

# Guidelines for Determining Whether or Not There is an Employer-Employee Relationship in a Worker Co-operative

prepared for the  
Co-operatives Secretariat,  
Government of Canada

by the  
Canadian Worker Co-operative Federation  
(CWCF)

March 31, 1995

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## **Preamble**

The contents of this Brief have been reviewed by Revenue Canada. The contents, in Revenue Canada's opinion, reflect its position with respect to contracts of service and contracts for services. In addition, Revenue Canada has confirmed that the models and examples contained in the Brief satisfactorily explain and illustrate the differences between worker co-operatives with employer/employee relationships and those made up of independent contractors. The letter confirming the same can be found in the Appendix to this Brief.

As noted in the Brief, each worker co-operative requires its own assessment to determine whether or not it has an employer-employee relationship or is classed as a group of independent contractors. Readers should recognize that this Brief only attempts to highlight the criteria used to make this determination. It is the responsibility of the members of a worker co-operative to develop the operating structure of their worker co-operative to meet the criteria required to have an employer/employee relationship or to operate as a group of independent contractors, as desired. After the operating structure is developed, the party can request that the local tax service office of Revenue Canada make an advance ruling regarding the co-operative, to determine its status before operations commence. Changes in the operating structure after this ruling may change the relationship between the co-operative, its member and/or non-member employees. Changes in structure should always be assessed in light of the appropriate criteria to ensure the co-operative's status is maintained as per the original ruling.

# Table of Contents

	Page
Purpose of This Document .....	1
Definition of a Worker Co-operative .....	1
Is There an Employer/Employee Relationship in All Worker Co-ops? .....	1
Functioning of a Worker Co-operative: Two Models.....	2
I. Model One (Worker Co-operative with an /Employee Relationship).....	3
II. Model Two (Worker Co-operative Made Up of Independent Contractors) .....	4
How to Differentiate Between a Contract <i>of</i> Service and a Contract <i>for</i> Services.....	5
Examples of Worker Co-operatives:	
Example One - Employer/Employee Relationship .....	7
Example Two - Employer/Employee Relationship .....	7
Example Three - Independent Contractor Situation.....	9
Special Criteria in a Worker Co-operative of Model One: Employer/Employee Relationship.....	10
Conclusion.....	11
Appendix: Letter from Revenue Canada .....	13

# **Brief of the Canadian Worker Co-operative Federation**

## **Re: Guidelines For Determining Whether There is an Employer/Employee Relationship in a Worker Co-operative**

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### **Purpose of This Document**

1. The purpose of this Brief is to outline the nature of worker co-operatives and the method for determining whether or not a given worker co-operative embodies an employer/employee relationship between the co-operative and its members.

### **Definition of a Worker Co-operative**

2. A worker co-operative does not have a legal definition in most jurisdictions. In terms of a functional definition, a worker co-operative is a business functioning as a co-operative which is owned and controlled by its worker-members. In other words, a worker co-operative is a worker-owned business which is governed on the basis of the internationally recognized, democratic principles of co-operatives.

3. The Canadian Worker Co-operative Federation (CWCF) classifies as a “worker co-operative” any business functioning as a worker co-operative, inclusive of various corporate forms and organizational structures. These corporate forms include co-operatives, business corporations, and non-profit societies so long as the worker-members control the organization, and their bylaws require one member-one vote. In other words, the vote must be based upon membership, not based upon the number of common shares or other equity.

### **Is There an Employer/Employee Relationship in All Worker Co-operatives?**

4. No. In some worker co-operatives, there is a relationship of employer to employees as between the co-op and its members, whereas in others the members are independent contractors. A typical example of the former would be a retail store, whereas an example of the latter might be a group of consultants working under a common umbrella for a business presence, ready collaboration and administrative services, who have incorporated a co-operative. It should be noted that the distinctive feature here is not necessarily the type of business, but rather

its organizational structure. Clearly, a consulting company could be organized such that there is an employer/employee relationship.

