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Business Matters

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TAXATION

Year-End Tax Strategies

It's never too early to start planning your year-end tax strategies.

For many businesses, the month of October signals that the end of the fiscal year is not far away. Realizing that December 31 is fast approaching should prompt you, as an owner-manager, to review your year-to-date corporate and personal data and start putting your tax strategies into place. At the same time, remember to set up a meeting with your CPA. (Corporations can have a fiscal year end other than Dec. 31; this would, of course, affect the timing of the year-end meeting.)

Remuneration

Five main issues affect remuneration and taxation:

1. Was a bonus or dividend declared during the fiscal year but not paid until the following calendar year?
2. How much remuneration did you receive through normal salary or wages in the calendar year?
3. Were the draws or loans taken by a shareholder or related party during the company's fiscal year fully repaid to the company in accordance with the requirements of the Canada Revenue Agency (CRA)?
4. Are any draws or loans taken between the corporate fiscal year end and the end of the calendar year to be included in your taxation year?
5. Will any discrepancies between the corporate fiscal year-end date and the timing of payments and repayments of draws or loans impact your taxable income?

Have your CPA tax advisor review both your corporate and personal records to bring you up to date on the tax rules and their potential impact on taxable income.

Corporate Income

Now is the time to carry out a cursory review of the corporate profit or loss to determine whether the level of corporate taxable income suggests paying you a bonus. Should profits be paid to you and your employees to reduce or eliminate corporate taxes? Depending upon the individual's marginal tax bracket, reducing corporate tax by means of bonus payments is a great tax strategy; however, where corporate or personal cash flow is problematic, it may be more astute to pay the corporate taxes rather than pay or defer the additional remuneration required to reduce the corporate tax to zero. It is certainly feasible to pay the owner-manager, withhold the appropriate deductions, and then have the owner-manager lend the balance to the company. However, consideration should also be given to the "Due to Shareholder" account. If it becomes too large, the company may have difficulty repaying this "tax-paid loan" to the shareholder(s).

Family members' remuneration is often overlooked as a means of reducing corporate profit.

A CPA may also provide guidance regarding payment to the owner-manager's family members who supply services to the company. Often family members' remuneration is overlooked as a means of reducing corporate profit without the need to accrue corporate profits to the owner-manager(s). The appropriate allocation of remuneration among family members may assist in maintaining a lower tax rate for all family members and thereby collectively leave more take home pay. Where there is more than one owner-manager, there may be a need to review the structure of owner-manager payout packages to maintain a harmonious relationship among all concerned.

In addition to the normal streams of income for the company, your CPA will be able to help determine whether regular dividends or capital dividends (if available) should or could be declared and paid.

Deductions from Personal Income

This time of year is also a great time for your CPA to combine a review of corporate profits and potential personal income with a review of potential deductions. Your CPA will review "employment" income and determine whether there are major deductions that should be taken advantage of to reduce personal taxable income. Major deductions that may be reviewed include:

- Registered Retirement Savings Plan (RRSP) contribution room (considering any Pooled Registered Pension Plan (PRPP))
- capital losses from prior years if any capital gains have been earned
- investment portfolios (considering gains or losses from current or prior years)
- profits or losses from other business ventures such as personally held rental property or partnership ventures
- non-capital losses from previous years that may be applied against current-year income

- potential for income splitting should you or your spouse receive a pension from previous employment plans
- portfolio management costs incurred for your personal investments.

The Right Thing to Do

Tax planning for owner-managers involves more than just determining taxes payable. When reviewing and discussing your business and personal income issues with your CPA, you should be able to determine the:

- impact of various income scenarios on current personal taxable income
- impact of various corporate payout scenarios on current corporate income tax
- cash flow requirements for both the owner-manager and the company when various hypothetical amounts and types of remuneration are calculated
- cash flow requirements for the corporate entity to pay out deferred bonuses, any resulting withholding taxes, or corporate taxes
- taxable income issues that may arise for owner-managers for the next calendar year, such as:
  - additional income as a result of investment portfolio changes
  - balances in RRSPs or TFSAs that could determine investment strategies
  - age change (e.g., turning age 65) that could create income from Old Age Security, CPP or other pension plans
  - number of years remaining before you need to roll your RRSP into a RRIF or an annuity
  - changes in the company's shareholder list
  - changes in family member status as a result of divorce, death, retirement, resignation or new family members joining the company in some capacity (e.g., as employees or shareholders)
  - anticipated sale of assets or investments.

