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TAXATION

Finalizing Your 2013 Income Taxes

Keep complete records and make use of all your eligible deductions.

Yes, it's time to start thinking about income taxes again. The Holidays are over and the credit card statements are starting to come in so you're probably thinking about money anyway. But instead of thinking just about paying off your credit cards, it might brighten your day a bit to think about deductions available to you this year and in future years to reduce the amount of personal income taxes you have to pay.

To understand how deductions work, take a look at the CRA's T1 General form available online at the CRA's website. Lines 101 to 150 are used to list and tally your various types of income. Line 150 shows your total income. Lines 206 to 233 list and calculate the deductions you can make to reduce your total



income to get your net income (Line 236). Lines 244 to 257 list and total other types of losses and deductions to give your taxable income (Line 260). Because the deductions available between lines 206 and 260 reduce your total income dollar for dollar, they can have a significant impact on the amount of your taxable income.

If you think you can claim any of the following deductions, make sure you have all the supporting documents. Talk with your tax professional to make sure you are keeping everything you will need in the case of an audit. You usually do not have to send documents with your tax filing, but you will certainly need them if the Canada Revenue Agency (CRA) questions your claims.

Interest Expense

Interest expense incurred to earn interest income, dividends or royalties, or for an investment in a limited partnership or a partnership in which you are not an active partner, is deductible. Expenses associated with interest income include investment management fees, and accounting and investment counsel fees. (Note that, as of 2013, the safety deposit box rental fee is no longer deductible.)

Employment Expense

Employment expenses, other than those included on a T777 Employment Expenses Workchart or the TL2 Claim For Meals and Lodging Expenses, that may be overlooked because they are not listed on a T4 include:

- repayment to the Workplace Safety and Insurance Board
- power saw expenses
- legal or extrajudicial fees incurred to recover pay or wages or repayment of salary or wages

Union dues are often overlooked, especially if they are not deducted at the source. In addition to union dues, mandatory premiums for professional liability insurance are also a direct deduction as are professional fees. If professional fees or union dues are paid for by an employer, the employee should not deduct the expense unless the amounts paid are included as earned income.

Moving Expenses

If you had moving expenses in prior years that were not completely utilized, they may be carried forward and deducted in the current year. Appropriate documentation must be available to complete the Moving Expenses Deduction form.

Support Payments

Support payments to a former spouse under the terms of a separation or divorce agreement are a direct deduction from total income. Arrears paid in

the current year are also deductible. Anyone receiving support payments must claim them as income. Spousal support payments must not be confused with child support payments, which are not a deduction from total income. Child support payments are not taxable in the hands of the recipient because they are payments solely for the benefit of the dependent child.

Child support payments are not taxable in the hands of the recipient.

Deduction for Split-Pension Amount

This deduction allows a pensioner to transfer a portion of their pension income to their spouse and thereby reduce the pensioner's taxable income. When the pensioner's spouse has taxable income significantly lower than that of the pensioner, the tax savings can be significant. Computing the optimum allocation between the spouses necessitates a number of different calculations best done by a tax professional.

Registered Retirement Savings Plan

Ensure you include RRSP receipts for contributions made from March 2, 2013, to December 31, 2013, as well as those contributions for the period January 1 to March 3, 2014. For those employees who contribute to a company pension plan, the RRSP amount will be reduced. Once again, it is best to seek professional guidance to ensure overcontributions do not create unnecessary tax liabilities.

Disabilities

Deductions are allowed for expenses incurred as a result of a physical or mental impairment so long as they were not also claimed as medical expenses or recovered from an insurance claim. These deductions must be claimed in the year the expense was paid. The expenditures must have been incurred to earn income as an employee, self-employed person or partner, to do research or similar work for which a grant was received, or to attend a designated education institution or secondary school. Be sure the impairment for which the expenses are claimed falls within definitions laid out by the CRA. Since there is a high probability that taxpayers making these claims may be audited, be sure that all the figures supplied to the CRA are supported by the proper documentation. (It is not necessary to file the data when filing the tax return.)

