

## **Standing Committee on Finance**

### **Industry Submissions**

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## Introduction

On December 2, 2009, the House Standing Committee on Finance held a hearing on taxation and characterization of Personal Service Businesses (i.e. PSB) by the CRA.

The essence of the meeting was CRA classification of small businesses which provides services as PSB with the result that:

1. The small businesses were obliged to pay tax at the higher regular corporate tax rate;
2. Allowable expenses were limited to salaries and wages, which meant that expenses related to transportation, training, and advertising, etc, were denied.

The view of the committee was that:

1. The federal government examine the income tax act with a view to proposing which might reflect the realities of modern labour market;
2. The rules regarding disallowance of the lower small business tax rate and of expenses deductibility, appeared to penalize professionals who have choose to become an entrepreneur and to incorporate.

The Minister of Finance responded to the committee in an Oct 6, 2010 letter in which it:

1. Noted that the objective of the PSB business provisions in the Income tax Act was to ensure that individual who would provide their services through a corporation would be treated comparably for income tax purposes;
2. Provided a comparison of:
  - a. Manitoba's small business tax rate of(11% to federal/provincial tax rate of 35%; and
  - b. Quebec's small business tax rate of 19% plus a provincial tax of 9% to the federal/provincial tax rate; and
3. Suggested an absence of equality.

The provided diagram presents a comparison of the tax applicable to an Employee against the income flow and tax applicable to a Contractor.

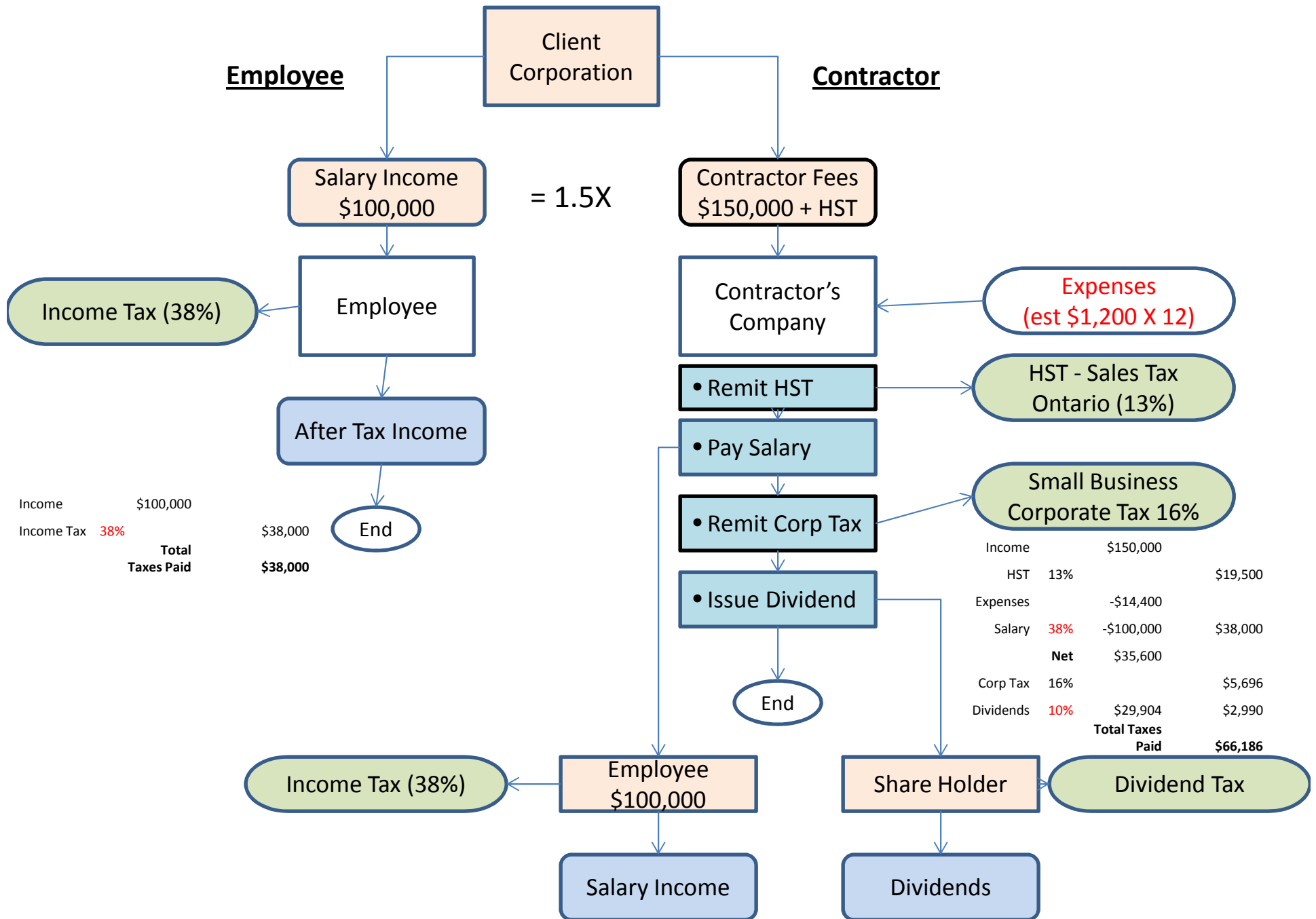
Employees receive benefits such as employee contributions to a pension plan and/or benefit program, training costs, among others which are additional to the salary that they are paid. Absent eligibility to participate in such programs, contractors charge a premium for their services, which in this instance is presented as being 50%.

While the employee only pays Income tax, the diagram presents the government realizes tax in the following forms:

1. HST on the funds received from the client
2. Income tax on whatever funds the individual takes out of the corporation
3. Corporate tax on the funds residual in the corporation after (expenses and salary)
4. Dividend tax on any funds distributed from the corporation by way of dividend.

This briefing document presents a series of submissions presented to the government through the Standing Committee on Finance from organizations which include:

1. APCC – Association of Professional Computer Consultants
  - a. Approximately 6,000 member association of individuals working as independent contractors
2. NACCB – National Association of Canadian Consulting Businesses
  - a. An association of approximately 100 businesses, which provide full time and contract staffing of Knowledge Workers in the Information Technology and related sectors.
3. CFIB – Canadian Federation of Independent Businesses
  - a. An association of Canadian Businesses of all sizes, crossing all verticals
4. Procom
  - a. Canada's largest staffing firm providing contract and full time placement to corporations across Canada.