5. Since each of these types of organizations can and often do speak of themselves as a worker co-op, one cannot give a single and simple definition of a worker co-op. It is clear that each organization calling itself a worker co-op must be assessed independently to determine whether there is a contract of service, i.e., employer/employee relationship, or a contract for services, i.e., an independent contractor situation. Since the application of the determining criteria is more an art than a science, many disputes and misunderstandings have arisen between worker co-operatives and Revenue Canada as to the appropriate classification of a co-operative or even a given worker. Although no single information sheet can prevent such disagreements from arising, it is hoped that this Brief may prevent some misunderstandings by providing a diagnostic tool for all parties concerned, assisting both worker co-operatives as they develop, and Revenue Canada in its categorization of worker co-operatives.

### **Functioning of a Worker Co-operative: Two Models**

6. A worker co-operative is a business incorporated under either provincial or federal legislation, usually under the *Co-operative Corporations Act*. As with all corporations, it is a legal entity in its own right independent from its current owners. The members make an equity contribution as a requirement for membership. The difficulty in understanding the nature of a worker co-operative often relates to the fact that the same individual plays different roles within the co-operative. In other words, the same person may be a member, a director and a line employee, or a member and an independent contractor. Each of these roles brings with it different rights, responsibilities and authority. It is the organization of these various roles which determines whether or not there is a contract of service or a contract for services. With a contract of service, the co-operative has the authority to control the manner of the day-to-day conditions of work, is capable of hiring and firing the employee-member, and sets the rates of pay. With a contract for services, the co-operative does not have the authority to determine how the work is carried out, cannot remove its contractor-members from contracts, nor does it have any obligation to remunerate a member-contractor for the work which he or she carries out. The member-contractors must find their own work and take the risk of profit or loss. It is hoped that the models and examples which follow will highlight these points.

What follows is an explanation of each of the two models of worker co-operatives, the first in which there is an employer/employee relationship, and the second in which there is an independent contractor relationship.

## **Model One: Worker Co-operative with an Employer/Employee Relationship**

**7.** A typical worker co-op of Model One is organized in the following manner. The members of the worker co-op are the employees of the co-operative. The co-op operates a business or businesses to provide employment to its members. These businesses can be in any sector of the economy. Each member has one vote at the general meetings of the co-op. Voting rights are based upon one's membership in the co-operative, not upon the number of shares owned as in a conventional business corporation. No individual member has legal control of the co-op, nor can such control be gained through the transfer of the co-operative's shares.

**8.** The members elect a board of directors which have the legal responsibility for the affairs of the co-op and have control over the co-operative's management. The management's authority and responsibilities are determined by the board of directors. The co-operative policies (operating guidelines) are generally approved by the board of directors; some specific policies may require the approval of the general membership.

**9.** The co-operative's day-to-day work is organized and supervised by the management, within the guidelines of the co-operative's policies. In a small co-operative, management responsibilities may be divided between more than one member, each being directly under the supervision of the board. In larger co-operatives, a more hierarchical organizational structure is usually in place.

**10.** As employees, members are responsible to carry out the duties of their job within the operational structure. Failure to do so can lead to termination as both an employee and a member of the co-operative. A person's employment can be terminated based upon operational policies, and his membership may be terminated by the directors; the person has the right to appeal termination of membership to the general membership, which is the final arbiter. Because no person has more than one vote even in a small three-person co-operative (the smallest legally possible), no member has guaranteed tenure or is in control of the workplace, but rather is subject to the policies and directions of the Board or the designated manager.

**11.** Non-member employees can be and often are hired by the co-operative. These employees may be placed anywhere within the operations of the organization; however, they cannot vote at a general meeting or be directors of the co-operative. It is usual for all potential new members of a worker co-operative to work for a probationary period before being eligible for membership.

12. The member-employees and any non-member employees are paid either a fixed or hourly salary, or a piece-work rate; the co-operative is obligated to make these payments regardless of its profitability.
13. The co-operative is responsible for the manner and quality of work completed, and can dismiss member-employees who fail to meet the required performance standards.
14. The profits generated through operations are generally proportioned between retained earnings and profit-sharing with the members based upon their work contributions. The details are stipulated within the co-operative's bylaws.
15. The above characteristics are based upon requirements of co-operative law and the bylaws of the particular co-op. Although all these characteristics are not expressed formally in all worker co-ops, the underlying co-operative law always gives the co-operative control over its membership, i.e., the right to admit or remove members, the right to set conditions of employment, etc. The formal expression of the other operating characteristics often depends upon the size and type of business engaged in.
16. A worker co-op exists as a business presence in the marketplace. It markets its goods and services through the co-operative's operations. In some cases it has a single place of business, e.g., a greenhouse, retail store, food wholesaler, manufacturing operation, etc.; in others it may have an administration centre (perhaps in a member/employee's home), while its operations are carried out at various sites, e.g., a construction co-operative.