Productive Talk

The long-term relationship of your CPA with the company, the owner-managers and family members allows meaningful discussions that will provide a level of satisfaction not only for the company and the owner-managers but also for your CPA, who takes pride in seeing you and your business succeed.

MANAGEMENT

Buying a Franchise

Do your research before buying a franchise.

Many people who want to be self-employed consider buying a franchise. Unfortunately, it is all too easy to get caught up in the excitement of the franchise concept, particularly in light of hugely successful franchises such as Tim Hortons or McDonald's. It is, however, best to weigh the pros and cons of franchise ownership before you decide whether a franchise is right for you.

Franchise Defined

The foundation of any franchise is the granting of a licence by the franchisor to another individual or company (the franchisee) to operate under the franchisor's name. Most franchisors have an established business model the franchisee must follow. As well, the franchisor provides assistance for a set length of time. Most franchises include a renewal option.

Advantages of Owning a Franchise

Franchise ownership has many advantages:

- The business model is already established and successful.
- Commonalities, such as floor plan, equipment, supplies and accounting are already in place.
- Advertising and trade names are already recognizable.
- Tested training programs will teach you how to optimize use of space and employees.
- The franchisor may be able to help you obtain financing by providing reliable cash and profit projections based upon years of experience.
- A good franchisor will have researched the geographic and demographic components to know the best operating location (e.g., many fast-food franchises seek locations in business, industrial or school districts to target the lunch-time crowds).
- Franchisors can negotiate volume discounts.
- Customers align with names they know because of the consistency of product and value for dollar spent.
- The franchisee has support from head office and other franchisees.

Control of day-to-day operations is the responsibility of the franchisee. However, the franchisor retains absolute control over quality, service protocol, advertising, and the products or services offered. The franchisee must embrace this arrangement as the tried and proven process that underlies the franchise's success.

Buying into a franchise is not a one-time expenditure.

Ongoing Costs

Buying into a franchise is not a one-time expenditure. After the initial investment, the franchisee is usually required to pay an ongoing fee based on a percentage of sales or a markup on products that must be purchased from the franchisor. Initial costs of a franchise are usually determined by the success of the franchise. Purchase of a franchise may require a combination of cash and borrowed funds.

The franchisee may also have to finance the cost of equipment, furniture and leasehold improvements preconfigured by the franchisor and a yearly royalty for use of the name. In exchange, the franchisor should provide continuous training, quality control reviews, advertising and marketing, product development and, of course, management guidance.

Many franchisors guarantee they will not sell another franchise within a protected territory. This promise is as important to the franchisor as it is to the franchisee since closing an unsuccessful franchise outlet not only cuts into the franchisor's revenue but also suggests to the public that perhaps something is amiss with the product, the business model or head office management.

Anyone thinking about purchasing a franchise should not assume that running the franchise will be easier than running any other business just because it is a franchise. Certainly, a lot of the start-up advantages will be provided by the business model of the franchisor. Beyond that, however, it is like any other business: hard work, dedication, consistent management and long hours.

10 Steps to Take before Committing

1. Determine your own areas of interest and expertise.
2. Research the franchises available in your areas of interest and expertise.
3. Research the franchise's history and operations:
    a. location of head office
    b. length of time in business
    c. number of franchises in your city or province
    d. any legal problems between franchisees and franchisor.
4. Check for availability of the franchisor's products or services in your area.