Briefing Note to the Standing Committee on Finance  
40<sup>th</sup> Parliament, 3<sup>rd</sup> Session

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## 1. Introduction

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Canada is known for its resources. However, one of its most important resources is the knowledge and talents of its people. Within Canada's labour market, the staffing and contracting sector is a critical function that enables the market to optimize the allocation of scarce professional resources to private and public sector organizations where there is a need.

Over the past 40 years, the Canadian labour market has evolved and, as a result, there is a need to review and upgrade Canadian tax legislation to reflect the realities of that market and the model which is currently functioning, and functioning well, to the benefit of the Government, Canadian corporations and professionals who provide their services through corporations.

Historically, that contract market has co-existed with Federal Legislation which has advanced the concepts of a Contract of Service as opposed to a Contract for Service. Periodically, an unemployed contractor has applied for EI coverage and been denied and the issue has flared up in a minor way with reference to phrases such as "employee like" or the "facts of the matter" being applied in subjective decisions.

However, with renewed focus on the issue of Personal Services Businesses and the emerging CRA strategy to aggressively target the Information Technology (IT) sector with audits and reassessments, the need to make changes to the legislation has become an issue which we submit requires attention and change.

Contracting enables the market to optimize the allocation of scarce professional resources to corporations and government bodies where there is a need. Despite the reality that contract resources are paid a premium over the cost of full time employees (FTE), their rates are competitive within a global context.

However, if:

1. The PSB audit and assessment exercise results in increased costs as agencies and clients alike make provision for the burden of employee benefits and
2. Individuals leave the contract sector thereby reducing the supplier of these scarce resources,

then the combined impact of reduced availability and increased cost may induce corporations to consider sending jobs offshore. This could have a very significant and detrimental impact on the Canadian economy. The opportunity exists to implement changes which address long standing issues, protect those in need of protection, ensure access to social programs and provide a foundation for continued growth and prosperity.

## **1.1 Summary**

NACCB wishes to intervene in the present review of legislation and policy governing Personal Service Corporations, as we believe this body of regulation has a powerfully negative impact on the Canadian labour market and, if expanded, would be incredibly destructive to the market for high value contract services.

Fairness is a fundamental principle of Canadian taxation and Canadian law. The current application of legislation related to Personal Services Corporations is fundamentally not fair as it now stands and as it is now being applied.

Through the course of this briefing note, NACCB intends to demonstrate

- 1) The market for contract services comprises a significant portion of Canada's economy, and offers meaningful benefits for the workers and client organizations that participate in it.
- 2) A fuller view of the tax situation for incorporated independent contractors, which actually generate higher tax income as compared to an equivalent FTE.
- 3) Efforts to strip incorporated independent contractors of the benefits and protections enjoyed by other types of Canadian incorporations serves to unfairly persecute these businesses and will have a damaging impact on the services sector.

## **1.2 About NACCB**

The NACCB Canada was created in November of 1999 to work with legislators to ensure they understand how the IT professional services industry operates and the contribution the industry makes to the Canadian economy. The NACCB Canada has grown to 75 companies representing over 2.5 billion dollars in annual revenue, 22,000 contractors and 2000 employees. Members, who are primarily small and medium-sized organizations, meet regularly to discuss industry issues, establish positions on these issues and share best practices.

The NACCB Canada supports many of the proposed changes to the VOR procurement mechanisms in the consultation paper. The purpose of this response is to provide a few suggested improvements to a positive overall strategic vision.

## **1.3 What Does A Placement Agency do?**

Placement agencies play a vital role in the Canadian labour market, facilitating the allocation of scarce resources to those corporations and government departments/ministries where a need exists. Virtually every major corporation and government department rely upon the services of one placement agency or another.

They function as an intermediary between clients who have a need and the population of consultants who are able to provide their services. Their role is to understand and vet the requirements of their clients and then source appropriate candidates.

Where they place an individual into full time employment, they are paid a fee which commonly is a percentage of the salary. Where they place an individual into a contract engagement, they assume all administrative responsibilities related to the assignment, and are compensated by charging a markup of the rate paid to the contractor. For individuals placed on assignment, they also deduct and remit employee premiums for CPP and EI with the agency contributing the employer premium portion.

## **1.4 Canada's Talent Crisis**

Canada's population is aging. As with most other Western countries, this reality creates a number of challenges for our continued prosperity. Among those challenges is the future supply of highly skilled talent. Both government and private sector are living with the reality that more of their employees will be retiring in

the next 10-15 years than there are new candidates to replace them. Nowhere is this reality more concerning than in our technology sector. The Government of Canada recently launched a consultation process around a Digital Economy Strategy for our country. The process was sponsored by the following ministries:

Ministry of Industry  
Ministry of Human Resources and Skills Development  
Ministry of Canadian Heritage and Official Languages

Following is the official website for the program: <http://de-en.gc.ca/en/home/>. As you will see through the numerous submissions, talent is seen as the key criteria to Canada's success in a digital world. At over 20,000 strong, independent IT contractors play a vital role in this supply chain. The IT Sector Council, the ICTC, project upwards of 170, 000 job openings in the IT sector in the next five years. We simply cannot afford to have any one element of the supply chain fall off. It is therefore vital that the CRA ensure tax fairness to this group so as to ensure they continue to be available to help ensure both corporate and government competitiveness in the future.

## **2. CRA Testimony**

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It was CRA's testimony to the Standing Committee on Finance

1. That individuals providing their services through corporations, which may be considered to be personal Services Corporations were taking advantage of a "loop hole":
  - a. The Federal Small Business tax rate is 11% and
  - b. These individuals were realizing some unfair tax advantage
2. That individuals were realizing the benefit of reduced taxable income as a result of taking deductions for business expenses.
3. Where people provided their services through Personal Services Corporations it was unfair to FTEs who paid income taxes.

The major concern expressed by the Department of Finance, expressed in the report "was that employees of the employer should be treated in the same way for tax purposes, regardless of the structure of the relationship".

- The implication that a person providing services through a small business is paying taxes at a preferential small business tax rate in preference to the income tax rate is misleading.
- A basic tenet of Canada's tax system is that citizens are entitled to structure their affairs, within the constraints of the tax system in the manner which they consider best to minimize their tax obligations.