### **Model Two: Worker Co-operative Made Up of Independent Contractors**

17. A co-op comprised of independent contractors does not control the manner in which they carry out their duties. The co-op provides office facilities and administration for a fee, based upon the contracts which the professionals carry out. The co-operative does not have a manager; rather, it has an administrator. The members of the co-op are responsible for finding their own contracts. Inquiries directed to the co-op itself are open to all members of the co-op interested in developing the proposal. The remuneration of the member is the balance of the contract after the administrative fees are paid to the co-op and all expenses incurred in carrying out the contract are paid. Although the co-op doesn't control the work of the member, it may still expel the member if it feels that the member's work performance doesn't reflect well on the co-operative, or the member doesn't follow co-op policy regarding administrative procedures.

**18.** In Model Two, it is actually the member who is contracting with the co-operative to receive services. The co-operative in turn would likely hire employees to provide these services to its members, but these administrative employees would often not be allowed to be members.

## **How To Differentiate Between a Contract *of* Service and a Contract *for* Services**

**19.** Contract *of* Service (employer/employee relationship)

### **Definition:**

(a) A contract of service is an arrangement whereby an individual - the servant or employee - agrees to work on a full-time or part-time basis for the other party to the contract - the master or employer - for either a specified or indeterminate period of time.

(b) Under such a contract, one party serves another in return for a salary or some other form of remuneration.

**20.** Contract *for* Services (no employer/employee relationship but rather the situation of a contract worker, self-employed person, independent contractor)

### **Definition:**

(a) A contract for services is an arrangement whereby one party agrees to perform certain specific work stipulated in the contract for the other party; it usually calls for the accomplishment of a clearly defined task, but does not normally require that the contracting party do anything himself.

**21.** There are four criteria which are used to distinguish a contract of service from a contract for services:

1. the degree of control, if any, exercised by the employer;
2. ownership of tools required to do the work;
3. the chance of profit and the risk of loss; and
4. the extent to which the work done by the employee is integrated into the employer's business.

**22.** In evaluating a particular situation, no one factor is definitive but rather the combination of factors as a whole must be considered in making a determination.

**23.** Having said that, it is clear that the authority to exercise control, not only over what is done but also over the manner in which it is done, is the most critical factor. It is not necessary that the control be exercised but is essential the employer be



entitled to exercise control. The degree of control exercised will often depend upon the type of work and the skill of the worker.

**24.** The criteria for control has been broken down into a number of elements:

1. the authority to select the person hired;
2. the authority to pay a salary or remuneration;
3. the authority to determine the work methods used; and
4. the authority to lay off and dismiss employees.

**25.** The ownership of the tools alone is not a sufficient factor in determining self-employment. It is traditional on some jobs for employees to provide their own tools. However, the fact that the employer provides the tools means he may exercise control over the worker.

**26.** In a worker co-op of Model One, the employee cannot dictate the manner in which the work is to be done. The co-op makes the rules as to the conditions of employment, and as to the hiring and firing of employees. This applies even where the co-op has a commitment to working by consensus, as generally consensus decisions are for broad issues of concern to the membership as a whole, and not with regard to day-to-day operations, such as hiring and firings, and conditions of employment.

**27.** Nor does the employee (with regard to his regular remuneration, or salary) share in the chance for profit or the risk of loss. It has been held that where a person holds shares in a corporation of which the person is an employee, it is erroneous not to distinguish between his role as a shareholder and that as an employee, unless of course, the person holds more than 40% of the voting shares of the corporation. An employee's earnings are not contingent on the outcome of the work for the employer. As long as an employee has performed his task he can expect remuneration and the employer has an obligation to pay. It should be noted that many employees do own shares in the business which employs them or participate in a profit-sharing plan; however the remuneration which they receive for their daily activities is usually separated from any profit-sharing they may receive. Similarly in a worker co-op, the employee in his role as a shareholder shares in the chance of profit and the risk of loss, but he does not do so as an employee.