Child Care Expenses

There are maximum deductions depending upon the age of the child, the number of weeks at school or summer camp and the earned income of the taxpayer claiming the deduction. So, be sure your child care receipt indicates the amount paid and the number of weeks for each child. Individuals filing for child care expenses must also provide the Social Insurance Number, name of the individual or company providing the service and specify the type of service.

Specialized Areas

Some specialized deductions come from forms supplied by employees, the government, educational and financial institutions. Others, often of a one-time nature, need to be drawn to your tax preparer's attention. For instance, legal fees incurred to collect support payments or to appeal an income tax assessment of previous years should be brought forward. If you have incurred unusual expenditures in the past year, assemble all the documents and discuss the matter with your tax preparer.

Tax Credits

Deductions, such as medical expenses, create tax credits that are deducted from taxes payable. These

tax credits are usually a percentage of the total expenditure incurred and, although helpful in reducing your tax payable, their omission in many instances will not have the same dollar savings as the deductions indicated above.

Perhaps the best known of the deductions subject to the tax credit calculation is tuition fees. If, for example, tuition fees and the accompanying education and textbook amounts totalled \$10,580, this amount would be subjected to a 20% (Federal and Ontario) tax credit resulting in a reduction of tax payable approximating \$2,121. In comparison, if the \$10,580 had been an RRSP contribution, the entire amount would have been applied against total income. Assuming for a moment that a taxpayer is in a 30% tax bracket, the RRSP contribution creates a \$3,174 tax reduction.

Keep Good Records

Taxpayers have a responsibility to themselves to pay the minimum income tax required by law. Retaining a complete record of income and expenditures to support your claims plus regular consultations with your tax advisor is the best way of keeping as many of your hard-earned dollars as possible.

MONEYSAVER

Cost-Cutting Ideas

A careful review of your costs should reveal many opportunities for savings.

Even though Benjamin Franklin's oft-quoted phrase "A penny saved is a penny earned" can no longer be taken literally now that the Royal Canadian Mint has removed pennies from circulation, nevertheless saving money by cutting costs is simply good business. When budgeting for 2014, the thrifty owner-manager may want to consider the following ideas.

Staff Costs

Review the employee medical benefit package: Can deductibles be raised and luxury benefits such as massage therapy eliminated? Get new quotes. Ask employees whether they are willing to supplement medical coverage with payroll deductions for extended coverage.



Review employee hours: Check the overtime hours for any seasonal or other pattern that would permit the use of less expensive temporary or contract workers.

Consider the possibility of outsourcing sales: Independent sales representatives may be willing to work on straight commission without the salaries and benefits now attached to regular employees.

Consider hiring local college or university students: Part-time employment of students could cut costs *and* your company could benefit from their experience with new technology. You will also get the opportunity to evaluate well-educated potential employees. These students may also teach you that you are paying too much for the level of skills and experience required for certain jobs.

Weather

Use the free weather app. Knowing the weather conditions can save thousands of dollars in scheduling employees for travel to projects, getting equipment to high ground or moving essential material or equipment to job sites during breaks in the weather.

Pay your suppliers by electronic transfer or email.

Payments

Use an electronic transfer facility to make recurring payments instead of using cheques. Although it may not be possible to pay all suppliers this way, there are many recurring payments, such as utility and telephone bills and payroll, that can easily be set up for electronic transfers.

Pay by email those suppliers that cannot be set up for direct electronic transfer. The process is as follows:

1. Select the etransfer option of your online banking facility.
2. Select the recipient, and its email address.
3. Select the account from which the funds are to be transferred. The amount is immediately removed from your account.
4. Attach a message to the email along with the amount being sent.
5. Create a security question and answer. (You will be asked to verify the information before the email is sent.)
6. Send the email to the supplier.

The supplier opens the email, links to your bank then enters the password provided by you to the supplier's bank. (You will need to contact the supplier with the password by telephone.) The money is then deposited into the supplier's account.

In the event your email is not acted upon by the supplier within a predetermined period, the payment will be redeposited to your account.

Suppliers

Approach suppliers to negotiate better prices. Since no one willingly reduces prices, be reasonable in your expectations. A supplier may be willing to provide a 2% or 3% discount to keep a good client happy; however, you may lose a good supplier if your demands are unreasonable.