## **3. Financial Considerations**

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### **3.1 Taxation**

Canada's taxation system is progressive, with higher tax rates applying at higher levels of income. The following table presents tax rates and taxes payables over a range of incomes from \$50,000 to \$250,000 per year.

- There is pre-tax income, which is what is earned and
- There is after tax income, which are the funds which the individual has in their hands net of all applicable taxes.

For a FTE,

- What they earn is reported on their T4's and represents their pretax income.
- What they have after they have remitted their income taxes is their after tax income.



For Independent Contractors (IC).

- There are two ways to tax money out of the corporation and get it in your jeans as after tax funds:
  - You can be paid a salary:
    - Salary income
      - is subject to the same tax rates for FTEs .
      - Enables the recipient to participate in CPP with the corporation paying the employer premiums.
      - Enables the recipient to defer tax through investment in RRSPs.
  - You can be paid in dividends:
    - Dividends are taxed at a provincial tax rate which is 31.5% in Ontario.
    - Funds distributed as Retained earnings have already been taxed at the Small Business Tax Rate.
    - Income received as dividends is not eligible for CPP nor RRSP participation.
  - Ontario has a tax surcharge which applies on all income at higher income levels.

### **3.2 Salary**

Where funds are taken out of the corporation as salary, the individual is subject to exactly the same income tax schedule as a FTE might be.

- Empirical evidence is that individuals earning less than \$125,000 take 100% of their earned income out of the corporation and are taxed on it.
- A major difference is that ICs demand (are paid) at premium rate in lieu of employee benefits and as such pay income taxes at a higher rate due to Canada's progressive tax system.
- As per CRA testimony
  - In 2007 55% of all Small Business claimed the small business tax deduction.
  - This means that 45% did not leave any funds in their corporation.
- A more meaningful insight might be gleaned by identifying the percentages by level of retained earnings (in \$10,000 or \$20,000 increments).

### **3.3 Retained Earnings**

- Are those funds left in the corporation after all expenses and salary have been paid out.
- It is these funds and these funds alone upon which the Small Business deduction can be claimed.
- Once funds are claimed as retained earnings:
  - The funds are only distributed as dividends.
  - If they were to be distributed a salary, the individual would pay excess taxation (i.e. small business and income).

### **3.4 Dividends**

- Are issued when the individuals want to get Retained Earnings out of the corporation and into their jeans as after tax income.
- The Dividend tax rate varies by Province and in Ontario is 31.5%
- The following table presents the blended rate when the federal and provincial small business tax rates are combined:

		Retained Earnings		
		\$10,000	\$15,000	\$20,000
Small Business tax rate				
Federal	11%	\$1,100	\$1,650	\$2,200
Provincial (Ontario)	5.50%	<u>\$550</u>	<u>\$825</u>	<u>\$1,100</u>
Retained Earnings		\$8,350	\$12,525	\$16,700
Dividend Tax Rate	31.50%	\$2,630	\$3,945	\$5,261
Effective Percentage		26.3%	26.3%	26.3%

## 4 Non-Financial

### 4.1 EI Participation

The Income Tax Act prevents a person who owns more than 50% of the shares of a corporation from participating in EI through that corporation. Bill C50, which became effective in January 2010, modifies that restriction so that the individual now has the option of limited participation in the benefits of EI should they want to do so.

The inability of the individual to participate in EI is one of the protections that the individuals decides to forego when they decide to offer their services through their own corporation. In effect and in actual practice they enter into contractual agreements with clients either directly or indirectly through placement agencies.

The recommendation presented by the CFIB that the CRA respect the contracts signed between self-employed incorporated workers and their clients has great merit and is supported by NACCB.

The CRA notes their loss of participation and as a result the premiums (approximately \$2000 consisting of employee and employer remittances) which might otherwise be available to the government if they were a FTE. It should also be noted that the government is avoiding the exposure of unemployment benefits which it might be obligated to pay out in the absence of employment for the individual.

### 4.2 CPP Participation

Participation in Canada's pension program (CPP) is a right available to every Canadian in the workplace. For individuals working under contract, either as temporary employees or as sole proprietorships working through a placement agency, it is a right validated in case law, with the employer or placement agency being obligated to deduct premiums and remit the employers portion of those premiums.

Likewise, CPP is available to individuals working either through partnerships or through their own incorporation, with their partnership or their corporation being obligated to deduct premiums and remit the employers portion of those premiums.

There is no situation where people working under contract are denied access to CPP participation

### 4.3 Comparison of Employment Models

A comparison of employment models shows that individuals who provide their services under contract are paid a premium in partial compensation for benefits realized by FTEs. The simplistic application of tax rates to income earned is not a fair comparison.

The following comparison of non-financial benefits of FTEs highlights the absence of the ability to apply an “apples to apples” comparison. Conversely, the comparison of gross incomes and after tax incomes highlights the reality that the IC pays more in after tax income to the benefit of the government, even after allowance for deducted expenses.

Comparison of Non Financial Benefits			
Ref.		FTE	Contractor
1	Income	\$80,000	\$75.00 per hr for 1800 hrs = \$135,000
	Less Expenses	N/A	15% = \$20,250
	Net Income	\$80,000	\$114,750
	Effective Tax Rate	34.30%	36%
	Income taxes	\$27,440	\$41,310
	After Tax come	<b>\$52,560</b>	<b>\$93,690</b>
2	Liability	Exposure limited to the employer	Contractually exposed to liability Common obligation to maintain E+O insurance
3	Continuity of employment	employer has this responsibility (8%+ termination pay)	Subject to availability of work
4	Continuity of income	employer has this responsibility (8%+ termination pay)	Subject to availability of work
5	Human resource support	Available through the corporation	Not available
6	career Counseling	Available through the corporation	Not available
7	Training	Available through the corporation	Self Funded
8	Legal Fees	Not applicable	Self Funded
9	Accounting Fees / reporting	Not applicable	Self Funded
10	Stability of work location	Not applicable	Varies with contract assignment
11	Work technology	Available through the corporation	Self Funded
12	Telephone Technology	Available through the corporation	Self Funded

## 5 Economic Impact

### 5.1 New Immigrants

- Contracting is a vehicle to assist new Canadians to get jobs and assimilate into the work force, obtain Canadian experience, obtain local references, transition from an unknown resource.
- What is the benefit to the Canadian economy when a new immigrant obtains employment in his//her chosen profession?
- What is the positive impact on the EI program when a new immigrant transitions from a benefactor of the program to a contributor to the program?

