MINDEN GROSS LLP

Spring 2012

**TOPICS:**



## Employees and Independent Contractors:
# How to Create the Relationship You Want

There are a number of classes of businesses in which it has become common for business owners to attempt to create independent contractor relationships with individuals providing service, rather than employment relationships. The distinction between these two categories of service providers creates significant consequences for both sides to the relationship in a number of areas, including employment legislation, wrongful dismissal actions, priorities and insolvency and contractual right and above all Employment Insurance, CPP and Income Tax. In many cases, both company and service provider find it advantageous to categorize their relationship as that of independent contractor.

By the same token, because of the tax consequences, Canada Revenue Agency can be rigorous in examining such relationships to be absolutely certain that they involve genuine independent contracts. CRA takes a dim view of attempts to characterize as an independent contract a relationship which is obviously that of employer-employee.

Adverse decisions by CRA can be appealed by business owners to the Tax Court of Canada, but obviously, the business owner's best course of action would be to avoid the problem by putting into place as many features of an independent contractor relationship as possible. Doing so requires an understanding of the general principles that a court would apply in deciding the point.

As one might expect, there is no one factor that will define the relationship. The court will make a comprehensive assessment of the entire relationship and take into account a wide variety of relevant factors.

The original criterion used by the court simply involved the question of control. If the business

owner had the right to direct what the worker had to do, including the right to say how the task had to be done, that was usually sufficient for the court to characterize the relationship as that of employer-employee.

The test subsequently evolved to a more sophisticated one involving four key elements: control (as described above), ownership of the tools used in the performance of the tasks, the worker's opportunity for profit, and which party took a more significant financial risk or assumed more liability in the event of a loss.

Subsequently, a further test was added involving a review of the degree of integration of the worker's activities into the owner's business, i.e. the degree of economic dependence involved in the relationship.

Today, a further evolution has taken place in recognition of the fact that it is simply impossible to make a reasoned decision based on specific tests. The court will look at the total relationship and ask whether or not the worker is performing the required tasks as a person in business on his own account. In doing so, the traditional tests will be reviewed. The court will look at the level of control that the business owner has over the worker's activities, whether the worker provides his or her own equipment, whether the worker hires his or own helpers, the degree of responsibility for management and investment held by the worker, and the worker's opportunity for profit in the performance of his or her tasks.

Not only are these rules not exhaustive, they can also be open to a great deal of interpretation. In one case, for example, CRA took the position that the owner's ability to fix remuneration constituted control for the purpose of assessing whether the worker was an employee or an independent contractor. While this view was upheld at trial, the Federal Court of Appeal rejected it. Similarly, courts have held that the ability to control the commission structure of a commission sales person does not constitute control.

The court will also consider the intention of the parties as a factor. The words that the parties choose to use to describe their relationship, for example in a contract between them will not determine the issue. However, and especially where an assessment of the factors on each side gives rise to a close call, any contract between the parties describing their relationship, or evidence of their mutual understanding of the relationship, will be taken into account as well.

In one case I dealt with several years ago, the parties were able to demonstrate a number of features of an independent contractor relationship. However, when the structure was created, the owner had each worker sign a document entitled "Employment Contract". Needless to say, the existence of this document did not help in the subsequent challenge by CRA.

When CRA challenges the relationship, it will communicate to the parties the list of factors in which it relies to say that the relationship is one of employment. For example, factors suggesting that the worker is an employee might include the following:

- The owner controls the hours of work;
- The worker has to attend meetings;
- The worker has to perform services personally;
- The worker cannot hire others to complete the work;
- The worker cannot work for other business owners;
- The owner establishes the worker's clientele;
- The owner provides any supplies, materials and equipment necessary to complete the work; and
- The worker cannot profit from a sale (other than through commission) and will not be exposed to any risk or loss in the course of discharging his or her duties because he does not establish the sale price and does not have to purchase any material used to complete the work.

