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THE Quarterly Dividend

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FAST TRACK

Whistle-blowing

The biggest and most important "business story" of 2015 concerned the German automaker Volkswagen and the scandal involving the carbon dioxide and nitrogen oxide emissions of the cars they had been producing since the 2009 model year.

However, what is overlooked in the story, is that this might never have been uncovered had certain employees of the company not come forward to the authorities and revealed

In this Issue:

Corporations and Their Shareholders (Part One)

Accountants make a "big deal" about the separation of a corporation from its shareholders. They constantly emphasize that the business entity is not an extension of its owners but a venture that has a life of its own.

They often fail to point out, however, that without the owners, the business is "nothing" and so its affairs are interwoven intimately with its owners.

Take Jack and his Corporation. He has been running the company for many years and has yet to turn a profit. In fact the company has shown accumulated losses totaling $154953 and he is just about ready to "throw in the towel". It's December 31, 2015 and the balance sheet is shown in Exhibit One.

(a) Jack decides that he has had enough. The company has cost him thousands of dollars over the years. The only way he can recoup some of his investment is to declare his Shareholder Loan to be "uncollectable" and write it off for income tax purposes on his personal income tax return.

He will be entitled to deduct one-half of the loan as an Allowable Business Investment Loss. This will reduce his 2015 personal income on a dollar for dollar basis, even to $NIL, with any additional balance remaining available for application against prior or future years. See Exhibit Two.

One drawback, however, is that the mechanism of an ABIL will not allow Jack to claim "Non-Refundable Tax Credits". He cannot structure the ABIL to "stop" at $11325 and apply the balance backwards or forwards.

In the final analysis, if Jack chooses to claim the ABIL, he will have spent and lost $154973. He can recoup $23245 (at a marginal tax rate of 30%) in income taxes for a "net" loss of $131728; or

(b) Jack is an eternal optimist (stubborn) who cannot reconcile himself to losing $131728. He really believes that either this company can be turned around or he can get involved in a new venture that will be profitable enough to allow him full repayment down the line.

If he is right, the first $154953 in corporate earnings will be offset by losses incurred in earlier years. The funds can then be used to repay his shareholder loan and taken out in full, tax-free, from the corporation.

But, what will happen if Jack had chosen (a) at the beginning but continues to operate the business? When his perservance paid off, and the company showed $154953 in earnings, the corporation, as a separate entity from Jack would have continued.

From Jack's income tax perspective, the shareholder loan will "disappear" when he claims the ABIL on his return. He will no longer be entitled to take out the $154953 tax-free and will have to pay income tax on any amounts "repaid". The Canada Revenue Agency will not allow Jack to withdraw funds that he had previously declared to be "uncollectible" without paying the tax.

From a corporate perspective, the books and records of the company will continue to show the large shareholder loan. There will be a discrepancy between the company's Balance Sheet and the "Income Tax" Balance Sheet belonging to Jack the Shareholder; or

(c) a third but unfavourable option is for Jack to sell his shares to a third party who might be

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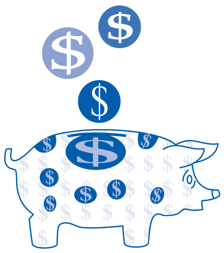


how the company had been able to "cheat" the emission tests for so long.

A "whistle-blower" is anyone who has and reports illegal activities taking place in an organization to the public or those in authority.

Whistle-blowers can be employees, suppliers, contractors, clients or individuals who somehow become aware of illegal activities taking place in the organization, either by witnessing the behaviour themselves or by being told about it.

One aspect of the employer-employee relationship that never seems to get any attention is the employee's absolute "duty of loyalty" to the person or company for whom he is employed.

The one exception to this doctrine, however, is the employee's right to "whistle-blow" against the employer in situations of "public interest". In the case of employees, since they are only privy to certain areas of the employer's business, whistle-blowing tends to centre around work-place issues such as health and safety concerns. But for the whistle-blower to be successful, the matter at hand must go beyond his own work-place experience and touch institutional wrong-doing. There must be a substantial public interest dimension.

Before going public, employees have a fidelity obligation to "go

interested in acquiring a company with a large loss carryforward.

The "value" of the loss can be determined as $154953 times the corporate income tax rate which varies depending upon the province in which the company is operating. In Ontario, the current rate is 15.5% so the losses have a nominal value of approximately $24000.

It is unlikely that Jack could ever sell his shares for this amount. The "going rate" is about 5% of available losses. So Jack might realize $8000 or so in the marketplace.

When Jack sells his shares, he will realize a capital gain on the disposition. Since the shares can be classified as "qualifying small business shares" he will apply a portion of his Lifetime Capital Gains Deduction on his realized gain, effectively negating this transaction for personal income tax purposes.

