

# THE Quarterly Dividend

Vol. 27 No. 3 Your guide to income tax & financial planning

## FAST TRACK



### Unconventional Wisdom

If you are like most people the first number you look at when scanning your annual personal income tax return is the line that indicates whether you owe taxes to the government or you can expect a refund from them after submitting your return.

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## Court's in Session and You be the Judge!!

### Case One:

Jessica and Judy share the costs of renting office space for their individual accounting practices. They also go 50-50 in the cost of equipment each will require on a daily basis. So when the high speed printer needed to be replaced, Jessica purchased a printer for \$1000 and Judy re-imbursed her for her share by giving her a cheque for \$500.

While at the checkout, the cashier asked Jessica if she might be interested in purchasing a warranty for the printer. It was good for five years and covered 80% of the replacement cost of the machine if it ever broke. Jessica gladly paid the extra \$50 and returned to the office. She put the paper in her file and forgot about the additional purchase.

As luck would have it, the printer broke down within its first two years of use. Jessica and Judy both agreed to repurchase the same make and model of printer once again, should they still be for sale for \$1000. Jessica remembered her warranty agreement and went to the store to replace the original machine for only \$200.

Upon arriving back at the office, Jessica told Judy about her good fortune.

Judy thereby exclaimed that she therefore only owed Jessica \$25 for the warranty and \$100 for the cost of the replacement unit.

Jessica disagreed. She maintained that Judy should give her \$500. She explained that had she not purchased the warranty two years previously, then each would have been out of pocket \$500 for the replacement. It was now Judy's responsibility to pay for half of the printer, and her half would be covered by the warranty.

You be the judge. Who is right? How much does Judy owe Jessica?

### Case Two

Sandy is a regular customer at Joe's Pizzeria and an avid Bitcoin user. One evening while enjoying a dinner out with the family, she spotted a sign over the cashier's desk that read "We now accept Bitcoin payments. Complimentary dessert for anyone paying with Bitcoin".

When they placed their order with the server, Sandy mentioned that she would be paying with Bitcoin, and would therefore be taking advantage the complimentary dessert.

When the meal was completed, the cost of the evening's festivities was \$150 when the value of a Bitcoin was \$5000. This translated into an amount owing of .03 Bitcoin.

Sandy immediately tried to pay the bill, by using the app on her phone. Unfortunately, the service was down, but Joe told her not to worry as she was a valuable customer and would accept the Bitcoins the next day.

The next day stretched into a week, and Sandy went back to Joe's to pay her bill. She offered Joe \$150 in cash, but he refused saying that the arrangement between the two had involved payment in Bitcoins.

On that particular day, the value of a Bitcoin had spiked to \$8000. Joe explained that if Sandy wanted to pay cash, he would accept payment of .03 Bitcoin at its current rate. The meal now was to cost \$240.

You be the judge. Is the cost of Sandy's meal \$150 or \$240?



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This alone makes many to believe that this line is the most important piece of information on the form.

Unfortunately, they would be incorrect.

The information on this line only tells you your position before settling up with the government. It does not tell you whether the calculations of such defined terms as "total income", "net income" or "taxable income" have been determined correctly. Nor does it consider the claiming of "non-refundable tax credits".

This makes these other lines "more important" on the income tax form.

There are often several different ways that an income tax return can be filed and choosing which one is the

## A Bit About Bitcoin

- (a) What - a crypto currency is a medium of exchange intended to act as an alternative to government issued fiat currencies. It is without physical substance and not linked to any currency, backed by any governmental central bank, legal entity, underlying asset or commodity. Holdings of crypto currencies allow individuals and businesses to transact directly with each other without any intermediary;
- (b) How - transactions consist of one or more "inputs" and "outputs". Transactions rely on a technology called "block chain", which serves as a registry of bitcoin addresses known as "keys". To make a purchase the user must know the "key" to the supplier with whom he is transacting and digitally sign the transaction;

Many merchants who accept bitcoin as payment do so through bitcoin payment service providers. These providers shield their clients from some of the price volatility associated with accepting bitcoin payments directly by allowing them to transfer bitcoin receipts to fiat money on a daily basis.

- (c) Price volatility - the price of bitcoins has gone through cycles of appreciation and depreciation referred to by some as bubbles and busts. As of June 15, 2018 bitcoins traded at \$8554 Can per bitcoin and there are 18 million bitcoins on the market.