**28.** The activities of an employee hired under a contract of service are an integral part of an on-going business. Integration is not an essential factor, as many subcontractors' activities are an integral part of the activities of the contractor who pays them. However where some control is exercised, this factor could indicate a contract of service relationship.

## Some Examples

### 29. Example One: **Employer/Employee Relationship**

\_\_\_\_\_ Grocery Workers' Co-operative Ltd. This is an enterprise operating a retail grocery store. It has twelve full-time member-employees, and five part-time member-employees. During peak periods, the co-operative may employ up to an additional ten part-time employees who are not members, because they are not permanent staff. The members have each invested \$4,000 in share capital and have one vote in the general meetings of the co-operative. The members elect a board of directors of six people who are responsible for the affairs of the co-op, and the directors appoint and supervise the manager. The manager has four department heads reporting to him; each of these department heads supervises the staff within their respective departments. The store has regular hours of operations and the employees, regular scheduled hours. The employee's rate of pay is dependent upon their particular job and length of service. The pay policy is approved by the whole membership at a general meeting. Discipline and termination are carried out according to policies of the co-operative. The manager has the right to discipline member-employees and the board the right to discipline the manager. The manager may terminate non-member employees and recommend to the board of directors the termination of a member-employee. Even directors can have their employment and membership terminated in this fashion. If profits are made during a fiscal year, they are distributed between corporate retained earnings and profit-sharing with the members, based upon the hours worked during the course of the year.

**30.** This example is an unambiguous case of a relationship of contract of service between the member-employees and the co-operative. Day-to-day control of the member-employees is established through the management structure which has been put into place by the board. The final authority for decisions of employment rests with the board of directors which supervises the manager and determines membership status.

### 31. Example Two: **again, Employer/Employee Relationship**

\_\_\_\_\_ Construction Co-operative Ltd. This enterprise is located in a small rural community. The focus of its business is residential renovations, and on occasion new construction: houses, out-buildings, etc. The co-operative has five members who are employed on a seasonal basis; additional non-member employees are often hired for a particular contract. Each member has contributed share capital of \$300. Each member of course has one vote at the general meeting; however, because of the small size of the co-operative, all members are members of the board of directors.

**32.** The board has the power to accept new members and to remove any member from the co-operative if he or she is not performing the work properly, or is not acting in the best interests of the co-operative. The board of directors sets the operating policies, i.e. rates of pay, working hours, etc., and appoints two members with management functions. One of them, the financial manager, is responsible for the financial aspects of the business: bookkeeping, banking, payroll, etc., and he maintains the co-op's business records in his home. The co-operative does not have an office other than this individual's home office. The other individual, the job manager, is responsible for ensuring that the various jobs get completed and the quality of the work is up to standard. All members are responsible for marketing the services of the co-op.

**33.** Most work in the small community is gained by word of mouth, and all members are successful in gaining work for the co-operative. A member who is successful in gaining a particular job will have the right to be a part of the crew which performs the work. In some cases, this member may be made the supervisor of the job if the customer is most comfortable relating to that person. Depending on the other work commitments of the co-op, however, the member may not work on that particular job. The final determination of who is to be the crew for any given job is the responsibility of the co-op's job manager.

**34.** All work done by the co-op is guaranteed by the co-op, and the co-op carries basic business insurance. Sometimes formal contracts are signed between the co-op and the customer, and sometimes only an oral agreement is in place. Sometimes materials are included in the agreements with the customer, and sometimes the customer only contracts for labour with the co-operative.

**35.** Each member provides their own basic carpentry tools; however the co-op purchases large items (staging, specialized power saws, etc.), and replaces the members' small tools as they wear out. Wages are usually paid weekly; however, due to a decision not to have a line of credit, sometimes wages are paid on an irregular basis. No expenses are paid to members for travel to job sites or talking to potential clients.

