SPRING 2015

THE

Quarterly Dividend

Vol. 24 No. 2

Your guide to income tax & financial planning

FAST TRACK

Learning from the Big Guys

One way of going into business for yourself is by purchasing an existing business, and sometimes the owner may have several offers "on the table" from which to choose.

Buying a business is not like purchasing a house. In the last few years, buying a residential home in Toronto, Vancouver and other Canadian cities has seen a over abundance of buyers in the market and a relative scarcity of sellers. This

In this Issue:

Understanding Loans

Shakespeare wrote "neither a borrower nor a lender be" but he was never a small businessman looking to finance a venture. Today, it is the rare entrepreneur who can heed his advice. The rest of us have to at least understand what we're getting into when we go into debt. Both commercial and private loans consist of the following ten provisions:

(a) the parties: the lender and the borrower (either as individuals or as corporations) enter into a binding loan agreement or contract which each should have reviewed by a lawyer prior to signing;

(b) loan purpose: the lender must approve what borrower will do with the money;

(c) guarantor: he will repay the loan if the borrower cannot, usually termed a "third party";

(d) loan amount: the amount of money lent, termed the "loan principal" or the loan proceeds;

(e) interest rate: determined as a fixed rate or in relation to "prime" and stated as "prime plus x%", always calculated on a per annum (per year) basis on the amount of the loan still outstanding (not repaid). The rate is set based upon the perceived "riskiness" of the loan. The higher the risk, the higher the interest rate;

(f) interest calculation: daily from day loan is advanced;

(g) principal repayment: depending on the terms of the loan agreement, the loan can be;

(i) "on demand" with the lender able to demand repayment at his discretion, or

(ii) a "term loan" that will call for principal repayment and interest payment together each month (called "blended payments"), or perhaps interest only each month with an agreed upon percentage of the principal permited to be repaid annually or semi-annually;

(h) prepayment: if loan is not "on demand" lender may accept a larger principal repayment than was previously agreed upon. When this occurs, he usually requires a "penalty" for interest foregone under the original loan agreement;

(i) security: lender will want to protect himself from borrower not being able to pay off the loan as stipulated in the contract. He will require borrower to sign a "general security agreement" covering assets purchased with the loan proceeds as well as borrower's others assets whose title will revert to him should the loan go into "default". This is sometimes referred to as a "personal guarantee" from the borrower. It is common when no guarantor has been named;

(j) fees: borrower should expect to pay lender's legal fees and expenses as well as other costs that the lender is in a position to charge.

Same Facts - Two Different Financial Statements

The term "holding company" is used to describe a situation where one company holds a large enough percentage of another company's voting shares to be able to exert control over its operations during a specified period of time.

The holding company is referred to as the Parent Company while the investee is the subsidiary.

Of course, not all subsidiaries are 100% held by their parent companies, and in fact, it often does not make sense for a parent to own any larger

Compliments of

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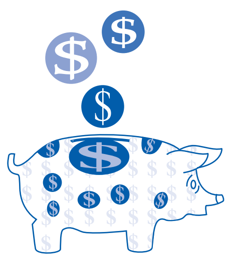


has sometimes led to an "auction" whereby the purchaser offering the most amount of money ultimately ends up with the property. The vendor does not care whether there is a good "fit" between the buyer and the "home", he is just looking for the most cash he can get, and then moves on.

While a seller of a business, too, would like to realize as high a selling price as he can, there are other considerations that come into play when selling a company. For example, he may be more "emotionally attached" to his business than to his home. While it may have been his family residence for many years and the place where he watched his family grow up, the feeling he likely has for his business, and the memories associated with watching it develop and grow over the years (and providing the livelihood that allowed him to own his home in the first place) will often trump the bricks and mortar of a house that could have been located somewhere else and provided roughly the same set of memories.

Another consideration when selling a business is that the owner would like to see the buyers "carry on" the company that he started many years before. While they will undoubtedly make changes and do things differently, he might be

share of its subsidiary than it has to, as long as it can control its operations and dictate corporate policy.

This arrangement, at least in theory, allows the parent to be able to concentrate on making additional investments in other companies with the intent of bringing them into their "group".

From an income tax perspective, the holding company and the subsidiary are treated as completely serparate entities. They recognize separate incomes and pay separate taxes, although that doesn't mean that the parent cannot influence the subsidiary's income tax position through the use of "transfer pricing" arrangements and other intercompany transactions.