5. Determine whether you can finance the operation. Many franchise websites provide a realistic idea of the cost and conditions of joining the franchise to ensure that only those with serious intentions and sufficient capital try to take the next step.
6. Meet with the franchisor's representative to find out the upfront cost and to get revenue, cost and profit projections for the area in which you wish to operate. Ask about the support to be provided and, of course, all other costs and conditions attached to the franchise. Review a copy of their standard franchise agreement. Ask for names of franchise operators within the area and arrange face-to-face meetings without the franchisor present to ask them a well-prepared set of questions.
7. Meet with your CPA. Crunch any sales, costs and capital expenditure numbers the franchisor may have provided. Objectively analyze the ability of the proposed location to support the operations. (Lenders will probably ask for income and cash flow projections as well as an estimate of any proposed capital expenditures.) Be realistic. If, for instance, 5,000 hamburgers must be sold each week to break even and there are only 10,000 people in your territory, you can only conclude that any outlet here will not be successful.
8. Review the preliminary contract and highlight areas you do not understand. Then, review the entire contract again in detail with your accountant and lawyer. Leave nothing to chance. Make sure you understand everything.
9. If you are still convinced this venture is right for you, approach a financial institution to determine the criteria for obtaining a business loan.
10. When financing is approved, meet with the franchisor to put the papers in order. Before signing anything, however, review the final documents with your accountant and your lawyer to make sure you fully understand your legal obligations and what ramifications failure to meet the conditions of the contract will have for your business and your personal life.

Choose Your Franchisor Carefully

Sources of information on franchising are almost limitless. A web-based search of the words "franchises in Canada" will provide more than 44 million results. You will soon find a host of franchise opportunities as well as an overabundance of positive sales hype.

Franchises can be wonderful business opportunities for those fortunate enough to align themselves with good franchisors that support their franchisees. On the flip side, committing your personal wealth to franchisors that are only interested in lining their own pockets can be a costly emotional and financial experience.

Do your research and choose wisely.

MONEYSAVER

Considering a Vacation Property

Don't let vacation dreams become your financial nightmare.

Fantasy

The dog days of summer spent fishing off the dock, the sun sinking slowly behind the distant shore, the call of the loon, or cross-country skiing and a warm fire at the end of a winter day. Whether these are fond memories of childhood or an imagined future, the desire to own a vacation property for personal use or even for investment purposes may blind you to the real cost of owning a second home.

Reality

Year-round vacation properties are costly. For example, getting a mortgage may be a challenge, especially if you do not have at least 20% of the property's appraised value as a down payment. (Some banks offer financing for 95% of the property's value, but default insurance

– often referred to as mortgage insurance – is required on any amount over 80% of the appraised value and, in some cases, on any amount over 65%. Canada Mortgage and Housing Corporation stopped providing second-home default insurance effective May 30, 2014.)

Cash Flow Needed

Assume, as an example, a purchase price of $300,000, and that you have 20% as a down payment (i.e., $60,000). A mortgage amortized over 25 years with an interest rate of 4% (the projected interest rate of 4% is simplified for the purpose of example only; however, it is important to anticipate changes – including possible increases – over time) will result in payments of about $1,260 per month. This means mortgage payments alone will be approximately $15,120 per year. In addition to the capital outlay and mortgage payments, other costs should be recognized:

- furnishings
- municipal taxes, insurance, utilities and maintenance
- tools and household items (e.g., lawn mower, snow blower, dishes, bedding, etc.)
- monthly management fee (optional)
- transportation costs back and forth to the property.

Rental Income

To offset the cost of ownership, you may consider renting out the property for part of the year. But before doing so, consider the following:

Income Tax Consequences

Any rental income you receive must be reported to the Canada Revenue Agency (CRA) and added to your other income. Naturally, expenses incurred to earn rental income are deductible. Expenses can include a reasonable apportioning of costs incurred for renting out versus personal use. Costs that can be considered for vacation property are not dissimilar to those for any other rental property. It would be wise to maintain records of the times the property is rented in order to provide a mathematical means (e.g., a percentage of the days or weeks of the year) of assigning costs to the rental or personal-use periods. Capital cost allowance on depreciable property can be deducted against property

income only to the point where the profit is zero. You cannot create an operating loss or increase a loss with capital cost allowance. Because there are other tax issues when utilizing capital cost allowance that occur "down the road," it is advisable to gain an understanding of tax consequences from your CPA to ensure the vacation property does not become an income tax nightmare.