Energy

Reduce energy costs. Cutting energy costs must engage every member of your staff and management. Here are a few ideas:

- Review current energy usage.
- Find the areas in your business that are consuming the most energy.
- Examine these areas to see what savings are possible.
- Purchase new, energy-efficient equipment where needed.
- Schedule regular maintenance for all equipment.
- Install occupancy-sensors (also known as motion sensors) for the lighting system where possible. By detecting movement, these sensors turn the lights off when no one is in the area.
- Install photoelectric sensors for automatic door systems to reduce the loss of heated or air-conditioned air.
- Install timers on heating and air conditioning systems to reduce heating or cooling by a couple of degrees at the end of each day and return to operating temperature before the start of work the next morning.
- Find out the peak-hour cost of electricity in your area. Determine whether shifting production to off hours is economical after taking into account the cost of staffing or additional lighting required for night shifts.
- Establish a routine to adjust timers and thermostats as the days lengthen and shorten with the seasons.
- Consider the R-value of your glass windows and wall insulation. The R-value of large glass areas could be enhanced with thermal drapes to keep sunlight out in the summer and heat in during the winter.

Examine All Operations

There are many areas within business operations where costs can be saved. To achieve maximum cost reduction it is necessary to evaluate all areas of business operations.

TECHNOLOGY

Scanning Your Way toward a Paperless Office

Scanning documents can significantly reduce the cost of handling and storing paper.

Thanks to modern technology, we are moving, albeit slowly, toward a paperless office. Although this transformation within the workplace has been anticipated for decades, we are still bombarded with paper every day. Using paper can often be convenient; however, paper use comes at a price. Although the cost of an individual box of paper may not be significant, over time, paper costs can add up both for the paper itself and also for the handling, sorting, filing and, of course, long-term storage. As well, the cost of destroying paper documents must be considered. Document disposal is usually carried out for two reasons: to avoid storage costs and because the legal retention period has expired.

Until everyone embraces digital media, businesses should consider scanning documents to reduce storage costs.

There are three basic types of image scanners suitable for office use: flatbed, film, and document scanners. Each has been designed for a specific need.

Flatbed Scanners

A flatbed scanner has a flip-up top similar to that of a photocopier and is used to scan documents horizontally. A document is placed face down on the glass, which is illuminated, and scanned from below. Since the moving parts are concealed beneath the glass, flatbeds have the ability to scan irregularly shaped or even damaged documents. Flatbeds also tend to offer higher native resolutions; professional models can offer excellent colour fidelity, making them well suited to scanning photographs or other high-detail documents.

Examining, recording and monitoring consumption and associated costs will provide either a feeling of a job well done or the realization that more needs to be done to achieve cost savings.



Flatbed scanners are available in a very wide range of models, depending on your needs and budget. Basic models are fairly affordable, starting at less than \$100, but these may be limited in terms of speed and resolution and can often scan only a single page at a time. Every office should have at least a basic scanner, although, if you are planning to scan many documents, you may wish to consider a model that can support greater speed, higher resolution and, especially, a document feeder that allows you to queue and scan several pages in sequence automatically. Some manufacturers build flatbed scanners into their multifunction printers (MFPs). Depending on your scanning needs, an MFP may provide an effective solution, although, with an all-in-one it's important to consider your printing requirements as well (e.g., inkjet vs. laser, duty cycle, pages per minute, etc.).

Film Scanners

A flatbed scanner may be suitable for scanning printed photographs while a dedicated film scanner may be able to capture higher resolution and better colour depth from original negatives or positives (slides). Because negatives and slides are usually smaller than photographic prints, dust and scratches can be magnified and disfigure the final print. Many scanners include software that allows the user to “touch up” or “clean” old photographs. Traditional photo-editing software such as Photoshop or GIMP can, of course, also be used.

Document Scanners

When you need to scan a lot of multi-page documents, a document scanner will make the task much easier.