### 5.2 Availability and Cost

- The contract business model as it exists in Canada provides Canadian companies a competitive edge.
- It attracts individuals who wish to pursue a career based upon their technical skills as opposed to career development within a corporation.

- This attraction provides a broad base of individuals with highly qualified skills for corporations to draw upon.
- It provides those skills at competitive rates
  - The rates charged the clients, while above what the clients might otherwise pay a FTE, are not significantly greater than the fully loaded cost of a FTE to the corporation.
  - The IC rates are well below the rates charged by system integrators or consulting companies which commonly charge multiples of the individual's salary
- If individuals were to cease to offer their service to corporations through their own corporation, added costs would be introduced to the business model with the inescapable result that the cost for those services would increase. At the same time as individuals transitioned to full time employment their mobility of the services which they offer would decrease.
- It remains to be seen how Canadian clients would react to a further increase in cost, following the application of HST to services combined with a decrease in availability. However, if there are lessons to be learned from the US experience, one might expect an increase in the already established practice of outsourcing to locations like India and Indonesia which already offer availability and low costs.

## 6 Conclusion

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Fairness is a fundamental principle of Canadian taxation and Canadian law. The current application of legislation related to Personal Services Corporations is fundamentally not fair as it now stands and as it is now being applied.

One has to ask why the government even cares if a relationship is "employee like".

- Participation in CPP is available to all
- Admittedly, the individual who incorporates their own small business is excluded from EI program due to the fact that the person owning more than 40% of shares is excluded, but
  - This applies to all small businesses, not just those providing services; and
  - Bill C-56 has introduced the ability for such individuals to voluntarily participate in some aspects of the EI program.
- The inference that such individuals are being taxed solely at the small business tax rate (11%) and/or benefiting from a loophole is misleading when in fact:
  - All income taken out of the corporation as salary is taxed at the same tax rates applied to FTEs.
  - When income is taken out as dividends, the delta in tax rates are minor and are offset by lost access to the benefits of the RRSP program
  - The income level received by the corporation
    - Is a premium to comparable salary levels and in effect monetizes the benefits which a FTE might receive with the result that the taxable income is greater for an IC than for a FTE.
    - Is only partially offset by permissible expense deductions
  - Small Business provisions defer taxation, they do not avoid it.
- The application of HST in those provinces where it is applied against services is in effect double taxation.

When trying to compare apples to apples, one might ask the question:

1. What is the value of a manager who will guide, review and help direct their career?
2. What is the value of knowing your physical work location so that you can manage your life better, plan your commute or even buy a home close to your place of work in order to minimize your commute?
3. What is the benefit of penalizing an individual who is successful in their contract relationship as evidenced by the lengths of that relationship? The structure of the deal should be the sole criteria.

## 7 Recommendations

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We would agree with the conclusions of the Committee report that the federal government examine the Income Tax Act with a view to propose legislative amendments in such a manner that reflect the realities of the modern labour market.

More specifically, we would recommend that:

1. The Income tax Act recognize Contract engagements in addition to Employment engagements
  - a. With no consideration being given to similarities of the engagement “employee like” relationships.
  - b. A financial reporting program, similar yet apart from corporate and personal income reporting slips e.g. T4’s, T4A’s etc.
2. The committee reiterate the fundamental belief that all Canadians have the right to arrange their affairs, within the constraints of the law in the manner which enables them to minimize their tax obligations.
3. There be recognition that every Canadian has the right to participate in the benefits made available to Small Business without regard to:
  - a. The number of employees
  - b. The success of their engagements as evidenced by duration
  - c. The nature of the product or service being offered through their small business corporation.
4. The existing rights of all Canadians who provide their services as individuals, as reaffirmed in the 1985 Sheridan decision, to participate in Canada’s social programs including Canada Pension and Employment Insurance.
5. Where an individual provides services through a corporation and enters into a contractual agreement with another corporation, the government should accept the provisions of that contractual agreement without regard to the services being provided or manner in which those services are being provided.
6. It be an agreed principle that there must be protections to ensure that no individual or corporation is able to take advantage and/or deny the rights of individuals to participate in Canada’s social programs.



2012 Pre-budget Submission

July 29, 2011

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#### About the APCC

The Association of Professional Computer Consultants ([www.APCConline.com](http://www.APCConline.com)) is a not- for-profit organization which provides: access to services for, and represents the interests of independent computer consultants. A national organization, the APCC was formed in 1985, with the majority of its members providing their services in the Information Technology sector.

## Executive Summary

The contract services and staffing industry is a large but poorly understood segment of the Canadian Economy. It is a critical element of the Canadian labour market that offers;

1. **Benefits to hiring organizations** rapid access to talented Canadian workers
2. **Benefits to individual workers** through superior compensation and more flexible career pathways
3. **Benefits to the Canadian Economy** by attracting global companies to Canada and increasing the responsiveness of Canadian companies responding to new opportunities.

The contribution of the Contract Services Market in Canada is poorly understood and its stability is harmed by Canada's patchwork coverage of Federal and Provincial regulations. Further, current policies do a poor job of creating a clear and effective competitive framework while also protecting vulnerable classes of workers.

In order to position Canada to benefit from an efficient contract services market, the APCC recommends

1. Recognize the Staffing Sector as a defined market sector and develop programs to develop information about its size, segmentation and benefit to Canada.
2. Repeal the punitive *Income Tax Act section 127(7)* on Personal Services Businesses.
3. Develop policies and/or legislation that support the current free market nature of the contract services sector, while establishing a useful framework to protect the rights of vulnerable classes of workers.

## Contract Services Industry Overview

The Global Economy, including Canada's economy, consists of goods and services. Labour and the manner in which organizations engage that labour, is a critical part of the services side of that equation.

Fulltime employment has always been the dominant form of engagement however over the past 40 years business and economic factors have led to a shift towards flexible contract engagements. This shift has affected all industries within the Canadian economy, from Information Technology to Accounting, Manufacturing and Retail, including government bodies at all levels.

There are no official measurements of how many workers participate in the contract service market (the majority this work is fulltime, and hence lost in the statistics); however industry estimates place the number at approximately 2.6 million Canadians. Most contract engagements are arranged through a 3<sup>rd</sup> party staffing firm which assist clients in identifying qualified and available workers in a rapid fashion.