Renting your vacation property to help with costs could trigger a "change in use" to the CRA.

Change in Use

Renting the property more than occasionally could trigger a "change in use" in the judgment of the CRA. Once a change in use is determined, the property is considered to have been disposed of at fair market value and a calculation of the gain or loss between the original cost and the "deemed disposition" price may trigger a capital gain on the difference. There are, however, other elections that can be made to defer the deemed disposition. Make sure to get the advice of a qualified tax advisor if you plan to rent the property for more than occasional use.

Multiple Residential Properties

There is nothing to prevent a taxpayer from owning more than one residential property; however, the *Income Tax Act* allows only one principal residence. Thus, if you already own your primary residence and subsequently purchase a vacation property, it will be necessary to consider the tax consequences of selling one of the properties in the future. In a nutshell, at the time the first residence is to be sold you must decide to either elect this property as your designated principal residence or defer the election until the sale of the second residence. When the designated principal residence is sold, any gain in value throughout the period of ownership is not considered to be a capital gain and is therefore not subject to capital gains tax. However, any gain on the sale of the property not elected as the principal residence will be regarded as a capital gain and taxed accordingly. Whichever property has the greater gain at the time of sale should probably be deemed your principal residence.

Something to Think About

Assume for a moment that two taxpayers decide to enter a common-law relationship or marry. Under CRA rules, if one person owns a traditional home and the other a vacation property and both properties are carried into the new relationship, tax laws dictate that only one property can be considered a principal residence. From the CRA's point of view, it does not matter that as single persons each owned a principal residence that would not have been subject to capital gains tax if it had been sold before the parties entered into their new relationship.

A Final Perspective

The total cost of ownership of a vacation property over the 25-year amortization period can be substantial. To the original $300,000 price of the property, you have to add in the $140,000 (rounded for simplicity) interest cost to carry the $240,000 mortgage at 4% over 25 years. Add to that a conservatively estimated $5,000 per year for taxes, utilities, insurance and maintenance and you have an additional $125,000. This gives a total ownership cost of $565,000 ($300,000 + $140,000 + $125,000). Assume also that the property is sold after 25 years for $600,000. Because only half of any capital gain is taxed, you would be taxed on $150,000 in the year the property is sold. Assuming a 40% tax rate, the tax liability on the taxable portion of the capital gain will be $60,000. As a result, the actual cost of owning a $300,000 cottage for 25 years will be $625,000 ($565,000 + $60,000) or $25,000 per year.

Certainly the overall cost of (approximately) $625,000 can be reduced by renting the property but, as suggested above, exercise care to ensure the property does not become redefined by the CRA as an income-producing property with all its potential tax consequences.

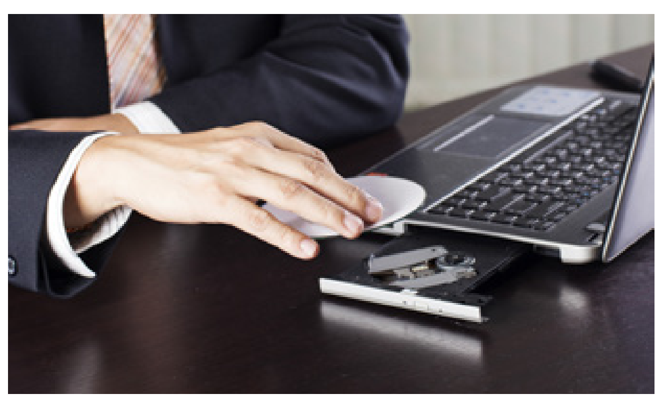
Calculate the Best and the Worst

No one can accurately predict interest rates, tax rates or property values 25 years into the future. In the final analysis, purchasing a vacation property as a long-term investment should be tempered with a measured look at the real cost of holding the property and the return that may eventually be realized when the property is sold. Prudence would suggest running the best and worst case scenarios to determine whether such a long-term investment meshes with your current lifestyle and risk profile.

