VERSION 2

SPRING 2018

THE Quarterly Dividend

Vol. 27 No. 2 Your guide to income tax & financial planning

FAST TRACK

Listening to the Radio on Sunday Mornings Can Be Detrimental to your Wealth!!

Listening to "AM Radio" at any time of the week is useful if your want to know the time, the weather, some local news or perhaps the sports headlines. But on the weekend, when station managers attempt to fill in their programming as inexpensively as possible, you

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The Shareholder Advances Account

There is one aspect of "small business" accounting that seems to baffle shareholders whether they are new to their business or are seasoned veterans who have been in business many years. This is the "Shareholder's Loan or Advances" account.

Lucy operates her business through a corporation. Because the company is considered to be a "separate entity" from its owner, there has to be a mechanism where transactions between herself and the company are recorded. This is especially true in owner/managed companies where the owner conducts daily transactions using "corporate funds" that are not all necessarily for business purposes.

Let us look at the kinds of transactions that will go through this account:

Debits - Shareholder Withdrawals

(a) cash payments to shareholder from business funds:

(b) shareholder's personal expenses paid through the company

Credits - Shareholder Contributions

(a) initial cash infusion into the company to get it started;

(b) repayment by shareholder for expenses incurred by the business on behalf of the shareholder;

(c) receipt of dividends declared by the company in favour of the shareholder;

Payments that she receives from the corporation must be tracked and any funds she advances to it must be segregated from the company's revenues and other funds that it might receive.

In order to facilitate record-keeping, a special shareholder's advances or loan account is set up on the books of the company. The "ins and the outs" of this account determine on an annual basis whether the shareholder is in "debit" or "credit" balance at year-end.

The most important thing to remember is that the shareholder must always be in credit balance at year-end. In other words, the company must be in a position of owing the shareholder money at year's end and not the other way around. Because if the shareholder is in a debit balance, it means that she has taken out more money from the company than has been recorded for income tax purposes. The Canada Revenue Agency wants to be assured that taxes have been paid on any amounts withdrawn.

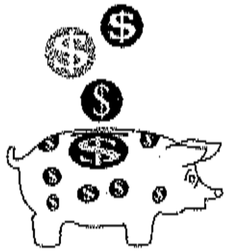
Let's examine some of the usual transactions in Lucy's shareholder's advances account:

(a) in addition to her weekly payroll cheque, Lucy writes herself cheques from the company when it "has money" and she would not mind having some additional funds for herself. These are shareholder withdrawals;

(b) every month the company's internet and cellphone bills are paid through her personal VISA account. These are clearly advances by Lucy to the corporation and she must make sure that not only are these expenses recorded as business expenditures but she will "get paid back" from the corporation;

(c) from time to time, when it is more convenient to pay cash for certain corporate expenses, she pays these items personally. She will be re-imbursed for these expenditures through the shareholder's loan account rather than worrying about paying herself back for small items on an individual basis.

REMEBER: THE ACCOUNT MUST BE IN CREDIT BALANCE AT YEAR-END!!



can be sure to hear "specialty shows" as local businesses buy up "airtime" and produce shows on gardening, home renovations, the latest "conspiracy theories", trivia and of course financial "advice".

I am sure that most of the information is both well meaning and accurate. But of course you have to pay attention to exactly is what is being said if you are to take any of their advice seriously. They always advise the listener to "obtain professional guidance before proceeding with what they hear" and this is 100% to be acted upon!!

One recent local show was discussing Tax Free Savings Accounts. And the commentator recommended treating them as listeners would otherwise treat their personal bank accounts at the mall. This got me to thinking about the special rules you have to be aware of when contributing to and withdrawing money from a TFSA. Here is what you need to know:

(a) annual contribution limits were $5000 for years 2009 to 2012; the next two years were $5500; $10000 was allowed for 2015, and

A New Look at Income Splitting

The Jones own a rental property whose income is declared annually on their personal income tax returns. They live in Ontario. Here is what they show:

	$	$
Rents received		21,000.00
Expenses		
Insurance		600.00
Mortgage interest		4,200.00
Property taxes	2,280.00	7,080.00
Rental income		13,920.00
Allocation:		
Spouse A		6,960.00
Spouse B		6,960.00
		13,920.00

Most families divide the rental income between the spouses, usually on a 50-50 basis. What they do not realize is that each individual "renter" can deduct any additional expenses that he incurred on his own against his share of the rental income.

Thus if Spouse A had to borrow funds (that Spouse B did not) for them both to come up with the required downpayment when the property was first purchased, then the interest on this loan would be deductible from the reported rental income declared by Spouse A.