Factors that might suggest an independent contractor relationship, on which an owner would rely, include:

- A written contract in which the relationship is described as one of independent contractor;
- The worker has his or her own sales leads;
- The worker does not receive any car or car allowance or payment of expenses;
- Hours are set by the worker;
- There is no dress code;
- No benefits are paid;
- There are no performance reviews;
- The worker has no other duties for the owner;
- The worker is paid on commission, based on invoices generated;
- There are no prescribed sales methods and the worker can determine his or her own sales strategy;
- The worker will sometimes complete a sale outside of the owner's premises, such as in the customer's place of business or home; and
- The worker charges HST on his or her invoices.

These are examples which I have seen while representing clients either facing or concerned with the possibility of CRA challenges. Needless to say, there are any number of other factors that might be relevant. If you have a concern of this nature, you should consider how the features of your relationships with your workers stack up against these lists and consult with a knowledgeable legal practitioner for more guidance. Appropriate adjustments at an early stage will help protect you from a CRA challenge down the road.

**By A. Irvin Schein**
*Partner*
Direct Line: 416.369.4136
ischein@mindengross.com

# Welcome

Minden Gross is pleased to announce that Andrew Zinman has joined the firm as an associate in the Employment and Labour group. Andrew's expertise covers a broad range of Labour Relations Board proceedings in addition he is experienced with collective bargaining, grievance settlement, and regularly acts as an advocate for his clients in mediation and arbitration. Andrew acts almost exclusively for management side labour relations primarily for the health care and construction sectors.

# Be Careful How You Ask For What You Wish For: Drafting Preconditions for Lease Renewal and Extension Provisions

When negotiating the terms of a commercial lease, one of the most coveted provisions for tenants is an option to renew or extend the lease. However, despite its significance and potential impact on both parties, this option is often not given due scrutiny.

Most extension and renewal rights are subject to certain pre-conditions, the most common of which is the provision whereby the tenant will lose its right to extend or renew if the tenant is in default at the time the option is exercised, or has been in default at any time during the term of the lease. While seemingly straightforward, the drafting and phrasing of these preconditions vary significantly from lease to lease. The judiciary has provided a great deal of insight into some of the variations of the "no default" pre-condition, which landlords and tenants would be wise to consult prior to drafting their extension or renewal rights.

## "Duly and Regularly"

In *Sparkhall vs. Watson* [1954] O.W.N. 101 (Ont. High Court) the lease contained a renewal option which was predicated on the tenant paying rent "duly and regularly". The lease provided a rent schedule whereby the tenant was to pay varying amounts of rent throughout the term of the lease. The tenant paid the rent in a non-uniform and sporadic manner, and in any event not in accordance with the terms of the lease.

The court concluded that the term "duly and regularly" meant that rent was to be paid in fixed intervals according to the rules established by the parties in the lease, which the court clarified as meaning "punctually, at the due date". In applying this strict and narrow interpretation of the condition precedent, the court noted that the tenant's breach was not a case of occasional, inadvertent or trivial default, but was a complete disregard of the purpose of meaning of the words set out in the renewal provision.

## "Not in Default During the Initial Term"

In *12990079 Ontario Inc vs. Beltsos* [2011] O.J. No. 1970 (Ont. C.A.) the tenant had sublet the premises to a sublessee, and the sublessee's insurance policy was defective due to a failure to name the landlord as an insured party. The sublessee rectified the breach and cured the default. However, the day prior to the default being cured, a slip and fall accident occurred on the premises which resulted in a lawsuit, naming the head landlord as one of the defendants.

Prior to the resolution of the lawsuit, the tenant attempted to exercise its option to renew contained in the head lease. The head lease provided that the tenant's right to renew was in effect so long as the tenant "is not during the initial Term in default under any of the provisions or covenants of this lease".

The court reaffirmed the notion that a momentary or historical breach which has been cured at the time that a tenant seeks to exercise a right to renew does not constitute grounds upon which a landlord can refuse the right. However, the slip and fall claim had yet to be resolved and was therefore classified as a "subsisting breach", which prevented the tenant from being able to benefit from the right to renew. If the claim had been resolved at the time the option was exercised, the default would fall within the category of a "spent breach", and would not preclude the tenant from its right to renew.