From an accounting viewpoint, there are two major ways that the Parent can "carry" its investment in the subsidiary. These are termed the "cost method" and the "equity method". Let's say Holding Company purchases all of the outstanding shares of Subsidiary Company on January 1, 2014 for $2500100 and during the ensuing twelve months the subsidary has a loss from operations of $77207 while the parent company experienced a loss of its own of $83194. Furthermore, during the year the arent advanced $246200 to the subsidiary to help keep it afloat.

See accompanying balance sheet to see how the same set of facts would be shown differently depending upon the way the Holding Company presents its investment.

Under the Cost Method, the investment is shown as $2500100. The funds advanced to the subsidiary are not included in the investment but are reflected separately as a loan to be collected from the subsidiary sometime in the future. Finally, the subsidiary's loss is not reflected on Holding Company's balance sheet, only the loss sustained by the parent company itself. This is a drawback, because the reader will not be able to deduce how well or how poorly the investment has been doing since it was acquired. This can affect decision making as to whether it should be retained or perhaps sold.

Under the Equity Method, the entire investment in the subsidiary is shown as only one figure, $2669093, as determined below. The most important difference in this presenation is that it gives a more complete picture of the Holding Company's investment in the Subsidiary. It takes into account that it lent money to the subsidiary to keep it afloat and that the investment itself incurred a loss since the time it was purchased. The main drawback is that while the presentation is concise, the reader will be hard pressed to figure out the specifics of the investment unless they are disclosed separately in a note to the financial statements.

	$
Investment	2,500,100
Loan to subsidiary	246,200
Subsidiary's loss for year	-77,207
	2,669,093

HOLDING COMPANY INC.
BALANCE SHEET COMPARISON
DECEMBER 31, 2014

ASSETS

	Cost Method $	Equity Method $
Cash	7,000	7,000
Due from Affiliated Company	246,200	
Investment in Subsidiary	2,500,100	2,669,093
	2,753,300	2,676,093

LIABILITIES

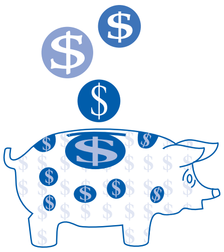
Mortgage Payable	1,625,000	1,625,000
Due to Shareholders	1,211,194	1,211,194
	2,836,194	2,836,194

SHAREHOLDERS' DEFICIENCY

Stated Capital		
300 common shares	300	300
Deficit	(83,194)	(160,401)
	2,753,300	2,676,093

HOLDING COMPANY INC.
STATEMENT OF OPERATIONS AND DEFICIT
FOR THE YEAR ENDED DECEMBER 31, 2014

Holding company's loss for the year	(83,194)	(83,194)
Subsidiary company's loss for the year		(77,207)
Net loss for the year	(83,194)	(160,401)
Retained earnings, beginning of the year	NIL	NIL
Deficit, end of the year	(83,194)	(160,401)



willing to take a few less dollars if he can be sure that the buyers will treat his existing customers in roughly the same manner that they have been accustomed.

In order to assist him in differentiating between competing offers for his business, the owner may ask prospective buyers to complete an Expression of Interest document. This can be beneficial for both parties. The seller will obtain certain financial and non-financial information about the other party, the purchaser will be forced to consider some issues that he may not have thought about when first thinking about making the investment.

The accompanying outline of an Expression of Interest "checklist" can be used as a starting point for both sellers and buyers. It should provide some clarity concerning the transaction both are contemplating.

Awhile back Loblaws Inc. bought a majority interest in Shoppers Drug Mart and was ordered by the Competition Commission of the Government to divest itself of about a dozen of its newly purchased outlets.

The process involved soliciting a document entitled an "Expression of Interest" from parties who were invited to submit bids to purchase one of the stores. To get on the "short list" potential

The True Cost of A Business Expense

When it is time to incur a business expense, the owner/manager of a business will want to determine its "after- tax cost", or the actual numbers of dollars it will cost the company to perform the contemplated activity. This will help it evaluate whether it should be making the expenditure in the first place.

Let's say Limited Company X is considering launching an internet advertising campaign with a budget of $10000 before income taxes. Its income for the year is $100000 pre- tax.

It will depend whether the company is (a) a Canadian Controlled Private Corporation that is taxed at 15.5% or (b) an Other Private Corporation whose tax rate is 26.5%.

As the following table shows, the after tax cost can be calculated as "[1 minus the tax rate] times the contemplated expenditure". So a $10000 expenditure in (a) "really costs" $8450 or $7350 in (b).

For non- incorporated companies, the calculation is identical but instead of using the "flat rate" associated with corporations, the owner/manager must substitute his "marginal income tax rate" into the formula.