### **Contract Services Market: Benefits to Hiring Organizations**

For Canadian Hiring Organizations (Private and Public Sector), the contract services market provides a source for strategic flexibility, that allows them to rapidly acquire workers in response to quickly emerging opportunities and/or gain access to critical skills on a project basis. **Benefits to Hiring Organizations include,**

- Provides the ability to secure skilled workers at a lower cost, as compared to a complete outsourcing arrangement, or engagement with a full spectrum professional services firm (i.e. System Integrators - SIs).
- Create a mechanism to increase workforce flexibility in response to project engagements and service short term increases in demand.
- Provides a reliable and robust mechanism to attract and retain workers with rare or difficult to secure skill sets. Contractors will typically move between engagements more smoothly, while Full Time Employees tend to be less willing to change employers.
- Provides the ability to engage with workers very quickly (short time to hire).
- Provides a mechanism to attract and retain workers to a project oriented position or to an engagement that is temporary by nature. This is particularly important for situations where worker turnover can be costly and/or harmful to a project's success.
- Manage workforce costs/obligations for work that is of a temporary nature. For work of a defined duration, using contractors mitigates the administrative burdens associated with FTE's including HR Costs, Administrative Costs, Downtime costs if underutilized, termination costs at project completion.

### **Contract Services Market: Benefits to Workers**

While we freely acknowledge the value of full time employment, many workers choose to work on contract for a portion of their career to the significant benefits it can present. For most workers, these primarily manifest as fluid access to the labour market and the potential to earn superior compensation. **Other benefits to workers include**

- Greater career independence and control over work
- The ability to capitalize on entrepreneurial opportunities by operating as a personal business
- The ability to self manage career development through contract selection
- The ability to self manage skills development through training and contract selection
- The ability to accommodate flexible hours and part time, if desired
- Superior compensation (typically 30-40% greater than FTE equivalents)
- The ability to earn a flexibility premium and be directly rewarded for skills development
- The ability to capture the 'business profit' in addition to personal wages
- Contractors are paid for all time worked

### **Contract Services Market: Benefits to the Canadian Economy**

A healthy contract labour market is an important source of flexibility the Canadian Economy at large and to date has proven to be a strategy advantage in attracting Global companies to locate operations in Canada. This is particularly true in Information Technology, but also manifests in Financial Services and other sectors.

**Specific Benefits to the Canadian Economy include,**



- Provides an efficient free market mechanism means to achieve the optimum allocation of scarce labour resources to hiring organizations
- Contracting provides a critical source of labour market flexibility, both in rationing access to scarce skill sets and in satisfying short term labour requirements.
- Provides very strong entrepreneurial incentives to individual workers.
- Delivers more tax dollars per worker, as compared to employee models (particularly with all levels of taxation are considered, i.e. Sales taxes, Corporate taxes & Income taxes)
- A fluid and highly skilled labour market can support attracting services work from offshore clients, thereby expanding the Canadian Economy.
- Supports the formation and growth of technical skill clusters. Flexibility and rationing of scarce technical expertise is critical to the development of specialist technical skills.
- Supports a healthy placement agency market, which increases the efficiency of the overall labour market (full time and contract placement)
- Flexible resourcing allows firms to be more nimble in meeting their business objectives, and hence more competitive.

#### Challenges & Barriers to Development

While the overall contract services market dynamic is positive, there are several legislative barriers that exist currently. These factors serve as an overhand on the growth of the contract services market and addressing them is a zero cost mechanism to improve and expand the industry's contribution to Canada. These barriers are,

- 1) There are few reliable sources of industry information and current economic statistics do a poor job of characterizing this industry. Collectively this has resulted in the industry and its contribution to Canada's economy, being poorly understood and often overlooked.
- 2) The industry is governed by a patchwork of Federal and Provincial patchwork of legislation and policy. This creates significant ambiguity and forms an overhang on market growth.

At the Federal level, *Income Tax Act section 125 (7)* governing Personal Services Businesses places individual workers at unfair risk of a retroactive reinterpretation of their tax status with potentially catastrophic financial consequences. It effectively serves to disadvantage small Canadian services businesses versus their large multinational peers.

- 3) Beyond this, the overall complicated regulatory environment has made it difficult to determine the regulatory obligations of hiring organizations across the country. Collectively this has enabled the importing of labour practices via foreign multinationals that do not understand the Canadian framework and/or seek to exploit gaps in the current legislation.

This situation can place classes of vulnerable workers in a tenuous position which hurts all parties involved.

At the APCC, we further are concerned with the backlash and negative perception these situations can cause, which end up harming the entire industry.

## Recommendations

### Recognition of the Staffing Industry as a Market Sector

For lack of a better definition, the APCC advocates that the **Contract Services and Staffing sector be recognized as a distinct aspect of and valuable contributor to the Canadian economy.** We request that Statistics Canada evaluate its sampling methodology to determine methods for securing information about the sector and its contribution to the Canadian Economy and Labour Market.

### Repeal *Income Tax Act* section 125 (7) & 18.1(p) – *Personal Services Business (PSB)*

These provisions were implemented in 1981 and effectively prohibit a Services oriented business with five or fewer employees from expensing standard business costs. **The world and economy have changed dramatically from that time, with today over 70% of Canadian business occurring in the services sector, much of which is conducted by Small Businesses.**

As it functions today Sections 125(7) & 18.1(p) are used to justify retroactive tax assessments for small services business and it frequently results in extremely punitive tax claims when typical business expense claims are rejected. **These provisions are unevenly applied even across small businesses, and given that similar expenses claims would be valid for a large services organization or multinational (such as IBM), this tax provision makes little sense and requires government intervention to correct.**

**These provisions of the Income Tax Act are patently unfair to small Canadian businesses. It drives a cloud of risk to both hiring organizations and individual consultants that hurts the overall contract services sector.**

Given its uneven enforcement, the tax benefit of these provisions is negligible and overall Services Businesses are a net benefit to government tax revenue when all levels of tax are considered (income tax, sales tax and corporate tax). We would be glad to provide additional information at your convenience.

### Protect the rights of individuals

While the merits of contracting apply strongly to knowledge base workers and professionals, such is not always the case with non professional workers. **We propose the government enact a legislative framework that encourages the current free market dynamics of the staffing sector (which attracts foreign companies seeking to engage talented Canadian workers) but at the same time offers protections to workers that may be in a vulnerable position.**

The current framework requires a very nuanced assessment of whether a given engagement represents a **contract of services (employment) versus a contract for services (independent).** This language has largely evolved through case law and while it may be legally significant, in practice it creates a significant grey area that is exploited by unscrupulous hiring organizations.