He sells the shares for $8000, they have an Adjusted Cost Base of $2 and his capital gain is $7998. Only one-half is taxable and due to the exemption above, he will get to keep it all

Exhibit One

Jack's Corporation Inc.
Balance Sheet
December 31, 2015

	$	$
Assets		
Cash		2
Liabilities		
Loan from Shareholder		154973
Shareholder's Deficiency		
Share Capital	2	
Deficit	-154973	-154971
		2

Exhibit Two

Jack's Personal Income Tax Return 2015

	$
Proceeds of disposition (notional)	1
Less: Loan to corporation	154973
Total loss	-154972
	x.50
Allowable Bus Invest Loss (ABIL)	-77486

$77486 loss is considered a business or "non-capital" loss. It can be applied retroactively up to three years or applied anytime in the next twenty years.

Corporations and Their Shareholders (Part Two)

Let's change the information from Part One slightly to see another aspect of the relationship between a shareholder and his corporation.

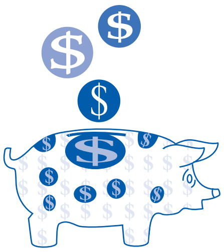
In Scenario #1 the losses Jack incurs in his business are recorded on a yearly basis and accumulate to a total of $154973. They are shown as a Deficit in the Equity section of the Balance Sheet and are offset through the Shareholder's Loan account.

In Scenario #2 Jack records his losses in a different way. Instead of writing them off year-by-year he treats them as an investment and capitalizes them. They are shown as an Investment on the Balance Sheet and are offset through the Shareholder's Loan account (just like Scenario #1 above).

By so doing, his corporation's balance sheet will look as Exhibit Three below.

Jack's Corporation Inc.
Balance Sheet
December 31, 2015

	$		$	$
Assets		Liabilities		
Investment	154973	Loan from Shareholder		154971
		Shareholder's Equity		
		Share Capital		2
		Retained Earnings	NIL	2
				154973



up the ladder", exploring reasonable steps in reporting the problem internally. Only once these avenues have been exhausted, or the individual at the next level "up" is the one who has been authorizing the illegal activities, can the employee tip off the authorities or the media.

This helps ensure that the employer's reputation is not damaged by unwarranted accusations and defamatory attacks based upon inaccurate information.

The Canada Revenue Agency has initiated its own form of whistle-blowing by encouraging taxpayers to report on their fellow taxpayers about certain information that they may "have" on their neighbours.

The program has two components: (a) the "informant leads" initiative accepts information from taxpayers concerning "small" complaints pertaining to the deliberate misrepresetation of income and expenses by fellow taxpayers. There is no remuneration for the tipster by the CRA; and (b) the Stop International Tax Evasion Program targets illegal international tax shelters. Once $100000 of federal tax has been recovered, the CRA will pay informants a percentage of the funds as a "reward". The identity of the informant is confidential and the money is paid out only after all appeals have been exhausted. The informant must not have had any connection to the fraud.

In the previous article, Jack had three choices concerning his large accumulated losses and one of them was to persevere and continue the business.

The question is how to apply previously incurred losses against future income.

In Scenario #1 the losses have been accumulated on a Carried Forward basis for income tax purposes. As earnings are generated they will be applied to the accumulated balance until such time as they have completely offset all losses previously recorded. See Exhibit One (previous article).

In Scenario #2 the losses have been capitalized over the years and treated as an investment. But now that the company is generating income, Jack must "write down" his investment on a yearly basis and record that amount as an expense.

This "expense" can be used to offset earnings generated from operations until such time as they have completely utilized.

In both Scenarios Jack has recouped his losses and been rewarded for his optimisn.

2016 - The 25th Anniversary of the GST/HST

It is hard to argue against the notion that the Goods and Services Tax that has now morphed to become the Harmonized Sales Tax is anything more than a "tax grab".

Look at the accompanying article, for example. Mark is clearly making a modest income from his real estate efforts. He has made $2033 in taxable income and even if he does this as a "side-line" and "has a real job" where he makes $100000 per year, the amount of additional income tax he will pay will be $600.

The HST on the other hand is really a "flow through". He collected $4102, spent $3804 on the expenses he incurred, and will give the difference back to the government. He is no further ahead for having participated in the scheme.

But at least he was in a zero-sum situation. The ones paying the tax are Mark's clients who must look at it as just another cost to be borne in their real estate tranaction.

All of us have expenditures that we incur that we cannot "write off" anywhere. So the HST that we pay goes to the retailer or service provider for him to forward to the government after deducting the expenses he had to pay to provide us with what we wanted in the first place.

The government will tell you that if you do not want to pay the tax, don't consume the good or service in the first place. That is all well and good but the tax is so pervasive that there are very few items that we can choose to give up that will not fall into their pervue.

