Andrews & Co.
Chartered Professional Accountants • Professional Corporation

+ 613.837.8282
info@andrews.ca

540 Lacolle Way
Ottawa, ON K4A 0N9

INDEPENDENT CONTRACTORS & PERSONAL SERVICES BUSINESSES

A Personal Services Business is a punitive designation under the Income Tax Act that taxes income in a corporation at a high rate and disallows deductions and expenses. This memo has been written to help our clients identify if they are a shareholder in a Personal Services Business and what can be done about it.

The Government of Canada, many businesses and other entities prefer to hire independent contractors instead of employees. The "employer" or "contracting entity" may gain a number of advantages including avoiding or reducing certain costs and liabilities such as Canada Pension Plan, employment insurance, cer tain obl igat ions under employment laws or in the case of the government, circumventing hiring restrictions and protocols.

By requiring the "employee" or "contractor" to incorporate the "contracting entity" transfers all or substantially all of the risk from themselves to the contractor.

Most corporations in Canada enjoy tax advantages over unincorporated individuals. However a corporation that has been formed primarily to allow an individual to provide services may be a special type of corporation. A Personal Services Business (PSB) is a corporation where the shareholder would reasonably be regarded as an employee or officer of the contracting entity if the corporation did not exist. In other words an "incorporated employee".

A PSB is well defined in both tax law and many cases that have appeared in Tax Court. Various factors are examined in determining if a corporation is a PSB or an individual is an incorporated employee. Considerations include the degree of control (master/servant relationship), ownership of tools, financial risk or the chance for additional profits, the ability to substitute another person to perform the duties and other factors. As an example a corporation that has a single client who requires the shareholder and only the shareholder to work at the client's location using the client's computers etc, is paid a daily rate and must follow the client's terms and conditions to perform the duties may well be a PSB.

A PSB suffers serious tax consequences. Firstly most expenses including salaries to spouses and other inactive family members, travel expenses, meals and entertainment are disallowed. If expenses that have been disallowed benefited the shareholder (i.e. salary to spouse or car expenses), those expenses may be added to the income of the shareholder.

A regular Canadian Controlled Private Corporation (CCPC) operating an active business that is not a PSB pays tax in Ontario at the rate of 15.5% on the first $500,000 of income. A PSB however is disallowed this preferential treatment and the tax rate increases to 39%.

+ 613.837.8282
info@andrews.ca
540 Lacolle Way
Ottawa, ON K4A 0N9

The first defence against being assessed as a PSB by the Canada Revenue Agency is to ensure that a contract is properly drafted between the contracting entity and the contractor and that the terms and conditions of the contract do not result in a PSB as defined in the Income Tax Act. If this is not possible and the terms required by the contracting entity result in a PSB, the tax costs may be reduced by paying an optimum blend of salary and dividends to the shareholder.

Seeking professional advice when accepting contracts, determining if a corporation is a PSB and when filing tax returns is strongly recommended.