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THE Quarterly Dividend

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Your guide to income tax & financial planning

FAST TRACK

Loneliest Man in Town #3

Every year we consider the "loneliest man in town", not by singling out anyone in particular but by pointing out one aspect of the life of the small businessman in the hope that readers will understand what it takes to be an owner/manager in the 21st century.

There are no statistics to bear it out, but conventional wisdom indicates that the biggest reason

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Year-End Business Papers

Now that "tax season" is back, there are three steps you must take to ensure that you will claim all business expenses to which you are entitled. They are: (a) determine the expenditures to which you are entitled; (b) locate the receipts that are related to these expenditures; and (c) summarize the information according to the captions that appear on Schedule T2125 of your income tax return.

Determine the expenses to which you are entitled

No two businesses are exactly alike and the expenses that make sense for you are not necessarily the ones that someone else might be incurring even if the two of you are operating similar ventures in the same industry. To determine the kinds of expenses you can claim for income tax purposes, just think of your "typical" business day and itemize the expenditures you incur. Just about any outlay or expenditure that has been made in order for the business to continue its operations and generate a profit are deductible for income tax purposes. Just to get you started, and this list is not exhaustive, I have classified the most common expenses into those that are "self-explanatory" and those that demand more attention to detail.

Self-explanatory

- advertising
- bad debts
- bank interest charges and service fees
- business taxes, dues and fees
- capital cost allowance (depreciation)
- delivery and freight
- fines and penalties
- insurance
- internet and email services
- legal and accounting fees
- local and business travel
- maintenance and repairs
- management and administration fees
- office expenses
- professional associations and publications
- rent, property taxes and utilities
- royalties
- salaries and wages (and their payroll costs)
- supplies
- telephone (land line and cellular)

Non self-explanatory

- *auto expenses:* if you use your automobile for business purposes you can choose from two different methods of deducting business-use charges. The most common method is to deduct the CRA allowable per kilometer amount for each business kilometer driven. The current rate is 53 cents for the first 5000 km and 47 cents for any additional km. This figure is intended to include all operating costs incurred, including depreciation. It is easy to use and as long as you maintain a log of kilometers driven for business purposes (outlining the customers you visited and distance covered), it cannot be challenged. The "downside" is that you may obtain a larger allowable business expense by using the more "traditional" method. This is obtained by itemizing all expenses incurred in running and maintaining your vehicle (capital cost allowance if you own the car, leasing charges if you do not, gas, oil, interest, parking, repairs, insurance, tolls, licence, etc.) and prorating them according to the amount of business driving you have done in the year as a percentage of the total mileage that you have put on the car. You can switch between methods from year to year so you can calculate them both and choose whichever one is "better" for you. Just remember that driving to and from work does not count as business usage.

- *education:* education expenditures related to your business, trade or occupation are very liberal.

Compliments of

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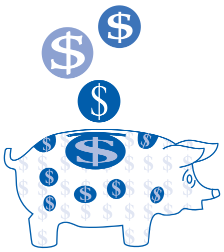


small business owners give up on their ventures is a lack of emotional support from their spouses and other family members for the pressures that come with running an independent business.

It has been said that going into business is 25% inspiration and 75% perspiration. The owner must come up with the initial idea for the business he has founded and then nurture the concept through many different stages of development. If he is skillful, he will create a niche for the product or service in the marketplace and persuade customers that once they have sampled what he has to sell, they will never go back to the old ways in which they used to operate. It is not only inspiration displayed at the beginning of the venture that accounts for the 25% figure. But inspiration every day thereafter is needed as he tries to position the business toward its greatest perceived chance of success.

The 75% perspiration comes from the actual hours employed in making the business operate. It encompasses the daily

Some courses may qualify as "tuition, education and textbook" amounts available for inclusion as a "non-refundable tax credit". In some cases this may be beneficial, but more than likely it is better to include these outlays as business expenditures;

- *home office expenses:* the home office has become a fixture of small business. In order to qualify for a percentage deduction, usually based upon the number of rooms you use for business purposes divided by the number of rooms in your home or condominium, the office must be used on both an exclusive and regular basis. If you can meet these criteria, a portion of your home mortgage, realty taxes, insurance, maintenance and other direct costs now become available as expenses to be charged against revenues generated in your enterprise;
- *private health insurance premiums:* amounts paid under a private health insurance plan for yourself or any family member can be deducted as a business expense as long as you are actively engaged in the business and it provides at least fifty percent of your total income for the year (before consideration of these premiums) or your income is less than $10000. The amount that can be claimed is tied to the premium your business pays for equivalent coverage of your full-time arm's length employees, if any. In cases where the company has no such employees the maximum expense is limited to $1500 for each of the proprietor, his spouse and children over 18 years of age and $750 for younger children. Any insurance premiums paid but not deducted here qualify for the medical expense tax credit.