Instead, the market requires a clear cut, dollar based line, below which all worker engagements constitute temporary employees, with an unequivocal requirement all the necessary payroll contributions. Above this threshold, workers and hiring organizations would be free to structure the relationship in any way that is mutually acceptable (including but not limited to temporary employment).

In order to be applicable across Canada, we are proposing that this dollar threshold be set as a multiple of provincial minimum wage (for example, 2X or 3 X minimum wages).

## 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.**

## Standing Committee on Finance (FINA)

### Pre-budget consultations 2012

## National Association of Computer Consulting Businesses Canada

### 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 NACCB represents over 75 member firms in Canada, whose prime focus is to provide contingent IT resources to virtually every sector of the Canadian economy. In turn, these 75+ firms act on behalf of over 25,000 independent technology businesses. Revenue for the sector is in excess of \$2.5 billion dollars. Technology is playing an every-increasing importance in the Canadian economy. IT is cross-sectorial, more so than any other discipline, and impacts all areas of the economy. Common to all sectors, and thus critical to opportunity for Canada, is the availability of talent and the investment in new business. The two are inseparable. There are two specific measures that we will focus on in our presentation to this committee:

- Outdated rules that govern the classification of independent IT workers.
- Specific measures by the CRA to apply areas of the tax act that are detrimental to small service businesses.

1) Current rules that the CRA uses to attempt to distinguish between what is a business and what is an employee are drastically outdated. Most were written in the late 70s and early 80s. The reality is that the nature of work has changed so much recently that these rules might as well be a hundred years old. The vast majority of businesses start with one or two people. Indeed, the most valuable company in the world started out with two guys in a garage. Using arcane rules to distinguish between the two is no longer acceptable.

2) CRA efforts to apply Section 125(7) of The Income Tax Act to Small Services Businesses (SSBs) is problematic. In attempting to use financially focused data to determine the impact of designating a business vs. a Personal Services Business, a full scope of tax implication must be undertaken.

- 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.
- 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).

#### 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?*

A recent US study suggested that by 2020 approximately 1/2 the US work force would be independent in some way. Knowing that Canadian trends often mirror those of the US, it is critical to understand this as we contemplate job creation. Long gone are the days of investing in manufacturing as a means to create jobs. We must instead invest in people. This investment comes in many forms; providing "digital economy" training for workers whose skills are tied to the old economy; encouraging our youth to pursue math, science, and business-oriented skills sets so as to ensure their employability in the future



economy; up-to-date tax policy that both fosters business growth and allows Canadians to market their skills globally. Specific to the latter point, as the US study suggests, more and more people will want to pursue roles where they can work independently and offer their services globally. As has already been mentioned, outdated tax rules will act as a hindrance to these individuals, running the risk of them pursuing their careers elsewhere. Conversely, Canadian companies want access to these highly skilled resources. Making it difficult for them to operate in Canada will have the effect of forcing Canadian companies to off-shore their work. We strongly recommend that Government adapt guidelines for SSBs that are in keeping with the times and adjust tax policy accordingly.

### **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?*

Demographic change is without doubt the single greatest challenge facing the Canadian economy in the years to come. The mathematics are obvious-more people leaving the workforce than entering. Workers all across the entire spectrum also have a different view to work and careers. New entrants no longer expect "the gold watch". Boomers expect to live longer, need to earn more to support retirement, but don't want the traditional 9:00-5:00. The result is a dramatic increase in the numbers of people who will want to work independently. The point has been made with respect to the need to create a favourable climate to foster such a dynamic. It must also be pointed out the value this creates in a world where competition for talent will become more fierce. Independent Contractors can impact many different companies and areas of government. Their talents are acquired when needed, they then move on to have impact elsewhere. There are areas of Government where as much as 40% of the workforce is due to retire in the next 5 years-this is huge. A significant part of the government's talent strategy needs to be the increased utilization of contingent work. This will not only allow Government to compete for resources, but will also afford significant cost savings as it will not need to replace all of these retiring workers with new employees. A recent Spanish study suggested that Spain could address a significant portion of its debt issue by increasing its utilization of contingent workers to fill the void of retirees. Government needs to foster a climate where these talents can flourish, not allow Section 125(7) of the Income Tax Act to smother it

### **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 a critical element of Canada's knowledge economy. They fulfill a variety of roles 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.

Expansion of an economy is heavily dependent on the ability to expand the labour force. As mentioned previously, this will become increasingly more difficult in Canada due to demographic changes. Part of our growth strategy will be dependent on capturing the global demand for higher paying roles. Encouraging the creation of these SSBs will ensure Canada's



competitiveness in this space. An increasing number of roles in the Digital Economy are characteristic of independence, working remotely, and collaborating with groups that do not fit the traditional definition of a "company". We must understand this and foster a climate to allow this type of work to grow.

## **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?*

There is much debate in Canada with respect to providing opportunities for those in remote areas, those who are disenfranchised, First Nations communities who struggle with job growth, etc. It is not the purview of the NACCB to try and solve these complex issues. We do, however, understand the value and relevance of small service businesses. They create opportunity for people individually. These individual opportunities grow into companies that hire other people. In a Digital Economy world, geography becomes less relevant. If a resource sitting in a foreign country can provide value to a Canadian company, then that same resource could exist in a remote Canadian town, in a First Nations community, or wherever. Government can play a role by both providing the climate for acquisition of appropriate skill sets, but also by ensuring an ideal tax climate in which to operate. We cannot legitimately expect to build factories in remote areas; it is increasingly difficult for manufacturing centers in Canada to compete globally. We must instead invest in people, and give them a climate in which they can flourish. The NACCB ultimately recommends a dialogue that involves Ministry of Finance officials, officials from CRA, and associations such as ourselves. The goals would be to redefine the rules that determine a small business, and particularly a small service business. To also change the tax laws so as to both encourage investment and at the same time maximize Government revenues. In doing so, we could collectively ensure job creation in all areas of the economy, including those areas that are currently most challenged.