**36.** If profits are made, they are allocated between the corporate retained earnings and the members based upon their hours worked. Any profit allocated to the members is not paid out in cash; rather it is held by the co-op for use as working capital. The co-op's goal is to produce a small profit to cover its further development, i.e. buying tools, member-employee training, etc. Since the business is seasonal, wages are kept as high as possible while still producing this small profit. On occasion losses may be incurred due to poor estimating, bad debts, etc. Generally the co-operative's policy is to use 75% of the contract's labour

charges for wages and to use the other 25% to cover business expenses and to generate profit.

**37.** This co-op also represents an employer/employee relationship. Control of the conditions of work is asserted through the policies of the board of directors. The two individuals with management responsibilities are appointed by the board and report to the board. Although there is little need for the formal supervision of each job site because all of the members are accomplished workers, every member is aware of the standards expected by the co-op, and the co-op as a corporate entity takes responsibility for the quality of the work, i.e., to correct mistakes or remedy inadequate work at the co-operative's expense.

**38. Example Three: Independent Contractor Situation**

\_\_\_\_\_ Co-operative Limited. This enterprise is comprised of a group of fifteen individuals who work as consultants, with each operating their own business. The co-operative provides office facilities, including office equipment, desktop computers (portable computers are the responsibility of individual members) and administrative services for its members as well as a corporate name. Each member has invested \$1,000 in share capital in the co-operative, and of course has one vote at the general meetings of the co-op. The members elect the board of directors of five people who set the policies for the operation of the co-operative. The board has the power to accept new members or to remove a person from membership. Removal of a member would likely only occur where a member's actions are seen as harming the reputation or best interests of the co-op.

**39.** An administrator is hired to manage the day-to-day affairs of the co-op, i.e., the provision of the services to members. Each member pays a minimum of \$3,500 in fees per year for the space and services received as well as additional fees of 5% of yearly gross billing above \$35,000.

**40.** Members are responsible for soliciting their own work (drafting proposals, etc.). The members' income is dependent upon the contracts each gains, and their obligation to pay the minimum fees to the co-op is independent of the profitability of any given contract which they complete. A member developing a proposal for a contract will often seek a collaborator amongst the other members of the co-op. The collaborators agree between themselves how to allocate the contract's responsibilities. Potential clients which contract the co-op directly, not an individual member, are given an information package on the various members' skills and directed to make a direct contact. Unsolicited calls for proposals are posted; however there is a policy that only one proposal from among the co-op members may be submitted to any call for proposals. This means that if several

members are interested, they must collaborate, or the right to respond to a call for proposals will be allocated on a revolving basis.

**41.** Any profits generated by the co-operative by the provision of services to the members are distributed between corporate retained earning and the members of the co-op based upon their billing during the year. However, any profits or losses on the contracts belong to the members themselves.

**42.** The co-op does not control the time, place or manner in which contracts are carried out by the members. Rather, the independent contractor on her own undertakes to produce a given result in the manner which she deems most appropriate. The co-op cannot decide that a member should be taken off a given contract, even in the extraordinary situation where the member is expelled, as the contract belongs to the member.

**43.** This is an example of a co-operative in which the members do not have a contract of service with the co-operative. Rather, the members are purchasing services from the co-operative. The members are each responsible for their own income, and each incurs the risk of loss or gain on each contract. Although the co-op has a corporate presence in the marketplace, its business is restricted to supplying services to its members. However the employees which have been hired by the co-op to provide these services to the members do have an employer/employee relationship with the co-op, as the board of directors sets the conditions of employment for the staff.

**44.** If the co-op described allowed the administrative employees to become members of the co-op, this would not change their employer/employee relationship with the co-op, as the co-op would still control their conditions of employment. There would be, in that scenario, two different categories of membership, one for employees and the other for self-employed members. Such an arrangement characterizes a multi-stakeholder co-operative.

### **Special Criteria in a Worker Co-operative of Model One**

**45.** Generally speaking, all indicia of an employer/employee relationship would be present in all worker co-operatives of Model One, with the partial exception of “chance of profit and risk of loss.”

**46.** Under the heading “Chance of Profit and Risk of Loss” in the Revenue Canada document entitled Contract of Service, “a” would apply to worker co-operatives. It states:

“(a) An employee’s earnings are not usually contingent, as he does not assume any risk of loss or benefit from any chance of profit arising from the work he performs.”

