

Standing Committee on Finance (FINA)

Pre-budget consultations 2012

Association of Professional Computer Consultants

Responses

1. Economic Recovery and Growth

Given the current climate of federal and global fiscal restraint, what specific federal measures do you feel are needed for a sustained economic recovery and enhanced economic growth in Canada?

The Association for Professional Computer Consultants (APCC) represents over 3,000 Canadian businesses that provide services to every major organization in Canada. Our members deliver high value, knowledge driven services that are critical to the efficient operation and competitiveness of Canada Industry and Government. Our industry, and its contribution to Canada's recovery, is threatened by CRA efforts to apply Section 125(7) of The Income Tax Act to Small Services Businesses (SSBs). Personal Services Businesses tax is an attack on small businesses that places these organizations at a disadvantage relative to their large business and international competitors. This policy will effectively destroy the small services business sector in Canada and likely send jobs overseas as it will be easier for client organizations to access these services through off shore providers. In the limited space available, we wish to highlight that the report tabled by CRA to the Standing Committee on Finance in 2010 ("Servant or Master? Differing Interpretations of a Personal Services Business") contains material misrepresentations that likely compromised the Government's ability to understand and form effective policy on this issue. Specifically, the CRA made a specious comparison of small business tax and personal income tax. This is wholly inaccurate as it neglects two salient points 1) Small businesses and their owners contribute Sales Tax, Corporate Tax AND Personal Tax. CRA's failure to include the Owner's Personal tax obligation in its presentation to the Standing Committee on Finance is an omission we find completely inexplicable. As such, all tax comparisons provided in the CRA document materially misrepresent the relative tax contribution made by these small businesses. 2) Personal Services Businesses earn a business premium of roughly 40% vs. their 'employment' value. This reflects compensation for risk, flexibility and value capture for untaxed employee benefits (pension, paid vacation, etc). As currently designed the PSB legislation goes well beyond catching 'incorporated employees' and will serve to destroy a vibrant and competitive part of Canada's economy. Revisions are needed to provide tax fairness for Canadian Small Canadian Businesses operating in the Services space and this is a critical issue for Canada's economic growth and prosperity.

2. Job Creation

As Canadian companies face pressures resulting from such factors as uncertainty about the U.S. economic recovery, a sovereign debt crisis in Europe, and competition from a number of developed and developing countries, what specific federal actions do you believe should be taken to promote job creation in Canada, including that which occurs as a result of enhanced internal and international trade?

Small Business comprises more than 50% of Canada's total economy and is commonly recognized as its engine of economic growth and prosperity. Over the past 30 years, Canadian corporations have increased their engagement of small services businesses on a contract basis due to the need to engage specialists across a diversity of skills, for defined duration, project oriented engagements. This transition effectively represents local outsourcing of non-core functions. The work is competitively sourced and Clients are seeking flexibility that cannot be satisfied by full time employees. Client firms pay premium prices to obtain the skills of qualified professionals when they need them, for the duration of their need.

Firms benefit by leveraging specialized expertise from small providers, while avoiding the cost and distraction required to build such an internal competency in a non-core function. As services becomes more nimble, firms are increasingly neutral between engaging domestic providers (in Canada), or looking overseas. This buy local vs. global decision is driven by the ease of doing business, quality of work and total cost (services price + administration/compliance costs + tax). Canada is recognized as one of the most business positive environments for knowledge driven services worldwide, based on: our stable political/economic climate, highly educated workforce, multi-cultural workforce, cost effective labour and proximity to the US market. Per StatsCan, this trade provides Canada a trade surplus of \$1.7 billion/year. We believe Canada has the capacity to attract even more global businesses, if the government is able to: 1. Recognize the economic reality that corporations want/need the flexibility to outsource services work to independent providers. Policies that seek to reverse this trend will simply push the work offshore at an accelerated pace. 2. Unfair tax policy for Small Services Businesses is a meaningful source of friction that hurts job creation and Canadian Competitiveness. Clear and common sense rules are required to unlock the performance of the Small Services Business sector. 3. Extend the protection of clear business rules to corporations who engage lower income workers so those workers are able to receive the full protection of Canada's EI legislation in a timely manner.

3. Demographic Change

What specific federal measures do you think should be implemented to help the country address the consequences of, and challenges associated with, the aging of the Canadian population and of skills shortages?