Document scanners allow you to queue multiple pages at once with an automatic feeder and tend to be faster than flatbed models, although that speed can come at the expense of reduced resolution. A key differentiator worth noting between the flatbed scanner and the document scanner is the latter's ability to scan both sides of the page simultaneously, also known as duplexing. This feature is essential when scanning documents with information on both sides of the page. For double-sided scanning, flatbed scanners require the user to turn over each page manually.

Features to Consider

Before purchasing a workplace scanner, you need to consider:

- minimum and maximum document size that needs to be supported
- speed
- colour support
- resolution
- roller assembly life
- operating system compatibility (e.g., Windows, Mac)
- connectivity (e.g., USB, Ethernet, Wi-Fi)

Some Documents Cannot Be Scanned

While ideally we would like to be able to digitize everything, there are practical limitations to what we can or cannot eliminate. Certain documents, such as signed contracts, loan agreements, guarantees, demand notes, mortgage agreements or powers of attorney are required by law to be kept in hard copy.

Maintain a reader that can access and produce a usable copy.

Canada Revenue Agency Requirements

Traditionally, financial records, along with any supporting documents, were kept solely in paper format. It is now acceptable to keep financial records in digital format. For example, scanning receipts or invoices and storing them on your computer is permitted by the Canada Revenue Agency (CRA). Financial records originally produced electronically and kept in electronic and readable format (i.e., you must maintain a reader that can access and produce a usable copy) are acceptable as well. All digital records and scanned documents should be clear and readable, and kept according to the CRA guidelines. For details, see the CRA's *Keeping Records* guide: <http://www.cra-arc.gc.ca/tx/bsnss/tpcs/kprc/menu-eng.html>

The Future

Ensure the documents you scan will be accessible on future software or operating systems. Today, the PDF format is the standard for document retention. However, it is a good practice to include a copy of the software used to read or scan the documents on the storage media along with the documents being stored. As always, it is considered a best practice to retain backup copies of all documents physically stored in different locations, such as a secondary hard drive or flash drive kept in a different office or a cloud-based service.

MANAGEMENT

Small-Business Fraud

Be vigilant: undetected fraud can destroy your business.

According to the 2012 *Report to the Nations on Occupational Fraud and Abuse* of the U.S.-based Association of Certified Fraud Examiners, privately owned businesses with fewer than 100 employees are the most common victims of fraud; the most common type of fraud is the fraudulent billing scheme. According to the Association, between 40% and 50% of all victim organizations, no matter what their size, *do not recover any of their losses.*



Fraudulent Billing Schemes

False invoices are printed and presented using the name of a legitimate supplier but with a different address to direct the payment to a place where the fraudster can

access the funds. Unfortunately, electronic payment systems make it possible to set up such accounts easily. Owner-managers may not pick up on the change because they only approve the invoice for payment and leave the actual electronic payment to the accounts payable clerk.

Payroll Fraud

The payroll cycle often provides the opportunity for a single employee or a conspiracy of two or three employees to misappropriate funds. For example, “ghost” employees can be added to the payroll. The payroll clerk sets up the ghost employee and deducts withholding taxes as required. But, instead of being remitted, the taxes are transferred to the fraudster’s personal account along with the net amount of the ghost employee’s pay. Payroll clerks have also been known to continue paying terminated employees. Unapproved raises are sometimes given to these ghost or terminated employees. In fact, some non-existent employees have had entire “careers” before the fraudster was caught.

Cheque and Credit-Card Fraud

Never provide employees with unlimited credit cards or pre-sign blank cheques. Since fraudsters are often opportunistic thieves, such carelessness is an invitation to a would-be crook. You may be able to recover your losses, but your company is still out the cash or still indebted until you do.

The “Angel”

Owner-managed companies are often approached by shady “management consultants” with a proposal to review company operations, streamline them to save money and bring in more business. The process goes something like this:

1. The consultants find serious operating issues. Cash flow, profit and loss projections indicate deficiencies and a negative outcome if operations are not changed.
2. The consultants claim the looming negative outcome can be changed if they are hired for a couple of months and allowed to run operations. New cash flow projections incorporating the suggested changes show a very positive outcome.
3. For a hefty consulting fee, a management team appears, as do new clients.
4. Sales orders increase dramatically, production goes into overtime to meet the demand, inventory is shipped to the new accounts and accounts receivable skyrocket.