MONEYSAVER
Buying Business Software

"There was a time when nails were high-tech." – Tom Clancy

What software tools does your business need to support normal operations?



Every business requires certain software functions: word processing, spreadsheet creation, email and calendar, Web browsing, PDF reader and printer, and antivirus protection. The options that can fulfill these tasks are almost endless, and range from "freeware" (sometimes saddled with an unsuspected spyware, embedded ads, or viruses) to whatever amount you want to spend. The secret is to match the software to your business needs and then purchase programs that are not only intuitively easy to use but actually improve productivity.

In addition to your company's *basic* software needs, each business also has its own *niche* software requirements driven by core activities. To determine what will work best for your business, have your employees evaluate the effectiveness of the software they currently use and ask them to suggest what capabilities they would change or add if it were possible to do so. If uncertainty still exists after this internal review, hire a software consultant to evaluate your company's existing software and make suggestions.

Examine Your Choices

Once you have determined your business needs, you will want to review the available options and find the right software solution. With so much software on offer these days, selecting the right product for you and your business can be a confusing and even overwhelming process. It is important to remember that software should not only be intuitively easy to use but also should improve productivity rather than creating cost and frustration. Here are some suggestions to guide your search:

- Ensure that the software you've chosen is compatible with the software you already use.
- Are you looking for Cloud support, or Cloud technology? Ensure that the software you choose supports the type of office you currently have (or intend to have in the future).
- Is it necessary to have software that can be used on your laptop, smartphone or tablet, or across multiple operating systems? If so, be sure to choose software that is cross-platform.
- Many software companies have multi-user or multi-machine licencing limitations. Be sure to read carefully when selecting the software licencing model to cover all of your office workers and/or client users.
- For essential software, ensure that the developer offers unlimited support across multiple channels (Internet, telephone). Also be sure to check the cost of this support.
- In general, it might also be worth considering a software company that provides remote assistance, especially if you have users who are not especially technically savvy.
- For more complex software or software that has sensitive data, it might be worth considering a platform that allows you to support multiple users with different permission levels, and/or to be able to deactivate these users at a moment's notice.

Security of your data should be your primary concern.

Making the Purchase

Depending on the product, traditional brick-and-mortar and online retail channels can still present significant opportunities and variety. In the mobile world, you are most likely to download apps via the platform-specific app store on your device. PC platforms now have app stores too and, although there may be some limitations on the kinds of software available through an app store, it can certainly be a very convenient source for software. Software for PCs can be purchased directly from the vendor either through its website or a sales team.

Security of your data on the new software should be your primary concern. Purchases through major software company websites may be a more secure way of making your purchase than through a small, lesser-known vendor. Buying from traditional vendors is certainly more secure than downloading adware or "freeware." If you do choose to go through a sales team, make sure you verify their identity by calling the company before your appointment to confirm the salespeople are actually employees of the company in question.

Additional Considerations

Finally, here are some additional points to remember when making any software purchase:

- Ensure the software will work on your operating system.
- Understand what the software actually does before making a purchase.
- Use freeware at your own risk. Free software can come bundled with unexpected "surprises", including spyware, malware and adware. In addition, freeware is often unsupported, and if something crashes, you could potentially lose all of your data.
- Always read the pop-up prompts on *all* software to make sure there are no unexpected tag-alongs (such as an annoying toolbar) being installed at the same time.

Do Your Research

Software is essential in modern business, but can be expensive to purchase and is constantly changing as new ways of doing old jobs are found. The purchase of the right software at the lowest cost is something that requires a lot of research and should be done carefully. Take your time and do it right.

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