:

- There was no written agreement between Mr. Darveau and the companies regarding his work as a consultant;
- The services rendered take up approximately 85% of the time worked by Mr. Darveau;
- Mr. Darveau acts as a consultant for practical, daily and short-term needs;
- He attends the annual conventions in the industry as President and CEO of the Groupe;
- Mr. Darveau has the authority to give discounts to clients;
- He works mainly from an office on Bermex's premises;
- The companies provide Mr. Darveau with secretarial, reception, photocopy, and equipment services, including paper supplies, forms, catalogues, brochures, and stationery;
- His travel expenses and meals are reimbursed;
- The companies assume the consequences of any management errors committed by Mr. Darveau;
- The services rendered by Mr. Darveau appear to be uniform, without any particular nuance related to the nature of each individual company's activities;
- The amount of the fees are uniform from one month to another and are sometimes billed in advance without any later adjustment being made on the basis of the time actually worked; [6]
- Mr. Darveau provided no financial statement in relation with these services.

Therefore, the judge concluded that a number of elements entered into evidence and already accepted by the case law weighed heavily against the existence of a contract for services, particularly in light of the high degree of integration of Mr. Darveau into the activities of the companies.

THE APPELLANTS' ASSERTIONS

The appellants raised a number of grounds for appeal.

First, they argued that the trial judge erred in dismissing an objection made against the admission into evidence of the questionnaire completed by the auditor. The form contained answers given by Mr. Guy Bouillé, the company's controller, in the presence of Mr. Darveau.

The second ground for appeal was based on the presumed validity of the notices of assessment and the burden of proof on the person or entity who wishes to challenge them. The appellants maintained that they had satisfied their burden and had rebutted the presumption of validity of the disputed notices of assessment.

The appellant also argued that the intent of the parties should have been taken into consideration in determining the nature of the contract binding them. They took the position that Mr. Darveau had multiple titles, including employee, president and CEO and self-employed worker within the Groupe, but that in reality, he was simply a self-employed worker providing services to the related companies.

Finally, the appellant asserted that the judge erred by failing to address the issue of the lack of a relationship of subordination between the appellants and Mr. Darveau. In their view, in the absence of such a relationship, [translation] "the analysis should not be pushed further". [7] More specifically, they were of the view that, to the extent that the companies are entirely controlled by Mr. Darveau, it would be difficult to conclude that there was a relationship of subordination between the appellants and their so-called employee.

Finally, the appellants faulted the judge for importing the common law criterion of integration into Quebec law in order to determine whether an employment relationship existed between the parties.

THE DECISION OF THE COURT OF APPEAL

a. The Admissibility of the Questionnaire :

At the outset, the Court of Appeal dismissed the appellants' argument regarding the inadmissibility of the questionnaire completed by the Agence's auditor. According to the Court of Appeal, the trial judge was right to admit the answers provided by Mr. Bouillé and set down in writing in the form into evidence. They were verbal declarations of which the auditor had personal knowledge and, as such, they were admissible into evidence.

[4] Under section 1014 of the *Taxation Act*, CQLR c I-3.

[5] Expression used by the trial judge and later employed by the Court of Appeal.

[6] At para 33 of the judgment of the Court of Appeal, the trial judge is quoted as saying [Translation] "This uniformity is surprising in the absence of a lump-sum contract".

[7] Para 44 of the Court of Appeal judgment.

Furthermore, the Court was of the opinion that the trial judge was in a better position to evaluate the reliability of Mr. Darveau's statements. Having concluded that they were sufficiently reliable, the Court saw no reason to intervene in this respect.

b. The Presumption of Validity of the Notices of Assessment:

Again, the Court of Appeal upheld the position of the trial judge, concluding that he applied the correct test by holding that the appellants were required to [translation] "demolish" the presumption of validity with prima facie evidence demonstrating in what way the facts on which the assessment was based were incorrect.

Furthermore, with respect to Mr. Darveau's testimony, the Court noted that the assessment of a witness' credibility is a matter for the trial judge. [8]

c. The Intent of the Parties:

As did the trial judge, the Court of Appeal concluded that the intent of the parties to enter into a contract for services was not clear from the evidence presented in the case.

d. The Integration Criterion:

The appellants argued that the fundamental criterion distinguishing an employment contract from a contract for services is the relationship of subordination and that, on the contrary, the evidence failed to reveal the existence of such a relationship.

The trial judge concluded that a high degree of integration of the worker into the activities of the client could indicate the presence of a relationship of subordination with the company. According to this analysis, a high degree of integration points toward a relationship of subordination: [9]

> [Translation]
> "By allusion, the judge considers relevant the fact that a person performs work which is an integral part of the purpose of the corporation. The relationship of subordination may therefore translate into a high degree of integration of the worker into the activities of the client; this would point toward a relationship of subordination".

After discussing the position of two Quebec labour law authors and a decision of the Federal Court of Appeal, the Court of Appeal approved of the use of the criterion of the worker's integration into the company in order to determine the existence of a legal relationship of subordination. The Court therefore confirmed that there exists no contradiction on this subject between the civil law and the common law. [10]

The fact that Mr. Darveau is a shareholder of the appellant corporations allowed him to enjoy some liberty of action, thus giving the impression that he acts as a self-employed worker. It is not surprising that as an officer, Mr. Darveau manages his own schedule, his work, his remuneration, and that he is not directly under the supervision of another authority. This liberty was not due to the alleged contract for services, but resulted instead from his status as an officer. Accordingly, one would not be prevented from arriving at the conclusion that in the execution of his duties, Mr. Darveau was an employee and not a self-employed worker.

