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THE Quarterly Dividend

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Your guide to income tax & financial planning

FAST TRACK

Do You Pay Bills Before the Invoice Has Arrived?

Let's say you have a leaky roof and you want to have it repaired before the rain comes and causes structural damage to your house. You ask a friend who had a similar problem to recommend a roofer. He obliges by giving you the contact information of the contractor he used. You contact him and explain your

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Working Backwards!!

John F. Kennedy is famous for saying, "ask not what your country can do for you, ask what you can do for your country!"

Accountants have taken this credo to heart but have changed the emphasis. They say, "ask me not how much income tax you are required to pay, tell me how much you can afford/are willing to pay and I will work backwards to make it happen!"

This is not as far-fetched as it appears to be at first blush. For all taxpayers, income taxes are an expense just like food and shelter. You have to feed your family, pay the mortgage or rent and educate your children. These are life's priorities to yourself. Then comes your obligation to others and society, one of which is the requirement to pay your income taxes. All of this from a seemingly ever-diminishing resource base. So if you must budget for the former, the latter should be no different.

Individuals who are employed must report the amounts contained on the T4's they receive on their income tax forms. Taxpayers who receive investment or pension income must report the amounts contained on the T3's or T5's they receive, subject to any "income splitting" amongst family members that they may have set up. However, generally speaking, their flexibility is limited.

The attraction of the owner/operated company is the ability, in many cases, to determine, in advance, the timing and amounts of revenue and expenses that will be declared during any particular taxation year. Once these have been determined, it is possible to "work backwards" and figure out the income tax liability and plan how it will be met.

It is not a question of "tell me how much income tax you want to pay this year", even though that is how it is sometimes perceived. Rather it is a question of planning ones affairs to be able to budget for the taxes and be in a position to meet them when they come due.

How is this accomplished? The most common way is through the progression from a sole proprietorship to a limited company within one calendar year. The last day of the sole proprietorship completes a tax "year-end" for the company. So any income earned from January 1 to that date is taxed in that calendar year.

The date to incorporation signals the start of a new taxation year no matter at what date it is established. If the incorporation date is April 30, for example, the "clock" starts ticking from that date forward, and the shareholder(s) of the company then have the ability to establish a "year-end" anytime within the next twelve months.

A sole proprietor can manage his income, in this situation, for the four months of January to April and then manage it once again throughout say the next nine months as well, if he selects a January 31st year-end. This is because only the income earned between May 1 and January 31 of the following year will be recognized in that second period. From then on, all fiscal periods will run from February 1 to January 31.

The ability to work backwards allows you to plan going forward. Sure you will never know for certain what your income will be for any particular period, but if you do the calculations based upon your best information at the time, you should never be too far off and any surprises will be kept to a minimum.

Compliments of

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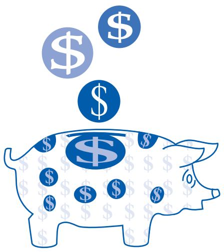


predicament. He comes to inspect the prospective job and is more than happy to give you an estimate as to how much he will charge for the necessary work.

You agree to the implied contract, but nothing has been set down in writing.

He arrives on the assigned day, does the work to your satisfaction and goes on to his next job. A week and then two go by, but yet he has not contacted you about payment for his services. What do you do?

Some would argue that you contact the roofer and remind him of his oversight. This might be an ethical course of action, but frankly you are under no obligation to do so.

Others would argue that it is up to him to keep proper records of the jobs he has done and issue invoices on a timely basis to his customers. They work under the philosophy that the customer really does not know exactly how much he owes the roofer until he has been issued an invoice. Then and only then will he pay the invoice.

You may not particularly like the actions of the those who identify with the second scenario but they do have a point. How can you know how much to pay if there is no invoice? Also, if the expense is allow-

A Common Miscalculation

Here's a story about three children, Stan, Dan and Fran. Their aging mother, Gran, a widow in her nineties, has drafted a will that calls for all her assets at death to be distributed equally when the "time comes".

Stan, however, wants to draw upon his inheritance early, saying something to the effect that he believes his mother will be happier should she see him enjoying his windfall while she is still alive.