None of this is new. We've known about it and complained about it for twenty-five years, when the rate was 5%, when it increased to 7% and now at its 13% level,

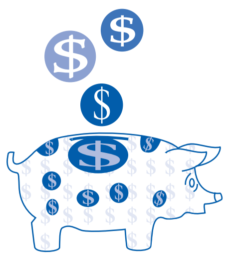
The only thing that we cannot be sure of is if the good or service provider does not actually take the money he identified as GST or HST and pocket it. In that case the purchaser of the product or service would have been better off finding someone to provide the item for "cash". At least he would have accepted the terms of the transaction for what they were instead of being taken for a ride and treated disrespectfully.

That is the purpose of GST/HST government audits. To keep these situations honest.

Let us hope that politicans will one day get their act together, and stop spending our money like it is coming from a bottomless pit. They should realize that every extra 13% we pay as tax is an amount of money that is being drained from productive use in the country's economy.

How to Correctly Report Commission and Self-Employment Income

There is one common mistake made by self-employed taxpayers and those who claim expenses incurred when earning commission income. This is in the treatment of the HST component included in the revenues received and the expenditures made. Here is an example of how it should be done:



PART ONE: REVENUES/INCOME RECEIVED

If you are self-employed it is usually easy to separate out the HST received from the revenues earned. Commission salespersons have to look behind the number printed on the T4A slip they receive to understand exactly how it has been derived. See the accompanying box outlining what Mark earned during the year.

Mark received his T4A slip from the Real Estate brokerage where he earns commission income for the real estate he sells. The form itself had only one number on it $31525.62.

During the year, Mark's transactions with the company were as follows:

	$	
Commissions earned	34258.56	(a)
Add: HST paid to broker on commissions earned	4102.24	(b)
	38360.80	
Less: Brokerage charges for "desk fees" (incl HST)	1712.94	(c)
Less: Brokerage charges for "partnership fees" (incl HST)	990.00	(d)
Less: Brokerage charges for "admin fee" (no HST)	30.00	(e)
What Mark "took home"	35627.86	

The company used (a) and subtracted (c), (d) and (e) to arrive at their figure. But Mark will have to adjust these figures when preparing his income tax return if he is it do it correctly.

PART TWO: EXPENDITURES INCURRED

Before considering the expenditure incurred by the taxpayer, it is must be determined whether he has been registered with the Canada Revenue Agency (CRA) and assigned a Harmonized Sales Tax (HST) number. If his cumulative earnings have exceeded $30000 he should have have one by now and is expected to file a separate HST return along with his personal income tax return for the year. If so, he must examine his expenses and determine the amount of HST (if any) in them and separate it out. Here is a summary of Mark's expenditures:

	Total $	HST Comp $		Tax Expense $	
Mark incurred these expenses					
Advertising (see note)	737	85		652	
Interest	2936	n/a		2936	
Office expenses	8243	948		7295	
Telephone	4543	523		4020	
Auto and travel	13910	1600		12310	
Computer expenses	2053	236		1817	
Training	875	101		774	
	33297	3493		29804	
Charges from brokerage firm					
Desk fees (b)	1713	197		1516	
Partnership fees (c)	990	114		876	
Administration fee (d)	30	n/a		30	
	36030	3804	(g)	32226	(f)

PART THREE: CALCULATE TAXABLE INCOME AND HST POSITION

To determine Mark's taxable income on his commissions, compare his commission earnings of $34259 ((a) above) and deduct his expenditures of $32226 (f). The difference will be recorded as income on his income tax form. To determine Mark's HST position, compare the HST he collected of $4102 ((b) above) and deduct the $3804 (g) that he paid in HST. The difference is paid back to the government

PART THREE: CALCULATE TAXABLE INCOME AND HST POSITION

If you paid $737 for advertising during the year and you want to figure out the expense portion and the HST portion, simply divide $737 by 1.13 and get $652 (rounded). This is the expense. The HST is determined by subtracting $652 from $737 to get $85. Alternatively, take the $737 and multipy by 13 and divide the product by 113. This will give you the $85 HST (rounded). You deduct the $85 from $737 to arrive at the expense.

Tax fraud is defined as any purposeful failure to declare income you have received with the intention of avoiding income taxes or to qualify for government sponsored social benefit programs. Typical examples include record free cash transactions, undeclared income, unclaimed tips and gratuities and the claiming of expenses to which the taxpayer is not entitled.

The frauds can be reported online, through the mail, by telephone or fax. In the case of (a) above, tips can be made anonymously. There is even a provision for taxpayers to voluntarily come forward and report themselves!!

If you do report the suspected fraud anonymously, the CRA will withhold your identity to the public. They will also maintain the confidentiality of the fraudster, any investigations they may have conducted, and the results of these investigations based on the information you provided.

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