The Court of Appeal specifically insisted on the fact that it is the appellant corporations who assumed any risk of loss and who benefited from the profits: [translation] "Indeed, a company does not assume the errors of an outside consultant". [11] Mr. Darveau brought with him no [translation] "expertise which would require the intervention of an external person in a field that that person knows better than any other, as he acknowledges, he dealt only with the daily problems of his companies. [12]

The Court added that to accept the appellants' theory would result in the absurd consequence that no relationship of subordination can exist between a person who controls a company and the company itself and that any agreement between the officer and the company he or she controls could not constitute an employment agreement.

The appeal was therefore dismissed.

TAX ASPECTS

The Court of Appeal of Québec therefore follows a jurisprudential trend which originated from the Tax Court of Canada and the Federal Court of Appeal over the last few years. The courts allowed for the integration of the common law criteria [13] into the wider analysis of the Quebec control test. [14] As a result, it is permissible to take into account the criteria of control, ownership of tools, expectation of profits and risk of losses as well as the integration into the company when determining a person's status as a self-employed worker as opposed as that of an employee.

Such a determination has significant consequences on tax treatment, both for the client and the worker.

An employer is required to withhold provincial and federal income tax from the wages of its employees and remit the amounts deducted within regulatory deadlines. The employer is also required to withhold employee contributions to the Canada Pension Plan (CPP), Employment Insurance (EI), the Quebec Pension Plan (QPP) and the Quebec parental insurance plan (QPIP) from the employee's wages.

[8] The Court of Appeal note that the trial judge was of the view that Mr. Darveau's credibility was affected by some of the answers he provided.

[9] Para 50 of the Court of Appeal judgment.

[10] Paras 53 to 56 of the Court of Appeal judgment.

[11] Para 59 of the Court of Appeal judgment.

[12] Para 60 of the Court of Appeal judgment.

[13] *Wiebe Door Services Ltd.*, [1986] 2 C.T.C. 200 (C.A.F.), confirmed by *671122 Ontario Ltd.* v. *Sagaz Industries*, [2001] 4 C.T.C. 139 (C.S.C.).

[14] *Combined Insurance Co.* v. *MRN*, 2007 CarswellNat 601 (C.A.F.) and *Grimard* v. *R*, [2009] 6 C.T.C. 7 (C.A.F.), reversing *9041-6868 Québec inc.* v. *MRN*, 2005 CarswellNat 5615 (C.A.F.).

Finally, the employer must pay employer contributions, which are generally based upon its total payroll. Employer contributions include those to the CPP, IE, QPP and QPIP, Health Services Fund, Commission de la santé et de la sécurité du travail, Commission des normes du travail, and the Workforce Skills Development and Recognition Fund.

The employer will generally be responsible for the contributions which are to be withheld from the employee's wages, but not for non-deductible income tax, except in the case of employees who are not Canadian residents.

Furthermore, the employer may be subject to fines for amounts not withheld or for unpaid contributions. At the federal level, the penalty is 10%, which may be increased to 20% in the case of repeated breaches, a breach that has been committed knowingly, or in circumstances amounting to gross negligence. At the provincial level, the penalty is 15%.

Finally, the employer is required to pay interest at the prescribed rate on these amounts (the prescribed rate is currently 6%, both at the federal and provincial levels).

Conversely, in the case of a self-employed worker, the co-contracting client is not required to make such payroll deductions. The self-employed worker alone is responsible for making his or her government remittances in accordance with the requirements of the *Income Tax Act*.

However, if the self-employed worker is not a Canadian resident, payroll deductions must be made by the client. Failure to do so renders the client subject to penalties and interest.

Furthermore, a self-employed worker must generally collect the GST and the QST on the services rendered to the client. A self-employed worker who would have erroneously been determined to be an employee may find himself or herself in default if he or she failed to pay these taxes and may therefore be subject to penalties of 5% on amounts due, plus 1% per month up to a maximum of 10%.

Tax authorities normally have three (3) years to issue a new assessment to a taxpayer. The time period is extended to four (4) years for corporations other than Canadian-controlled private corporations, such as public corporations or corporations controlled by non-residents. However, this period no longer applies where a corporation made a false or erroneous declaration. In such a case, the tax authorities are not subject to any time limit for issuing a new assessment. Such a situation may occur where the determination of the worker's status turned out to be incorrect.

In the event that an employer notices its mistake before the tax authorities intervene, it may remedy its default with respect to missed payroll deductions by making a voluntary disclosure. If the voluntary disclosure is accepted, this should limit the amounts due with respect to what should have been withheld or contributed as well as the applicable interest; the penalties will not then be claimed.

It must also be noted that the investigative powers granted to Revenu Québec and the Canada Revenue Agency allow them to verify a company's entire staff register in the event an error is found in the processing of a worker.

Therefore, the choice of a worker's status should be made by taking into account the situation of all the workers insofar as a wide-ranging verification could have a much larger impact on the audited company.

CONCLUSION

The Court of Appeal acknowledges that the subordination concept should be given a liberal interpretation. More specifically, it teaches us that it is possible to analyse and consider the integration of an individual into the activities of a company in order to determine his or her true status.

The "integration" criterion is especially useful in the case of high-ranking executives, professionals or highly specialized workers insofar as the classic criterion of subordination is often absent in such cases.

It should be noted that an incorrect qualification of the employment contract may have a significant financial and legal impact on both the company and the individual in question, both from a tax and an employment law perspective. It is therefore crucial to conduct a proper analysis of each individual's true status.

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