

## Income Tax

IMP. 135.2-1/R1      Personal services business

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Reference(s):      *Taxation Act* (R.S.Q., c. I-3), ss. 1, 21.17, 21.18 (par. d), 21.20, 62, 87.2, 128, 135.2, 487.1, 487.2, 771, 771.1 and 1029.6.0.0.1

*This bulletin supersedes bulletin IMP. 135.2-1 dated January 31, 1994.*

This bulletin outlines the tax consequences, for a corporation, of carrying on a personal services business.

### APPLICATION OF THE ACT

#### PERSONAL SERVICES BUSINESS

1. According to section 1 of the *Taxation Act* (TA), the expression “personal services business” means a services business carried on by a corporation in a taxation year, where an employee who provides services on behalf of the corporation, referred to as an “incorporated employee” in this bulletin, or a person related to an incorporated employee, is a specified shareholder of the corporation, and the incorporated employee could reasonably be regarded as an employee of the person or partnership to whom or to which the services were provided, but for the existence of the corporation, unless

- (a) the corporation employs in the business throughout the year more than five full-time employees; or
- (b) the amount received or receivable by the corporation in the year for the services provided is paid or payable by a corporation with which it was associated in that year.

#### SPECIFIED SHAREHOLDER

2. Under section 21.17 of the TA, a specified shareholder of a corporation in a taxation year is a taxpayer who owns, directly or indirectly, at any time in the year, not less than 10% of the issued shares of any class of the capital stock of the corporation or any corporation related to it (see the current version of bulletin IMP. 1.6).

3. For the purposes of point 2 above and pursuant to paragraph *d* of section 21.18 of the TA, an individual who performs services on behalf of a corporation that would be carrying on a personal services business if the individual or any person related to the individual were at that time a specified shareholder of the corporation is deemed to be a specified shareholder of the corporation at that time if the individual or any person or partnership with whom the individual does not deal at arm's length is entitled, or by virtue of any arrangement may become entitled, directly or indirectly, to not less than 10% of the assets or the shares of any class of the capital stock of the corporation or any corporation related to it (see the current version of bulletin IMP. 1.6).

### **EMPLOYEE OR SELF-EMPLOYED PERSON**

4. In order to determine whether an individual who is an employee of a corporation that carries on a personal services business could reasonably be regarded, but for the existence of the corporation, as an employee of the person or partnership to whom or to which the services were provided, it must be determined whether the relation between the individual performing the work and the person or partnership that retains his or her services is, for the individual, that of an employee of the person or partnership. In order to determine whether the individual's status is that of an employee or a self-employed person, the facts of each case must be reviewed according to the criteria set forth in the most recent version of bulletin RRQ. 1-1. If the individual's status is that of an employee, the services business carried on by the corporation will be considered, for the purposes of the TA, a personal services business.

### **ASSOCIATED CORPORATIONS**

5. Chapter IX of Title II of Book I of Part I (sections 21.20 to 21.25) of the TA determines whether a corporation is associated with another corporation in a taxation year. As a rule, two corporations are considered to be associated with one another where one of the corporations controls the other corporation or where both of the corporations are controlled by the same person or group of persons. There may be legal control, where a person controls a corporation and that person can elect the majority of the members of the corporation's board of directors, or *de facto* control, where control is exercised "directly or indirectly in any manner whatever".

### **TAX CONSEQUENCES FOR A CORPORATION CARRYING ON A PERSONAL SERVICES BUSINESS**

#### **Restrictions on deductible expenses**

6. Section 135.2 of the TA limits the amounts that may be deducted in respect of a personal services business, under sections 128 to 183 of the TA, by a corporation that carries on such a business. The corporation may deduct only the following amounts, to the extent that they would otherwise be deductible:

- (a) a salary, wages or other remuneration paid in the year to its incorporated employee;
- (b) the cost to the corporation of an allowance or a benefit granted in the year to an incorporated employee;

- (c) an expense which, had it been made by an individual, would have been deductible in computing the individual's income for the year under section 62 of the TA;
- (d) an amount the corporation pays in the year as judicial or extrajudicial expenses to recover an amount owing to it for services it provided.

7. Thus, only the expenses described in point 6 above, to the extent that they would otherwise be deductible in computing the corporation's income from the personal services business, are deductible in this computation. However, it should be mentioned that, in addition to its personal services business, it is possible that the corporation carries on a business other than a personal services business and that, in this respect, the expenses relating thereto may be deductible under section 128 of the TA, without being limited by section 135.2 of the TA.

### **Deemed benefit**

8. Under section 87.2 of the TA, a corporation that carries on a personal services business in the year or that carried on such a business in a previous taxation year must include in computing its income for the year every amount that, in accordance with sections 487.1 and 487.2 of the TA, is deemed to be a benefit received by the corporation during that year where a person or partnership contracts a debt because of services provided or to be provided by the corporation or because of the individual's previous, current or intended office or employment (see the current version of bulletin IMP. 487.1-1).

### **Taxation rate**

9. A corporation's income for a taxation year from a personal services business is not taken into consideration in determining the corporation's income from an eligible business, since an eligible business does not include, according to paragraph *b* of section 771.1 of the TA, a personal services business. Thus, the corporation cannot, in respect of the income from such a business, take advantage, under section 771 of the TA, of the lower taxation rate applicable to the corporation's income from an eligible business.

### **Refundable tax credit**

10. For the purposes of Division I.1 of Chapter III.1 of Title III of Book IX of Part I of the TA ("Rules and Definitions Applicable to Certain Refundable Tax Credits"), a "qualified business", as defined in section 1029.6.0.0.1 of the TA, means, in relation to any business carried on by a taxpayer, any business carried on by the taxpayer other than a specified investment business or a personal services business.