

Minister of Finance



Ministre des Finances

Ottawa, Canada K1A 0G5

OCT 03 2012

2012FIN372099

Mr. Frank McCrea  
President  
Board of Directors  
Association of Professional Computer Consultants  
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Toronto, ON M4P 2C9

Dear Mr. McCrea:

Thank you for your correspondence of May 2, 2012 regarding the income tax rules for personal services businesses and the concept of tax integration for corporations and their shareholders. Please excuse the delay in replying.

The income tax provisions relating to personal services businesses were implemented to deal with situations where a corporation has been interposed between a service recipient and an individual in what would have otherwise constituted an employer-employee relationship. These rules are intended to maintain the neutrality of the tax system by helping ensure that two individuals who are essentially paid the same amount for providing services as an employee are taxed in a similar manner in the year employment income is earned.

As stated in the report of the Standing Committee on Finance to which you are referring, a personal services business will continue to be eligible to deduct salary and wages paid. Therefore, there will generally be no corporate level tax payable on personal services business income to the extent the income is paid to employees of the personal services business as salary or wages, including those paid to an owner-manager. Such income will be only taxable in the hands of these employees at their regular personal tax rates, as would have been the case if they had earned the income directly. Accordingly, in this case the personal services business rules simply ensure that the corporation of the individual providing the services does not claim expenses that would not be available to the individual if the individual had been an employee of the service recipient.

Alternatively, should an owner-manager decide to receive the profit of the business as dividends, rather than as salary, then the income will be taxed partly at the corporate level and partly by the person receiving the dividends. In this case, the overall tax paid will approximate the tax that would have been paid if the individual had instead delivered services directly as an employee of the service recipient or had taken the business profits as salary from the individual's corporation. The effect of the rules for a personal services

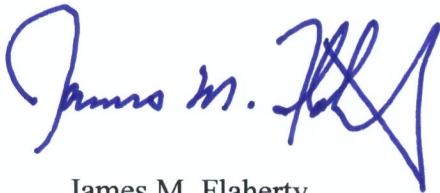
business is to reduce the benefit of the tax deferral that would otherwise be available if the owner-manager decided to retain the business profits within the corporation.

The income tax rules nevertheless provide criteria to ensure that not all corporations in employment-like relationships with service recipients are considered to be carrying on personal services businesses. For example, the personal services business rules will not apply if the corporation has more than five full-time employees. In other cases, the application of the personal services business rules will depend on the circumstances of each situation.

On October 31, 2011, the Department of Finance Canada proposed an amendment to the income tax rules relating to a personal services business. Under the proposed amendment, personal services business income will be subject to the general federal corporate income tax rate of 28 percent rather than 15 percent. The proposed amendment applies to taxation years that begin after October 31, 2011. As noted above, this tax rate will not apply to income that is distributed as salary from the corporation. This proposal will help make the incorporation of personal services businesses for tax purposes less attractive, which will improve the neutrality of the tax system.

I appreciate receiving your comments on this issue and assure you that they will be taken into account. The views and suggestions of Canadians are essential to our ongoing efforts to ensure that the tax system is fair and effective.

Yours sincerely,



James M. Flaherty