## Standing Committee on Finance (FINA)

### Pre-budget consultations 2012

## Procom Consultants Group Ltd.

### 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?*

My name is Frank McCrea and it my privilege to be able to make this submission to your committee. In respect of your format and limit of 350 words per section, I will make it in 5 parts. My credentials are as follows: 1. BSc in Computer Science, University of Western Ontario '69 (first graduating class) 2. Worked as a Computer Developer employee across a range of industries including Retail, Financial Services and the Ontario Government 3. I formed my own incorporated service delivery company, now known as Procom in 1978. From its humble beginnings with myself as the sole employee for 4 years, Procom today a. Employs over 200 core employees and several thousand more individuals on contract assignments at client organizations. b. Has 10 offices across Canada (coast to coast) with 4 office in the US. c. Is the largest supplier of IT resources to each of the five major Canadian banks, three of the major auto firms and is a supplier to a significant number of major Canadian corporations. d. Was recognized by Deloitte as being one of Canada's 50 Best Managed companies for each of the past 6 years. e. Was ranked by the Financial Post as one of Canada's 500 largest corporations in each of the last 2 years (# 421 in 2011). 4. I was recognized by Ernst and Young as Ontario's Entrepreneur of the Year in Services in 2000. 5. I founded the National Association of Computer Consulting Businesses and am now its retired Chairman. It is with this background that I wish to address the Committee and speak about the permanent and lasting damage I see to the Canadian Economy from Canada Revenue Agency's efforts to broadly apply Section 125(7) of the Income Tax Act (Personal Services Businesses) for the first time since its creation in 1981. My work has created hundreds, if not thousands of Canadian jobs, and I can say unequivocally that I would not have survived my start as a small business if subjected to the PSB provisions currently being applied by CRA.

#### 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?*

The nature of work is changing dramatically. In a recent conversation with the President of a US corporation, I learned that his company had outsourced different types of jobs to four different international locations. One is in the Philippines where they have 3,000 telephone support persons. Over the next two years, his company plans on moving a further 3,000 to 6,000 support jobs offshore. The only challenge lies in finding a suitable location to move those jobs to. The firm is evaluating two offshore locations and is basing its decision on the quality of spoken English and fully costed pay rates ranging between \$6.00 and \$16.00 per hour. Their only concern is the risk associated with having all the jobs in one location. In a separate conversation with persons having some insight into Canada's auto union and the current labour discussions, there is a concern that at least one company is seriously considering an exit from Canada, taking all their jobs to the US or Mexico where they have negotiated significantly lower wage rates for net new employees. Welcome to the Global economy. One of the

unfortunate aspects of off-shoring is that the first jobs that get sent off-shore are at the entry level positions. These positions are a critical entry point for new graduates and, if retained, would provide a platform for career development into higher value, better rewarding work. A second unfortunate aspect is that when Canadian firms spend funds offshore, not only do they build the offshore economy, they deny the government the ability to tax them, each time they change hands within our economy thereby denying significant tax. On a positive note, I have managed my company through many economic downturns. In each and everyone my company has thrived and most commonly doubled in size. In uncertain economic times, corporations shun the long term commitments to employees in preference to limited commitments to contractors. These contract jobs are high paying quality jobs which span the spectrum of our knowledge based economy. A health contract market supports / enables a health economy.

### **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?*

Over the past 30 years, Canadian companies have relied upon contract labour as a strategy to respond to global competition, skills shortages and changing demographic preferences. Contract Labour allows firms to manage expenses by only incurring the costs of expensive resources when they need them, sometimes in preference to going off-shore. Through contract labour, Canada developed a market for onshore, but outsourced services work, thereby mitigating its' off-shoring job losses relative to the US and Europe. In the United States and Europe we see a different story. Both markets have resisted the trend towards Contract Labour through Bill 1706 (US) and AWR/AWD legislation (Europe) and this reduced the flexibility advantage of their contract labour market. By not having a viable onshore alternative, these policies have exacerbated and accelerated the export of jobs out of the United States/Europe, to more business friendly locations. Conversely, Canada has evolved a relatively beneficent approach to contract labour, with our courts mitigating the damage of similar legislation. The result has been that Canada's almost free market usage of contract labour has grown to a point where virtually every organization, including the federal government relies heavily on it. This free market is extremely good for Canada and our economy. It optimizes the allocation of our scarce resources, making them available at competitive pricing. It also fosters an entrepreneurial spirit across the nation, providing a means for young and old alike to initiate new ventures, form small businesses and explore the opportunities of business development within the new economy. This positive success story for Canada has however started to change. Changes in tax policy has made it financially punitive to work in a Small Services Business, which has some caused workers to exit the space. With the domestic ecosystem shrinking, we expect Clients will expand their use of offshore providers to achieve the required flexibility. These challenges undermine the competitive basis of Canadian Small Services Businesses, a very dangerous move when one considers that according to Statistics Canada data, over 16% of Canadians are considered self employed and 78.8% of small businesses operate in Services industries.

### **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?*

The contract labour market is effectively a free market mechanism for allocating scarce skills to organizations that need them. It is a critical relief mechanism for skills shortages and a vital source of labour productivity by quickly matching skilled workers to companies in need. At the heart of this

market stands a community of small entrepreneurial businesses that are built around an owner/operator who delivers services on a contract basis (this is also the genesis of my organization, Procom). These businesses are critical to the growth and prosperity of Canada's economy. Should the viability of these businesses be interrupted, the most likely outcome is that their work will be redirected to off-shore providers, residing outside of Canada's tax base. **The two primary challenges facing this community are,** **1.** Income Tax Act (ITA) Section 125(7) This section was added to the ITA in 1981 to frustrate individuals who might restructure their employment from one of FTE to one of contractor. It was associated with Ralph Sazio of the Hamilton Tiger Cats in a 1969 assessment. The strategy responded to excessively high income tax rates then in place. Recently the CRA has launched a number of tax assessments applying Section 125(7) of the Income Tax Act in an effort to define small businesses providing services as Personal Services Businesses. In the near term, this would trigger tax penalties as existing tax filings, based on normal small business requirements are thrown out. Longer term it will destroy the owner's ability to build business capital inside the corporation, thereby handicapping their growth prospects. **2.** Gaps in current labour protections There is an undeniable demographic and economic trend towards contract labour. This stands at odds with Canadian Labour policy, where most protections are based on an individual's employment standing. As work increasingly becomes delivered through contract mechanisms, **Canada must develop labour policy that: - Provides enhanced protections to all types of workers in lower income, more vulnerable positions, while also - Recognizing and encouraging free markets for high income, independent positions.**

