Can Canada Increase Entrepreneurship?

An overview of the administration of tax-raising processes suggests key aspects of tax administration are biased against self-employment

By Ken Phillips
There are 2.6 million self-employed people in Canada. Even though the Canadian and provincial governments generally have formally stated positive attitudes toward self-employed people, key aspects of tax administration are biased against people being self-employed. This blocks entrepreneurship. To understand how the bias works, a brief overview of the Canadian tax administration process is needed.

A quick overview of the administration of tax raising in Canada

The Canada Revenue Agency (CRA) provides revenue-raising administration services for the Canadian federal and provincial governments. When Canadians pay taxes, the notices they receive from CRA itemises the:

- Federal tax payment;
- Provincial tax payment for the province in which they live.

They also includes deductions and payments for:

- The compulsory Canada Pension Plan;
- Employment Insurance premiums.

Canada Pension Plan

Under the Canada Pension Plan it is compulsory for contributions to be made to the Plan in equal amounts by an employer and employee. Employers must make both the employer’s and employee’s payments to the Canada Revenue Agency. Self-employed people must also contribute, paying both portions.

Canadians receive payments from the fund when they retire, based on the amount of credits they have built up in the fund over their working lives. The fund is entirely financed by contributions and investments.

Canadian Employment Insurance

Under Employment Insurance (EI) (see here and here) it is compulsory for employees to make contributions (via their employer) to EI, with employers making additional contributions for employees. The employer must make the payments to the Canada Revenue Agency. Self-employed people do not make contributions to EI.

Anyone who is out of work can receive unemployment benefits, but only if they have contributed to the scheme. In other words, self-employed individuals cannot receive unemployment benefits from EI.

[Note: Self-employed people can choose to join EI, pay premiums and receive payments for ‘special benefits’ covering maternity, parental, sickness and compassionate care.]
The key is employer-employee

In overview, the administrative system in Canada for raising and collecting income tax and funds for welfare support schemes primarily hinges around the existence of the employer-employee relationship.

Canada Revenue Authority explains it this way.

If the worker is an employee (employer-employee relationship), the payer is considered an employer. Employers are responsible for deducting Canada Pension Plan (CPP) contributions, Employment Insurance (EI) premiums, and income tax from remuneration or other amounts they pay to their employees. They have to remit these deductions along with their share of CPP contributions and EI premiums.

An employer who fails to deduct the required CPP contributions and EI premiums has to pay both the employer’s share and the employee’s share of any contributions and premiums owing, plus penalties and interest.

The consequence is that the key design feature, or trigger, for the integrity of the collection system is the employer—employee relationship. If a business or individual engages someone as a self-employed person and, in the opinion of CRA, the individual is an employee, the financial penalties for an incorrect classification can be, and most often are, massive.

How the system is enforced by CRA

Independent Contractors Australia is currently involved in a programme to expand the network of people across the globe looking to defend the right to be self-employed. We have had extensive discussions with like-minded Canadians. We have been supplied (in confidence) with the details of a number of actual investigations conducted by CRA into whether an employer-employee relationship existed instead of a self-employed-business relationship. On the basis of those cases, the following observations can be made:

• CRA has a published, public process by which it undertakes an investigation. This is the key document.

• Essentially, CRA conducts a common law test. Here's ICA's own summary of the elements of a common law test.

• The only authority which can legitimately and independently conduct a common-law test is the courts. Yet CRA sets itself up as investigator, prosecutor, judge and jury—

"The only authority which can legitimately and independently conduct a common-law test is the courts. Yet CRA sets itself up as investigator, prosecutor, judge and jury..."
What the CRA has instead is the power of institutional and financial intimidation over Canadian taxpayers, a power it obviously and frequently uses.

The consequences of the CRA enforcement process

The CRA has an obligation to collect revenue and it must do that by applying the law as set out under statute. Canadian law requires income-earners and payers to pay tax and make contributions to welfare schemes (Pension Plan and Employment Insurance). The law is quite clear that employers, employees and self-employed people all have obligations to make payments. The issue we raise is not the obligations themselves, but how the collection of payments under those obligations is administered.

But what is evident is a bias by the CRA towards finding and enforcing employment. For whatever reasons, CRA presumably finds it preferable to collect money from employers. This reflects an administrative (and possibly cultural) bias within CRA to find an employer-employee relationship and declare against self-employment. There is no process or incidence that we can see, for example, where the CRA seeks to, or does, declare employees to be self-employed. In short, the CRA does not appear to be acting impartially.
This is wrong. In fact the CRA should not care whether individuals are employees or self-employed. Whatever status an individual is, the CRA still has the legal authority to collect the required revenue. The only issue should be from whom is the revenue collected, from the employer or the self-employed individual?

Assuming that this assessment is accurate, the bias of the CRA creates a series of negative impacts on Canadians and the Canadian economy.

- Self-employed people set themselves up in business and organize their affairs under business principles. They charge their clients rates that reflect their costs, including their payment obligations to the CRA. Likewise, businesses that use the services of self-employed people make payments to self-employed people based on business understandings that the self-employed person has certain obligations to the CRA.

- When the CRA comes along and declares self-employed people to be employees, this turns on its head the business relationship between self-employed people and their clients. When the CRA does this retrospectively, and imposes massive back charges and fines, the CRA is in effect undertaking an intimidation exercise. The CRA’s decisions are not law unless and until proven in Canadian courts. But because the CRA is a government institution it has the financial and institutional power to intimidate.

- The outcome is that the administrative and cultural bias of the CRA against self-employment results in a widespread apprehension about self-employment. Individuals are wary of being self-employed and businesses that would like to do business with self-employed people are also cautious. The worry is created because the CRA creates significant concern over potential but unknown transactional costs associated with being self-employed.

- At Independent Contractors Australia we reason that self-employment is a work status and an environment that enables entrepreneurship, innovation and, as a result, economic development. Further, that self-employment is superior to employment in achieving these objectives. Because (on our assessment) the CRA is biased against self-employment, entrepreneurship and innovation in Canada is institutionally diminished by the CRA.
Is there a fix?

Yes, but we are not going to be prescriptive in suggesting one. Our intent in this analysis is to present what we have assessed to be a problem of CRA institutionalized bias and highlight it. If the reasoning presented here is accepted as valid, solutions can be found.

The challenge, we suggest, is for:

1. The CRA to look at its administrative processes and assess whether its strong focus on investigating and deciding on the legal status of individuals is primary to achieving its revenue-collecting obligations. That is, can the revenue collection systems more adequately embrace both self-employed people as well as employers?

2. The CRA to consider and review its institutional bias. That is, where legal status must be determined, can this be done in a way that reduces, minimizes, or eliminates, the risk that unpredictable transaction cost could be imposed on members of the Canadian community?
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FURTHER READING

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Public Administration Wage Growth

By Ben Eisen

http://www.fcpp.org/publication.php/3625

About the author

Ken Phillips is co-founder and Executive Director of Independent Contractors of Australia. Ken is an independent contractor operating as his own business, as a researcher, commentator, advocate, lobbyist, and consultant on workplace management issues. Amongst his many activities, Ken is a published authority on independent contractor issues and directs research on related commercial and competition issues. His strongest interest is management issues and the development of internal and external relationship building for organizations. Within this framework he promotes the concept of ‘markets in the firm’. Ken was ICA’s representative at the 2003 and 2006 International Labour Organisation debate on the ‘Scope of Employment Relationship.’ The ILO outcomes formed the conceptual basis for Australia’s Independent Contractors Act. Ken’s book, Independence and the Death of Employment, is published by Connor Court.

Further Reading

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