## "Material Default"

In the case of *1556724 Ontario Inc. vs. Bogart Corp* [2011] O.J. No. 1940 (Ont. S.C.J.), the tenant's renewal right was contingent on the tenant being in good standing and having "not been in material default under the lease". Throughout the term of the lease, the tenant had committed numerous defaults; however, at the time the tenant purported to exercise the renewal option, all prior defaults had been cured. The tenant argued that because it had cured all previous defaults, that they were "spent breaches" that should not interfere with its right to renew. The court found that the tenant's previous breaches constituted "material breaches" under the terms of the lease, and therefore did not grant the tenant the right to exercise the renewal option. Despite the fact that the tenant had cured all defaults prior to exercising the renewal option, the failure to comply with the condition precedent precluded the tenant from relying on the renewal provision. The court based its decision on the facts of the case and did not provide a method for determining what type of conduct would constitute a material breach. However, it is clear that the court will scrutinize a tenant's conduct closely and will consider a wide range of actions when making a determination with respect to a default under the terms of a lease.

## Conclusion

It is important to note that the above examples only represent some of the most common condition precedents utilized in renewal provisions. When negotiating the inclusion of a renewal or extension option in a commercial lease, the manner in which such a provision is drafted is of paramount importance. The exact wording and phrasing of any condition precedent in such a provision must be clear, precise and demonstrative of the intent of the parties. Landlords must keep in mind that the inclusion or exclusion of a time related caveat to a condition precedent, or a limit on the nature or extent of the condition precedent, will each have a significant impact on the tenant's ability to exercise an option to renew or extend, and will alter the manner in which a court will interpret such a provision. On the flip side, tenants should always negotiate for reasonable qualifiers on the nature of a default, such as "material", "continuing" or "at the time of exercising", and otherwise limit any pre-condition that spans the term of the lease.

**By Daniel R. Wiener**
*Associate*
Direct Line: 416.369.4126
dwiener@mindengross.com

MINDEN GROSS LLP

BARRISTERS & SOLICITORS
145 KING STREET WEST, SUITE 2200
TORONTO, ON, CANADA M5H 4G2
TEL 416.362.3711 FAX 416.864.9223
www.mindengross.com

## Professional Notes

**Melodie Eng** presented What Does Quiet Enjoyment Mean Anyways at the ICSC 2012 Canadian Shopping Centre Law Conference.

On February 15, 2012, **Stephen Posen** presented a paper at the Six Minute Commercial Leasing Lawyer for the Law Society of Upper Canada on the subject of non-disturbance agreements; on February 23, 2012, he presented a paper to the ICSC Canadian Shopping Centre Law Conference on the subject of due diligence pertaining to commercial leases; and on April 17, 2012 he also presented a paper on landlord and tenant remedies for Springfest; and was designated recently as one of the top 500 lawyers in Canada.

**Philip Bevans** presented Best Practice in Risk Management to the Association of Corporate Counsel

**Matthew Getzler** presented at the Society of Trust and Estate Practitioners (STEP) Canada 2011 Year in Review

**Boris Zayachkowski** will present "Dealing with Reciprocal Easements and Operating Agreements in a Pad Lease"

**David Louis** released Implementing Estate Freezes, 3rd Edition.

**Michael Goldberg** and **Timothy Dunn** spoke at the Royal Bank of Canada Wealth Management Summit

**Stephen Posen** was added to the Artists' Health Centre Foundation Community Circle

Members of our Commercial Leasing group attended the ICSC Canadian Law Conference. Michael Horowitz was a member of the planning committee and moderated the panel "Getting to the Lease in One Piece" Christina Kobi was a panelist. Stephen Posen presented "Due Diligence in Commercial Leases".Other members of the team participated as Roundtable Leaders.

## Firm News

Find out what is happening at the firm by following us on Twitter @Mindengorss

The Minden Gross hockey team took on teams from Royal Bank of Canada and Farber Financial Group