## **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?*

My entire career has been rooted in industry, building a business that has grown and prospered with Canada's shift to a knowledge driven economy, based on services businesses. For the most part, the legislative environment has been positive, and small services businesses in Canada have flourished. Today, over 79% of Canadian small businesses work in Services industries. In the high value Professional, Scientific and Technical (PST) Category, Small Business employs 93,782 individuals. The PST Category also comprises the largest proportion of 'High Growth Firms, at 7.2%, driving Canadian employment growth and technology innovation. With the 2010 launch of the Personal Service Business audits, I became attuned to how fragile this success has been. Since then, I have met with Politicians, Senior Policy Staff and CRA representatives. I now recognize that the economic contribution of small services business is not fully appreciated. Nor is staffing recognized as its own industry as are Banking, Oil & Gas, Resources, Telecommunications, etc. Europe and the United States provide first hand evidence of how bad policy can kill this sector. I suggest similar policies on Canada would be likewise disastrous. With the application of PSB legislation, I see the beginning of such a change. **It is this light, that I ask the Committee to reevaluate its understanding of the small services business industry and the PSB issue specifically.** This is a vibrant free market industry that is a critical part of Canada's economy. It does not require government spending or largesse to thrive, simply smart policy that is designed to encourage free market forces while balancing protection of lower income individuals. As such I **respectfully recommend,** **1.** Suspend CRA's enforcement of the PSB legislation (Do no harm in the short term). **2.** Identify the Small Services Business Industry as an area of importance for Canada and develop effective tools to measure it. **3.** Recognize the staffing industry and consider it within Canada's Digital Strategy. **4.** Review Canada's tax and labour policy with a goal of encouraging these small business entrepreneurs and supporting Canada's platform to become a premier global centre for knowledge driven services work.

must be adapted to this new reality by clarifying how the Code will apply to mobile payments.

CFIB is seeking other improvements to the Code, including repealing “Honour-all-cards” and “no surcharging” rules, implementing a dispute resolution process and measures to strengthen oversight of certain payment processor activities.

***Do not allow credit and debit card transaction fees to be charged on tax***

At the present time, credit and debit card transaction fees are charged on the entire transaction amount, which includes GST/HST. This is a fee on a tax, and we believe it is unfair. Transaction fees should only apply to the overall value of the good or service being purchased. There are a few ways in which this can be rectified. **The merchant can withhold the equivalent of the fees paid on HST/GST when remitting GST/HST to government as a form of vendor compensation, or there could be an addition to the Code of Conduct stating that processing and/or credit card companies are only able to charge the transaction fee on the amount of the transaction excluding the GST/HST.**

**Canada Revenue Agency (CRA)**

***Review rules used to define passive versus active income***

Entrepreneurs who own self-storage facilities or apartment blocks often operate active businesses from which they draw their principal income and many also have employees. These active business owners are denied access to small business tax incentives simply because they have chosen a specific type of business and have fewer than five employees. These types of rules are too simplistic and do not reflect the changing marketplace. **CFIB suggests that these rules and tests be reviewed so that entrepreneurs in these types of active businesses are not denied the benefits provided to other types of small businesses.**

***Update rules to reflect changing world of work***

**The world of work is evolving, and Canadians are taking advantage of improvements in technology and the increased need for flexible work arrangements by turning to self-employment instead of traditional “9-to-5” work.** SMEs are also turning to contract-based sources of labour to fulfill their business needs which can fluctuate greatly throughout the year. This is especially true of the information technology (IT) and construction sectors. At the same time, the nature of contract work is changing as mobile workforces become more common, moving from project to project. Some of these projects can last for many months or even years which falls outside CRA’s narrow definition of a contractor. Unfortunately, due to the nature and arrangement of the work performed, CRA may rule someone hired as a contractor as a “personal services business” thereby subjecting them to the same taxes as an employee. As more and more Canadians are choosing to work in this way, CRA’s rules must evolve with the times. **CFIB recommends that CRA work with the Minister of Finance to update and apply the relevant rules with a view to reflect the realities of the modern labour market.**

**SMEs be given mandatory customer service training with an emphasis on better understanding the importance of SMEs to the Canadian economy, as well as the types of challenges small business owners face when operating their business. We support the creation of government-wide service standards for measuring customer satisfaction, and encourage the government to publish these results annually, in an effort to increase the overall value and quality of government services for business owners.**

### **Continue to reduce Red Tape at Canada Revenue Agency (CRA)**

CRA is the single largest producer of red tape for small businesses in Canada. CRA has made good progress over the last several years to reduce red tape and improve service to small business. Examples include the introduction of a Taxpayer Code of Fairness and Taxpayer Ombudsman, the ability to receive written feedback from CRA through *My Business Account*, and the addition of ID numbers for call centre staff are all measures that have been well received by small business but still more can be done. In addition to continuing its work to improve customer service for small business at CRA, CFIB recommends the following:

#### *Increase remittance threshold for payroll taxes/GST*

The frequency of remittances for both GST and payroll taxes can be onerous for small business owners, especially those that have to remit on a frequent basis. In order to reduce the regulatory burden of frequent remittances, CFIB **recommends that the government consider increasing remittance thresholds for both payroll taxes and GST for small businesses.**

The adjustment of the remittance threshold for the GST in 2007 was a very popular move with small business owners and we encourage the government to consider reviewing these thresholds again, and add a specific focus on payroll taxes.

#### *Keep pace with the changing world of work*

As of 2011, **there were over 2.6 million self-employed individuals in Canada, making up a significant portion of the labour force.** Increasingly, self-employed individuals are working as contractors, while other small businesses have turned to subcontracting to fulfill their various business needs. While the labour needs of businesses have changed over time, existing government legislation and other rules have not kept pace. Many small business owners have experienced challenges in either their own work status or the work status of their workers, causing them to deal with significant red tape and in some cases, increased costs in the form of back taxes. Unfortunately, due to the nature of the work performed, CRA may rule someone hired as a contractor as a “personal services business,” subjecting the contractor to the same tax treatment as though they were an employee. **CFIB recommends that CRA and the Department of Finance work together to update the relevant rules to reflect the realities of the modern labour market in consultation with small business owners.**

#### *Review rules used to define passive versus active income*

Small businesses that run self-storage facilities or apartment blocks often operate active businesses from which they draw their principal income. Many also have employees. These business owners are denied access to small business tax incentives simply because they