This will result in the two spouses showing different rental income figures on their individual income tax returns.

This is okay as long as both spouses have incomes that are relatively equal. But what happens when one spouse earns more than the other.

Then the following scenario might "work".

	Spouse A	Spouse B
Employment income	35,000.00	50,000.00
Rental Allocation:	6,960.00	6,960.00
Total	41,960.00	56,960.00

Note that the total family income is $98920 and the difference between the incomes reported by Spouse A and Spouse B is $15000.

The best tax planning is when both spouses are paying income taxes at the same marginal rate.

For federal income taxes, the first income tax bracket goes from $1 to $45282. The tax rate is 20.05% in Ontario.

The second bracket adds an equal amount and covers $45283 to $90564. The tax rate is 29.65%. If we can find a way to (a) raise the income of Spouse A closer to or above $45282 so that he will be closer to the income of his wife; or (b) reduce Spouse B's income to approximately the same figure, we will have both pay income tax at the same marginal rate.

The ideal way of accomplishing this goal might be to have the rental property "pay" Spouse A a salary. Thus any additional dollar of income he will "pick up" will be a dollar deducted the income of his spouse.

Let's try a salary of $13540.

Rental income (above)	13,920.00
Less: Salary expense	13,540.00
Revised rental income	380.00

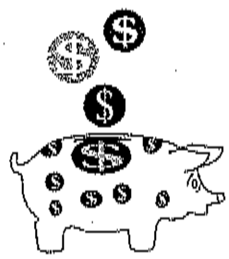
The rental income has now been adjusted to $380 split 50-50.

Spouse A would be responsible for declaring the additional salary on his personal income tax return.

Their income tax returns would now look like this:

	Spouse A	Spouse B
Employment income	35,000.00	50,000.00
Net rental income	190.00	190.00
Rental salary expense	13,540.00	
Total	48,730.00	50,190.00

The total amount of family income has remained constant at $98920 but we have closed the gap between the reported incomes of the two spouses to $1460 (the difference between $15000 and $13540). Each is now comfortably in the second bracket.



back to $5500 for 2016, 2017 and 2018; (b) any unused room can be carried forward; (c) withdrawals are easy but replacing them have their own special rules which can best be explained in the form of two examples:

Example One: Sandra did not miss making her maximum annual contributions from 2010 to 2013 but only had $2000 to "put in" for 2014. Since the annual maximum was $5500 in 2014 and she only put in $2000 she can carry forward $3500 to 2015. She can therefore contribute $3500 from above and $10000 otherwise allowed for a total of $13500 in 2015.

If she withdraws $1000 from the TFSA account in 2015, it will affect her room but not until 2016.

Her 2016 contribution limit will be the $13500 available at the end of 2015, plus the $5500 otherwise allowable. There is plenty of room to replenish her previous $1000 withdrawal.

Example Two covers the situation where Sandra would like to replace all or a portion of the withdrawals in the same year that they had been taken out. This is only possible if she has sufficient

Contributing to the Canada Pension Plan (Correctly)

This article comes with some "homework" that it would be best attended to sooner rather than later.

It is important that you understand that there is a correlation between the way an owner/manager's self-employment income is recorded on his personal income tax return and whether or not he is making contributions to the Canada Pension Plan.

If you are being paid as an employee of a corporation and you receive a T4 from the company for which you work, you have nothing to worry about. The T4 is prima-facie evidence that Canada Pension Plan contributions are being made on your behalf and your earnings.

However, it you prepare your own income tax return or have someone else fill it out on your behalf, make sure that your "remuneration" is recorded on line 135 as net self-employment income, line 137 as net professional income or line 139 as net commission income.

The form will "automatically" pick up the "employee portion" of the Canada Pension Plan required portion on line 222 on page three and 310 on Schedule One and the requirement for payment on line 421 on page four of the return.

Common mistakes by income tax preparers show this income incorrectly. They list it on either line 104 as "other employment income" or "other income" on line 130. In either case, the income inclusion will be on the form, but the taxpayer will not be contributing to the Canada Pension Plan as he might have intended.

To make sure that you have not had your earnings "misallocated" over the years, request a current "Statement of CPP Contributions" from Service Canada or the Canada Revenue Agency.

In some cases, the Agency corrects the placement of the income to its proper line, but sometimes it does not notice the "error". If you fall into this situation, ask if it is possible to go back and correct the errors, now that they have been drawn to their attention.

