MANNING ELLIOTT LLP
CHARTERED ACCOUNTANTS

Personal Services Businesses

On October 31, 2011, the Department of Finance tabled an amendment that will significantly change the taxation of personal services business corporations ("PSBs") for tax years beginning after October 31, 2011.

A corporation is carrying on a PSB where the individual performing the services on behalf of the corporation (the "incorporated employee") is a specified shareholder of the corporation and would reasonably be regarded as an employee or officer of the company or partnership to whom the services are provided. There is an exception for a corporation that is associated with the corporation to which it provides the services, or has more than 5 full-time employees.

In the past, PSBs allowed for tax planning opportunities that utilized significant tax deferrals and the sprinkling of dividends to individuals with lower marginal tax rates. However, the new legislation has been tabled in an effort to combat PSBs as a tax planning tool. Under this new legislation the effective tax rate on PSB income will increase from 25% to 38% for corporations in B.C. This 13% increase removes the potential to obtain any significant tax deferrals. Further, the legislative changes penalize the use of PSBs as it increases the flow-through cost to the individual shareholder to as much as 54% compared to a maximum personal tax rate of 44% had the income simply been earned as an employee.

As a result of these changes we do not advocate the continued use of incorporated PSBs as the increase to the tax rates have now made this type of structure undesirable.

If you have been earning income through a PSB there are several options that can be investigated to avoid the impact of this new legislation:

- The undesirable impact of these legislative changes can be avoided by simply paying out all of the Corporation's income from its PSB to the shareholders as wages. It is important to note that the wages must be paid out by the end of the year, as the accrual of wages and bonuses are not deductible for a PSB.
- The simplest solution may be to become an individual employee of the Company to whom services are being provided and to wind-up the existing PSB Corporation if it no longer serves any additional purpose.
- If the corporation through which you are providing services is also a shareholder, changing the form of remuneration from wages or management fees to dividends will avoid the implications of earning income as a PSB.

The best solution will depend on your own unique situation. As a result, we recommend that you contact your Manning Elliott advisor to determine the best course of action to ensure you are not negatively impacted by these PSB rule changes.