Locate your information

(a) bank statements including cancelled cheques and deposit books;

(b) payroll information for all employees;

(c) receipts for "out of pocket" cash expenses, including those paid by debit/credit card;

(d) invoices for capital expenditures such as equipment, computers, etc;

(e) lease contracts for automobiles, rental premises, insurance;

(f) "receipts" for invoices paid over the internet;

(g) correspondence with CRA, especially payroll and HST remittances;

(h) receipts related to "home office" claim (if applicable);

(i) automobile log (see above);

(j) receipts for expenses incurred in "wining and dining" current and potential clients; and

(k) "other" expenditures that are particular to your industry and the way you conduct your business affairs.

Organize receipts according to category

The last step is add up the individual receipts and summarize them according to the categories outlined above.

While I have concentrated on business expenses, the same process holds for business revenues as well.

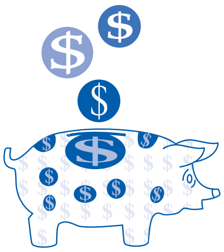
The Time Value of Money

One concept that appears to elude many people is the impression that $1.00 received today is exactly equal to a $1.00 to be received one year from now. In fact, nothing could be further from the truth!!

The dollar obtained now can be invested for a year, and even at interest rates that are as low as they are today and "after tax" considerations are factored in, it will grow to some factor higher than the $1.00 you would receive one year from today.

Consider the following example. Ron agreed to sell his property for $1000000 on January 1, 2013. The purchaser has stipulated that he will give Ron $250000 upon closing and $250000 each year on January 1, 2014, 2015 and 2016. Do not consider taxes. Is Ron really getting $1000000 for the property?

The answer of course is "no". There are mathematical tables that show the "present value" of $1.00 that will be received at any time in the future. The factor will always be less than "one" for the reason outlined above. The only information that Ron requires is (a) a schedule of the payments he will receive and (b) the presumed interest rate that the money received and invested today will generate over the period of the payments.



chores of physically running the business as well as the emotional drain of having the business on his mind virtually twenty-four/seven. It is not a stretch to say that every aspect of life is viewed through the prism of the business. It is the barometer through which everything is measured and analyzed.

It is not hard to understand that should he be so wrapped up in the business, he might just lose his perspective on much of what goes on around him. If he is lucky, he will have a spouse and other family members to "take up the slack", keep his spirits up and offer encouragement and advice all along the way. If he is unlucky, he will encounter a spouse and other family members who will be all too willing to suggest that he seek his livelihood in some other endeavor. They will point out that he "is never at home with the family" or that he "is not giving his loved ones the attention" they need or deserve.

The first business owner, of course, will not qualify as "the loneliest man in town". He might very well

If we assume that Ron can invest his money at 5% per annum we can determine the true amount of the proceeds for which he sold his property. Please see the accompanying table 1.

The payment on January 1, 2013 is worth $250000 times a factor of one or $250000 today.

The payment on January 1, 2014 is worth $250000 times .95238 or $238095 today.

The payment on January 1, 2015 is worth $250000 times .90703 or $226758 today.

The last payment on January 1, 2016 is worth $250000 times .86384 or $215960 today.

Ron is not receiving the full $1000000 for his property. He is receiving ($250000 + $238095 + $226758 + $215960) or $930813 in 2013 dollars.

The reverse is also true. Any time you can delay paying a bill for a period of time (interest free), while having the opportunity to invest that money and earn a return on it, the better off you will be.

Take your local retail furniture box store who is offering you a "Don't Pay a Cent Event" on a couch that they retail for $800. Ron, the same man flush with cash after selling his property, thinks this would be a great deal for him when furnishing his new condo. He figures he can invest the $800 that he is not laying out now and it will grow to $926 (table 2) by the time he has to pay the bill (at 5% per annum).

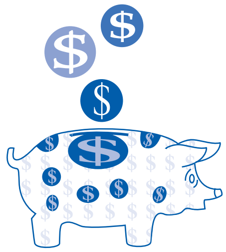
Not only that, he will enjoy the use of the couch for three years (if it lasts that long!!)