It's all-time highest valuation was in December 2017 at \$25972 Can.

Due to the high value of the bitcoin, merchants need to trade in fractional values of the current market rate at the time of the transaction. Please see Case Two in the accompanying article to understand how valuations can fluctuate continually throughout the day and that a merchant or customer must "lock in" the valuation at that particular moment or risk having the value change (either up or down).

Because of Bitcoin's decentralized nature, nation states cannot shut down the network it has created or alter its technical rules. That has not stopped certain jurisdictions' attempts to ban or restrict its use. In May 2018 the United States Department of Justice launched an investigation into possible price manipulation regarding futures settlement dates citing a history of hacks, fraud and theft involving bitcoin dating back to 2011.

- (d) Income tax implications - the Canada Revenue Agency considers transactions involving crypto currencies to be subject to income tax under the same rules that apply to barter transactions. This suggests that the enterprise will be considered to have sold goods or provided services at a price at which it would normally have charged a third party;



## The Loneliest Man in Town

It's a well known fact in our society that the elected government of the day enacts legislation but it is the bureaucrats in the Civil Service who are charged with interpreting and enforcing the laws. We see it at the airport when you come through customs and when the policeman hiding in a "speed trap" captures you going "over the posted" speed.

In most cases the civil servants do their jobs well, but the most important part to remember is that you are dealing with them "face to face" as they select your number from the baggage retrieval area or when they pull you over to the side of the road and remind you about how

quickly their radar guns have clocked you.

This "one on one" relationship allows you to look the government official in the eye and argue your case in person even if only for a few minutes. Later on if you are not satisfied with the initial outcome, you can speak to a supervisor at the airport or have your day in court with regard to the traffic ticket.

The same cannot be said in regard to taxpayers' relationships with the government employees of the Canada Revenue Agency.

In recent years, the Agency has become more intrusive in the lives of taxpayers, while at the



correct one for you in any particular year will be the challenge you face every April.

The determination of total income will include earnings that you have had during the year. But sometimes there are ways to defer some or all of these earnings to a later taxation year. This would make the calculation of total income look very different.

A similar notion exists for the determination of net income. Sometimes it is wise to "save" some of your RRSP contributions and apply them in a future year when your income is expected to be higher.

And the same goes with how you arrive at taxable income. In this area it is primarily the claiming of non-capital or net capital losses from other years that may be available for

same time making it more difficult to have matters attended to quickly and efficiently should a "disagreement" arise.

In previous years, those filing "straight-forward" income tax returns could expect them to be assessed with a minimum of questions being asked by government employees. If the taxpayer claimed a certain amount in donations for the year, there was no need to require him to produce receipts to back up his claim. It was accepted that most taxpayers were honest and were unlikely to "cheat" on items that could so easily be scrutinized.

That is no longer the case. In language reminiscent of George Orwell's novel, 1984, the Agency has set up a "Refund Integrity" section to make sure that no taxpayers are given refunds on the overpayment of their taxes without being considered at least twice before the cheque is ultimately sent out.

This can be termed "bureaucratic arrogance" and continues a trend that was started a few years back. At that time the Agency closed its doors to the public and denied all taxpayers the opportunity of going to their local CRA office to deal "face to face" with a tax department clerk who could consider their particular circumstances and assist them in resolving "day to day" problems.

The CRA of 2018 has established "tax services offices" in places that are far from the major metropolitan cities of our country. It is not unusual to call the Agency's 1-800 telephone line and be connected with someone hundreds of miles from your home. Or have them assign

your file to someone with whom you will only be able to communicate via fax or Canada Post.

Issues that can result in thousands of dollars having to be paid to the Receiver General are only considered by CRA auditors who cannot be easily accessed or contacted. No matter how "well meaning" these representatives may be, without actually sitting in the room with them and personally outlining your concerns, you will never be afforded a "fair shot" at having your situation properly considered.

Without personal contact, taxpayers must hope that the person on the other end of the line is the right person for their particular situation. Someone who understands what they are trying to convey and how they arrived at the position they are sitting in today. Someone who is willing to work with the taxpayer in having it resolved as best as can be expected within the taxation laws.

It is commonly known that when dealing with anyone on business or personal matters, a lot of the success of that endeavour depends upon the goodwill of the parties involved working together attempting to resolve issues as they come up.