5. Cash flow starts to become an issue, but the management team’s presentation to the bank indicating increased sales and receivables convinces the bank to arrange a large increase in the operating line of credit.
6. More supplies are ordered, more production is scheduled, more sales and more receivables are booked.
7. Suddenly, the new customers are finding reasons for not paying within 30-60 days.
8. One morning the management consultants don’t show up.
9. Calls to the new clients demanding payments are ignored, or worse still, their phones are out of service.
10. Your business is in trouble.

Later on you find out that the new customers were not legitimate businesses but just a front. The consultants used your company and your leverage at the bank to manufacture the inventory, sell it to third parties for the best price they could get and leave you with bank debt and working capital problems.

Fraudulent billing schemes are the most common type of small-business fraud.

Overordering

In this scenario, a fraudster buys excess supplies. After the order has been paid in full, some goods are returned. Reimbursement for the returned goods is deposited into a false account. A twist on this scam is to take credit instead of cash and apply the credit to the account. Additional purchases are made using the company credit then sold at a discount to third parties.

Personnel Fraud

In addition to creating schemes to steal money from their employer, employees can cost their employer money in other ways.

Misrepresentation of Qualifications

All credentials and claims to experience should be checked out carefully before any employee is hired. Misrepresentation of qualifications such as a mechanic’s licence, a university degree or professional designation, a licence to operate heavy equipment or special vehicles can affect your business. If you hire someone with false qualifications, you could be putting

yourself at risk for legal action if the employee causes an accident and breaches the terms of an insurance contract or violates provincial or federal regulations governing your business.

Abuse of Employee Privileges

Employees who abuse their privileges can also cost employers significant amounts of money over a year, for example, by:

- taking a sick day to work at another job
- abusing flex hours by not working the additional hours to make up for the time off
- extending coffee/smoke breaks
- showing up for work late every day
- spending excessive amounts of work time on personal matters

Business Misrepresentation

Businesses can even misrepresent themselves through the creation of false data. If you are approaching another company for a merger or buyout, make sure their data is correct by exercising comprehensive due diligence on your target. It is worth hiring a forensic CPA to scrutinize both the target company as well as the business and personal histories of the principals. More than one potential buyer has been surprised to find senior personnel in the target company who have been bankrupt, done time in prison or have mob connections. Corporate data may be falsified in order to:

- obtain increased operating lines of credit from a financial institution
- inflate earnings to obtain additional investment capital or sell the company
- hide operating losses or inventory write-downs
- obtain bonuses in a performance-based incentive plan
- cover up a fraud

Protecting against Fraud

A well-designed bookkeeping system to record transactions and produce financial records is your best protec-

tion against fraud. Bear in mind that a bookkeeping system without regular review provides little protection.

First Line of Defence

Take time to understand how your bookkeeping system works and review the results at least once a week. Comparing the financial data with the business of the week will help you find those unusual or unrecorded transactions. Such vigilance, combined with pointed questions to staff, will do much to convince individuals they cannot falsify information and get away with it.

Second Line of Defence

If you discover something suspicious and cannot resolve it internally, call your chartered professional accountant immediately. Do not let any suspected fraud continue “until we find more evidence.” First signs may give little indication of how much money or how many people are involved. Delay will not only increase the losses but could also affect any later insurance claim or legal proceedings. Your CPA is impartial, knows business norms and understands your business.

Because small businesses tend to have fewer resources to spend on fraud prevention, they are more vulnerable; fraud can, however, have a greater proportional impact on a small company than on a large one. Talk to your CPA about the adequacy of your accounting controls. In addition, observe those things that cannot be picked up by an audit, such as the employee who suddenly seems to be living beyond their means or exhibiting control issues concerning shared responsibilities.

Conclusion

Be vigilant.

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Richard Fulcher, CPA, CA – Author; Patricia Adamson, M.A., M.I.St. – CPA Canada Editor.

Contact us: patricia@adamsonwriters.ca