Implicit in the $800 charged by the retailer to be collected three years from now, is the interest cost he is paying when he agrees to forego the cash now and accept the lump-sum payment on January 1, 2016. By using the tables at an implicit interest rate of 5%, we find out that the present value of $800 three years from now is $691 (table 3). That means that the retailer would be indifferent between receiving $691 today or $800 three years from now.

And Ron is not really re-investing $800 today. He must work out the amount that is required to invest today to generate $800 on January 1, 2016. This will depend on the interest rate he can "get" on his money. Typically the interest rates charged at the bank for borrowers is higher than the interest rate paid by the institution to savers. Since the retailer must pay 5% on his borrowings, Ron will certainly receive less than that for his investment. If he can only earn 3%, for example, the $800 three years from now will be equal to $732 (table 4) today, and it would be in his best interest (ha ha) to offer the retailer $691 for the couch now.

If that is the case, and the retailer customarily marks up his merchandise by 50%, Ron is buying a $345 couch today no matter how he ends up paying for it. I hope the couch lasts long enough for him to make the payment without having to buy a new one at the same time!!

Table 1			**5%**	
	Date	**$ Received**	**Factor**	**PV Jan 1/13**
	1-Jan-13	250,000	1.00000	250,000
	1-Jan-14	250,000	0.95238	238,095
	1-Jan-15	250,000	0.90703	226,758
	1-Jan-16	250,000	0.86384	215,960
		1,000,000		930,813
Table 2			**5%**	
	1-Jan-16	800	0.86384	926
Table 3			**5%**	
	1-Jan-16	800	0.86384	691
Table 4			**3%**	
	1-Jan-16	800	0.91510	732



be the luckiest man in town. He will be spared many hours of having to explain his absences from home and the many hours he has put in at the office.

It is the second business owner who will earn the title this year. His sheer determination to keep on going when many around him exhibit negativity is a testament to the fact that he has what it will take to succeed. There comes a time when the small businessman must show such self-confidence that others will have to eventually realize that whatever their personal opinions might be, this small businessman will pursue his goal on his own terms and not let anyone or anything stand in his way. Hopefully they will come to this realization sooner rather than later.

Thanks for Your Referrals

We very much appreciate your referrals. If you know of someone who can benefit from the services we provide or who would like to receive our publication, please let us know. We will send them a copy with your compliments.

Health and Welfare Trusts

Monica is a self-employed professional running her business through a corporation from which she draws an annual salary of $50000. She incurs $1600 in medical expenses annually. She has been told that she can claim these expenses on her personal income tax return as she has in the past or alternatively enrol in a Health and Welfare Trust that will allow her to claim these expenses through her company.

The annual administration fees of the Trust are 10% of the medical claims for re-imbursement. There are two scenarios: (a) the "traditional" way where Monica incurs the out of pocket medical expenses and claims them as a credit on her personal income tax return. In this case, she will need to draw sufficient salary to live on and pay the $1600 in medical expenses she will incur; or (b) she enrols in a Health and Welfare Trust and treats the medical costs and administration fees as a business expense. This will reduce her corporate income taxes and allow her to pay herself a salary of $50000. But not only that, she will be re-imbursed the $1600 in medical expenses she incurs by the Trust on a tax-free basis.

In addition, some medical expenditures that are not recognized by the CRA will be allowed by the trust for re-imbursement.

If the HWT is a “winner” at $1600 medical expenses it will be even more so if your family incurs higher expenditures. The only catch is that you must have a corporation to take advantage of it.

	No Plan (a) $	With Plan (b) $
Corporation		
Revenue	150,000	150,000
Expenses		
Management salaries	51,600	50,000
Health spending account		1,600
Health spending account fees		160
Other	20,000	20,000
Total expenses	71,600	71,760
Corporate income before taxes	78,400	78,240
Corporate income taxes	12,152	12,127
Corporate cash flow	66,248	66,113
Medical services during year		
Prescription drugs	600	
Dental	550	
Glasses	450	
	1,600	
Personal		
Salary	51,600	50,000
Medical expenses	(1,600)	-
Personal income taxes	(9 ,564)	(9 ,076)
Personal cash flow	40,436	40,924
Cash flow analysis		
Corporate cash flow	66,248	66,113
Personal cash flow	40,436	40,824
	106,684	107,037
Difference - (compare (a) to (b))		353