This is still possible with today's Canada Revenue Agency. Sometimes a taxpayer "gets lucky" and comes upon an auditor who has been assigned his file who will be of this mind set. Sometimes he will not be so fortunate. Like in so many other things in life, taxpayers too must work with the hand they are dealt. My only hope is that it is free of bureaucratic arrogance.



## Shareholder Advances (Part two)

An article In the last issue mentioned the importance of shareholder advances to owners of owner-managed corporations. This article will continue the discussion.

The corporate framework separates the shareholder from the entity he has created to operate his business. Whatever earnings are generated are taxed in the corporation and then must be withdrawn from the company to be taxed a second time in the hands of the owners.

This seemingly simple concept alludes many shareholders (and their accountants) so that the topic of shareholder advances is the most

widely misunderstood concept in the world of "small business".

To understand the issues involved, first start off with the basic accounting equation of the balance sheet. This is that the total of the company's assets must equal the sum of its liabilities and its owner's equity.

The company's assets are easily determined. They are its cash, inventory and equipment to name a few.

The liabilities include the amounts owing to outside parties and the shareholders themselves if they have lent the company funds.



use today or held onto for a future tax year.

Finally, there are the non-refundable tax credits where the taxpayer can choose to claim all or part of his medical expenses this year or next or charitable donations this year or sometime in the next five years.

It is not always the best taxation strategy to maximize this year's refund or keep the current year's tax liability down. You have to be aware of what your future taxes will look like and prepare your form with that knowledge in hand.

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The company's equity is defined as the owner's original investment in the shares of the corporation and its accumulated earnings (and losses) since commencing operations.

At the beginning of each year, when the books are closed from all transactions that took place the year before, the shareholders of the company are well aware of the amount of equity the company has on its books.

Since this figure is already known and accounting equation must always balance, the only two factors that change during the year are the company's assets and its liabilities.

In the accompanying balance sheet you will notice that the company's total amount of assets equal the total of its liabilities (\$8000) and owner's equity (\$12000).

Drilling down to specific accounts, you will notice that the company had a cash position of \$3000 and a shareholder loan account of \$2000.

This means that although the company had the cash on hand to repay the shareholder for the advances he had made on behalf of the corporation (and a little bit more), the maximum he could withdraw from the company would be the \$2000 to which he was entitled.

This amount would be received "tax-free" as it was a loan repayment. Any additional funds he might desire from the company would have to be given to him as a taxable distribution via

salary or dividends.

It is essential to note that the company must always have a shareholder loan account on its books in the liabilities side of the ledger. If the shareholder, in our example, took out the entire \$3000 in cash from the company, his loan account would change from being a company liability where it owed him money, to a corporate asset where it was now being owed money by him. The CRA recognizes this situation as a "taxable event" and charges the shareholder income tax on the \$1000 he took beyond his loan. He would now be responsible for the taxes on the \$1000 and have to repay the loan to the corporation.

	\$
<b>ASSETS</b>	
Cash	3000
Accounts receivable	2000
Inventory	10000
Equipment	5000
	20000
<b>LIABILITIES</b>	
Accounts payable	6000
Shareholder advances	2000
	8000
<b>OWNER'S EQUITY</b>	
Share capital	1000
Retained earnings	11000
	12000
	20000

## A Ninety Day Challenge

Canadians are not known for being a nation of complainers. Our winters may be long and cold, our summers too short and of course a Canadian based hockey team has not won the Stanley Cup for a least twenty-five years. But we never tell each other that we have been given the short end of the stick in this world.

But put two (or more) individual Canadians in a room and each will have no qualms telling the other about how he was dealt a "lousy hand" and that his situation is becoming next to intolerable.

His friend will commiserate with him, and then try to "one up him" in the misery department. He will ask, "Do you really think

you have it so bad? Wait until you've heard my story!!"

This national pastime has become out of hand. Conversations between friends should not dwell on "aches and pains" to the exclusion of some talk about more pleasant and exciting things.

So here is a challenge for the Summer Quarter. For the next ninety days, make a conscious effort not to participate in these kinds of conversations. If the person you are with starts to go down that road, change the subject and politely tell him that all this kind of talk puts you in a "bad mood" and you want to try and enjoy the summer. Because we all know that they are too short!!

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