The APCC's membership is comprised of knowledge driven Small Services Businesses (SSBs) that primarily operate in the Information Technology space. Our members have indicated that they choose this career path to capitalize upon their knowledge, enjoy significant flexibility it offers and avoid the lack of security commonly found in corporations. Our members include many businesses founded by individuals that have retired from traditional employment yet wish to continue to work on a part time basis. They are attracted to the SSB sector as it allows them to remain professionally engaged by selecting short term contracts of interest, while also providing flexibility and a lifestyle that is compatible with their view of retirement. Encouraging this dynamic represents an attractive, zero cost mechanism for the Government to retain knowledge workers in the labour market while at the same time mitigating skills shortages from Canada's aging population. We believe the government should support the SSB sector by exploring ways to remove the red tape inhibiting these businesses and remove policies that are damaging to this sector. Along these lines, the recent launch of Section 125(7) of the Income Tax Act that defines Personal Services Businesses (PSBs) represents a direct threat to the small services business sector. It imposes dramatic changes to the corporate taxes rules for small services businesses and results in substantially higher tax rates being applied to these businesses. The result is that despite having properly paid corporate and personal taxes, a PSB determination under 125(7) will result in a significant financial penalty to the business operator, the prospect of which is extremely threatening to an individual in their retirement years and looking to protect their retirement savings. This risk alone is enough to chase workers at retirement age out of the SSB sector, thereby removing them from the labour market. Recommendation: • The government recognize that Section 125(7) of the Income Tax Act has outlived its time and does not serve the public interest or fit with the demands of today's economy. • The CRA be directed to suspend any application of section 125(7), repealing it at their earliest convenience

4. Productivity

With labour market challenges arising in part as a result of the aging of Canada's population and an ongoing focus on the actions needed for competitiveness, what specific federal initiatives are needed in order to increase productivity in Canada?

Small services businesses (SSB) are the backbone of Canada's knowledge economy. They fulfill a critical role in Canada's economy by providing organizations an efficient market based mechanism to access scarce or emerging skills. Canadian organizations use this channel to overcome skills shortages and access the critical skill sets required for their growth, effective operation and competitiveness. Work in the SSB sector also provides significant benefits to individual workers. SSB workers, • Demand and receive the full market value of their skills (representing approximately a 40% premium to their employee value). • Enjoy the flexibility to accept projects from a variety of firms, providing for the cross pollination of best practices and access to unique skill development opportunities (further enhancing their market value). • Directly benefit from the quality of their work through expanded engagements or new business opportunities from satisfied clients. Recent actions by CRA to broadly apply section 125(7) of The Income Tax Act to Canadian SSB's is hurting the viability of this sector. It will push talented workers out of the SSB sector, thereby hurting the services ecosystem in Canada and damaging the overall Canadian economy, by making it more difficult to engage domestic workers with critical skills on a timely and cost effective basis. With local suppliers diminished, client firms will simply move this work offshore, removing high quality jobs and lowering Canada's tax base. The government must recognize the SSB sector as a critical asset of the Canadian economy and take actions that will promote the health of these businesses. Recommendations: 1. Suspend / Repeal section 125(7) of the Income Tax Act defining Personal Services Businesses. This legislation puts small business operators at extreme personal risk and places their companies at a disadvantage vs. large company competitors. Clearly this is bad policy and it will hurt the development of Canada's next generation knowledge driven industries, including IT, Management Consulting, Engineering and Financial Advisory services. 2. Consult with the various organizations and associations which represent the growing service oriented small business sector to discuss the government's concerns and explore enhancements which can address those concerns.

5. Other Challenges

With some Canadian individuals, businesses and communities facing particular challenges at this time, in your view, who is facing the most challenges, what are the challenges that are being faced and what specific federal actions are needed to address these challenges?

"The only thing that is constant is change" This quote was coined by Heraclitus of Ephesus, a Greek philosopher alive from 535 BC to 475 BC. It was true then and has survived the test of time up until today. The Canadian economy is changing. In the context of wider global trends, over the last 30 years Canadian companies and government organizations have embraced outsourcing as a highly efficient and cost effective mechanism to enhance organizational flexibility and productivity. The outsourcing trend first swept manufacturing which, combined with offshoring, saw the rise of global supply chains. Today it is being embraced by the services sector and is fundamentally redefining the world of work for many Canadians. Canada's tax policy for services remains rooted in an era that no longer matches today's economy. Personal Services Business (PSB) legislation was authored in 1981 as a reaction to Ralph Sazio, coach of the Hamilton Tiger-Cats. In the 1960's, Mr. Sazio redefined his work relationship from employee to incorporated provider, providing control (but not avoidance) of tax payments under significantly higher personal tax rates that then prevailed. Since then, Canada's economy has changed dramatically. Today's small services business owner/operator is a true entrepreneur, that secures work through competitive procurement and competes directly against global corporations (think IBM,

Accenture, HP, et al) for every piece of business they earn. For many types of knowledge driven work, small business has an edge over their less nimble large business competitors, however this dynamic is fragile. While PSB legislation might have made sense in the era of Mr. Sazio, today it reduces the competitiveness of Canada's Small Service Businesses and places significant financial hardship on the owner/operators of these businesses. Combined with this threat, is an opportunity. Effective policy changes will enhance Canada's reputation as a center of excellence for knowledge driven services work by providing a friendly environment to do business and a healthy eco-system for small business service providers. Reforming PSB legislation and enhancing protections provided to low income workers are two critical steps Canada must take to meet these changes and secure a prosperous future.