	(a)		(b)	
	Without Expense	**With Expense**	**Without Expense**	**With Expense**
	$	**$**	**$**	**$**
Income from operations	100,000	100,000	100,000	100,000
Proposed expense		(10,000)		(10,000)
Income before taxes	100,000	90,000	100,000	90,000
Income taxes	15,500	13,950	26,500	23,850
After tax position	84,500	76,050	73,500	66,150
True cost of the expense		8,450		7,350

The Case of the Missing Housewife

Marvin goes into a police station to report that his wife, Marion, did not come home as expected.

Marvin: "I've lost my wife. She went shopping yesterday and has still not come home."

Sargeant: "How tall is she, sir?"

Marvin: "I think about five feet, something."

Sargeant: "And what about her build?"

Marvin: "She's not slim, but not fat, either."

Sargeant: "What color are her eyes, sir?"

Marvin: "Um...I can't remember."

Sargeant: "And what about the colour of her hair?"

Marvin: "It changes all the time depending on which hairdresser she went to last week."

Sargeant: "What clothes was she wearing when you last saw her?"

Marvin: "I don't remember exactly. It could have been a blue dress, but maybe it was black."

Sargeant: "When she left to go shopping, did she go by car?"

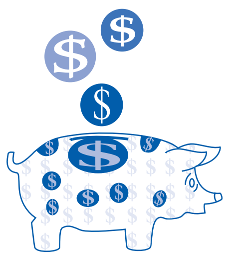
Marvin: "Yes, sir."

Sargeant: "And what is the make of the car?"

Marvin: "It's a 2014 Honda Accord painted a very special silver grey. It has an eigh-speed automatic transmission, a 6.35 litre V12 engine that generates at least 460 horsepower. It has larger than normal alloy wheels, bucket seats, a GPS and unfortunately, a very thin scratch on the front door of the passenger side. And…."

At this point, Marvin started to cry.

Sargeant: "Don't worry sir….we'll find your car!!"



candidates filled out the accompanying questionnaire, from which we can learn what issues were considered important to the screeners. Here is what they want to know:

Identity and Description of Business Today

(a) overview of business

(b) shareholders and directors

(c) Scope and description of products and services offered

(d) Description of marketing efforts

(e) Managerial, operational and financial capability to compete effectively

(f) Commitment to long-term viability and success

(g) Principal advisors and contacts

Identity and Description of Where You Would Like Your Business To be One Year from Now, Five Years from Now

(a) to (g) Same as above

The Family Tax Cut

It's income tax time again and taxpayers and income tax practitioners throughout the country are conducting the annual ritual of filling out the income tax form. And so it is also time to hear that popular refrain common to virtually everyone in the land. How much do I owe/or am I getting back? And why is it more/less this year than it was last year?

It is a common misconception that the most important line on the return is the “bottom line” but that is not the case. Rather than looking at the final result, you should look at how you got there by determining what is being included/excluded in your taxable income, the income tax "bracket" where that income falls and whether you are claiming all of the deductions and credits to which you are entitled.

One new wrinkle for 2014 is the introduction of the "Family Tax Cut" that is available to spouses and common-law partners who reside together in Canada and who both file income tax returns for the year.

Here is how it works: Mary and Tom are married and living together. Both plan to file income tax returns this year.

	Mary $	Tom $	Combined $
Federal Income Tax Before "Income Sharing"			
(a) list their individual taxable incomes	125216	46764	
(b) list their individual Federal tax owing on their incomes	25963	7212	
(c) list their individual "non refundable tax credits"	7074	2204	
(d) subtract (c) from (b) for each and add them together	18889	5008	23897
Adjusted Federal Income Tax After "Income Sharing"			
(e) list their individual taxable incomes	125216	46764	
(f) take 50% of the difference between the two taxable incomes			
$125216 - 46764 = $78452 x 50% (max $50000)	39226	39226	
(g) make them "even" by adding/subtracting as necessary	85990	85990	
(h) list their individual Federal tax owing on these incomes	15841	15841	
(i) list their individual "non refundable tax credits"	7074	2204	
(j) subtract (i) from (h) for each and add them together	8767	13637	22404

Compare (d) and (j). Since (j) is lower the couple qualifies for an income tax savings of $23897 - 22404 or $1493.

Mary will reduce her Federal income taxes payable by $1493 on her income tax return. The maximum is $2000.

Note: There are certain factors that are not shown in this example that will complicate the calculation. These come into play when the "family caregiver amount" is claimed or when certain "non-refundable" credits are transferred between spouses.

What does this mean to you? If you are married or living common-law, the most important number in the calculation is determined at (f). In this example if (f) had been lower than $36063 there would have not been any savings at all. It only came into play when the differences between the two taxable incomes was at least $72126.

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