The Emotional Cycle of Working with a New Client

Some entrepreneurs like the "excitement of the chase". They get introduced to a potential new client and go into "overdrive" trying to figure out how they will attract and keep the new business.

Other entrepreneurs are not like that at all. The "fun" of being in business is not to see how many new clients you can secure in one year, but rather one of forging a business relationship between yourself and the business owner. The goal is to work together, learn from each other, and face whatever challenges lie ahead successfully.

Attached you will find a curve outlining the various emotions experienced by the entrepreneur:

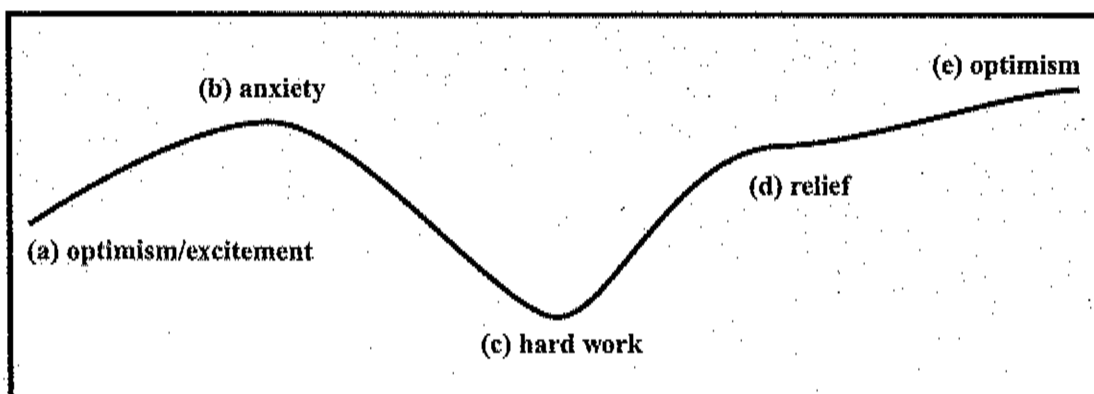
(a) optimism/excitement at first "signing up" the client;

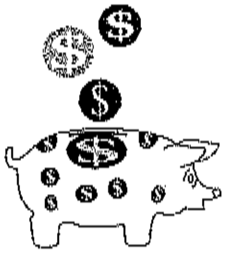
(b) this is followed by anxiety as you learn more about the client, assess what work will be required to service his needs;

(c) hard work is next as you figure out the "ins and outs" of the new client and "get to work";

(d relief follows a job well done;

(e) finally, optimism that this will be the start of a long-standing business relationship together.





contribution room. And she should take care in her calculations.

Same situation as above but instead of withdrawing $1000 in 2015 she takes out $20000.

Her 2016 contribution limit will be the $13500 available at the end of 2015, and the $5500 otherwise allowable for a total of $19000. She can also work on replacing the $20000 but it is considered as one withdrawal of $20000 and not some package of smaller amounts. She doesn't have enough room to replace the funds this year and will have to wait until 2017.

At that time she will have the $19000 calculated above plus the $5500 annual allowance. This gives $24500 contribution room which is more than enough to allow the $20000 replenishment.

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.

A Tale of Two Charities

Charities come in all different shapes and sizes with varying purposes that they wish to attain for their supporters.

There is no "one way" to conduct your affairs, be you a "for-profit" entity or one that is "not-for-profit". The question becomes one of "efficiency". Is the organization going about its charitable endeavours in a manner that is "lean and mean"? Or is there a lot of "waste" where contributors' money is not going as effectively as possible to the fulfillment of the charity's goals? Here are two charities with different goals and ways of approaching them. Here is a "snapshot" as to how each goes about "its business".

	Charity A	Charity B
Charitable Activity	Raise money to send to network of needy low income individuals in countries where donors have chosen to underwrite the needs of those communities.	Raise money to construct and maintain "brick and mortar" church as a local place of worship, perform on-going outreach to the community, and assist local low income individuals in the community.
2017 Donations	$700,000	$1,600,000
2017 selected expenses		
(a) Salaries	$NIL	$70,000
(b) Charitable activity above	$640,000	$70,000
(c) "overhead"	$42,000	$111,000
(d) amortization	n/a	$225,000
Excess of receipts over expenditures	$18,000	$584,000
2017 selected assets		
Cash	$285,000	$350,000
Property, plant and equipment	n/a	$1,672,500
2017 selected liabilities		
Bank loan	n/a	$7,750,000
Members' loans	n/a	$5,600,000
2017 capital	$285,000	$3,725,000