**47.** On the other hand, “b” would not usually apply; it states:

“(b) An employee hired under a contract of service normally shares in neither the profits realized in a successful business nor the losses incurred in an unsuccessful business.” Even though sharing in the chance of profit and the risk of loss is usually an indicator of an independent contractor situation, in a worker co-op of Model One, there is an employer/employee relationship even though this element is present as a rule.

**48.** Whether the routine sharing in profits and losses should be viewed as a special criterion in worker co-operatives is unclear. As mentioned previously, courts have held that where workers are insurable employees, the existence of profit-sharing does not remove their status as employees. Further, where three or more individuals incorporated a business corporation (not as a worker co-op) having an employer/ employee relationship, were each employed by the corporation, and each held for the time being an equal proportion of the voting shares, they would each be in insurable employment unless and until one of them acquired more than 40% of the voting shares. At that point, the individual with the 40% or more of the voting shares would be in excepted employment. Because of such considerations, it is unclear whether worker co-ops need a special criterion on the point of profit-sharing. However, due to the fact that sharing in profits and losses is a routine part of all worker co-ops, even those of Model One, perhaps this should be viewed as a special criterion for worker co-operatives.

## **Conclusion**

**49.** It is appropriate to conclude by quoting from the Revenue Canada document Contract for Services,

“The relationship between a person and an independent contractor and that between an employee and his employer are sometimes quite similar; the main difference between the two relationships is that in the former case the party paying for the services is entitled to dictate what is to be done or what result is to be achieved, whereas in the latter case, the employer is also entitled to stipulate the manner in which the work is to be done.”

**50.** In a Model One worker co-operative, the co-operative, through the board of directors, is entitled to stipulate the manner in which the work is to be done. No individual controls the manner of working, and each member is liable to be fired

if appropriate. On the other hand, in a Model Two worker co-operative, each individual can stipulate the manner in which the work is to be done for his or her client. Further, no individual can be taken off a contract by the co-op; if the co-op expels a member, his contracts leave the co-op with him.

**51.** The intention of this document is to shed some light on the insurability status of members of worker co-operatives, whether employers or otherwise, so that the four-part test of employment can be clearly applied and understood in its application to worker co-operatives. It is hoped that with the information available in this Brief, government officials will find that fewer worker co-operatives fall into the gray area between clear insurability and clear non-insurability, thus ensuring fewer misunderstandings.



Revenue Taxation  
Canada

Canada Pension Plan  
Unemployment Insurance

March 29, 1995

Kutz, Hotzel  
Barristers & Solicitors  
316, 1167 Kensington Crescent N.W.  
Calgary, AB T2N 1X7

Attention: Hazel Corcoran  
Corporate Secretary  
Canadian Worker Co-operative Federation (CWCF)

Your file  
C-101/94

Our file  
7082

Dear Ms Corcoran:

This is in reference to your letter of March 24, 1995 addressed to Mr. Georges Goulet concerning a draft information circular (the draft) prepared by the CWCF containing guidelines for the determination of an employer-employee relationship in a worker co-operative. As per your request, Mr. Goulet forwarded a copy of your letter to me.

We have reviewed the draft and in our opinion the contents reflect this department's position with respect to contracts of service and contracts for services.

The models contained in the draft sufficiently explain the differences between worker co-operatives with employer-employee relationships and those made up of independent contractors. Furthermore, the three examples used to illustrate these models satisfactorily explain the subject matter.

If it is the intention of CWCF to eventually have a finalized version of the draft issued as an official Revenue Canada Information Circular, I would like to mention that the process is more involved and may require a few months to be completed. We would suggest that the heading "Revenue Canada Information Circular" be removed from the first page of the draft until such time that it might be approved as an official Revenue Canada Information Circular.

On the other hand, if the draft is for use by CWCF members, a preamble could be added that the contents of the draft have been reviewed and that this department agrees with the information contained therein. If this is the case, we would appreciate receiving a finalized version of the document prior to its issuance.

If you should have any further questions concerning this subject, please feel free to contact me at (613) 952-5422.

Yours truly,  
*(original document and signature on file at CWCF Calgary office)*  
Pierre M. Paquette, LL.L.  
Chief  
Canada Pension Plan and Unemployment Insurance Programs Section

c.c. G. Goulet  
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