The other children are content to wait, believing that no one knows exactly how much their mother will need nor for how long a period of time. Who knows, they reason, maybe she will live for many years to come and will need whatever savings she has accumulated over that period. If a good chunk of the money has been given to Stan, it's as good as gone, for she will never be able to ask for it back.

The mother, however, agrees to give Stan the "advance" he is requesting so that he can put a sizeable downpayment on his first house and not have any mortgage going forward. He is given $300000.

Ultimately, the day arrives and mother passes away. It is now time for the siblings to "settle up" upon their mother's estate. How should this be done?

This is not a difficult question, but many families do not seem to be able to make the calculation. Perhaps it is the fact that they are dealing with a parent's will that lets emotions "get in the way".

However, the simple answer is that Stan should give Dan and Fran $100000 each. The reason, of course, is that original advance to Stan was $300000. He received his own $100000 and $100000 for each of the others. Now that it is time to "settle up", he must repay each of them. It looks like he will have to mortgage the property after all, although he has saved several years' interest in the interval between the time of the "advance" and his mother's death.

Are You Thinking of Doing Your Own Tax Return?

Before the advent of laptop computers and income tax software, the "traditional" method of doing an income tax return was well established. List your sources of income and deductions and calculate your income tax liability for the year. At the end of the exercise, see "where you stand". Do you owe the government any money, and if so, how much? Can you change any of the numbers to arrive at a different result? If so, what numbers and what will be the result?

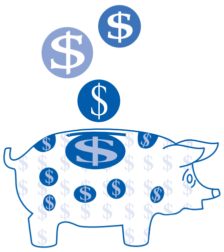
Nothing has really changed over the years. The same procedures are still followed, the only difference now is that as soon as the taxpayer enters the information into the computer, it instantaneously tells him how much he owes or how much he can expect back as a refund. He no longer has to wonder if he has done the calculations correctly, all he has to be concerned about is that he put the correct information in the right place in the program.

In order to take full advantage of the technology, it is in the taxpayer's interest to understand three things: (a) there is typically more than one way to prepare an income tax return; (b) the choices made this year can/will impact future tax returns; and (c) not every line on the return will apply to every taxpayer.

The Summer issue of The Quarterly Dividend highlighted how the same set of circumstances can produce very different income tax outcomes depending upon how they are presented for income tax purposes.

While it is often a good idea to look back and see how income was treated in a prior year, it is not wise to blindly follow whatever was done last year. Every year stands on its own merit and personal circumstances change. It is better to assess this year's income taxes independently from what has gone on before.

The Income Tax Act is a complex document that includes provisions that were drawn up to meet government fiscal policy at the time they were enacted.



able for income tax purposes, the invoice will record the roofer's Harmonized Sales Tax account number and this will allow you to claim the input tax credit when the bill is ultimately paid.

What happens if we alter the above facts slightly? Say the roofer in question is the Canada Revenue Agency and the "quote" issued is a verbal explanation by an Agency auditor of how much additional income tax you will owe once a formal Notice of Re-Assessment has been prepared and sent to you.

Do you rush to the bank and pay the tax bill based upon the word of the auditor, or do you wait until the Agency issues you the Notice of Re-Assessment that you have been told to expect?

In this case, it is clear that you wait for the Notice of Re-Assessment from the Agency. If you pay too early, you will probably be paying the wrong amount as interest and penalties will likely be added on to the actual income tax liability. And then you will have to pay this amount separately. Also there is a strong likelihood that any payment made will be assigned to the current year and not to the year for which the Re-Assessment has been issued.

So just as it is logical and proper to wait for the roofer to

You will not qualify for all of the available deductions listed on the form and you might qualify for others that are included in the caption "other deductions".

Many taxpayers seem to have their own "deduction of choice" that has worked for them in the past and which they employ year in and year out. Once again, do not get "wedded" to one particular way of doing the return. See what's new this year and whether any of it is applicable to you.

This article would be remiss it if did not emphasize the importance of professional income tax advice in the preparation of all but the most basic of income tax returns. The professional can "stand back" from the taxpayer and his particular situation and offer a perspective that may have been overlooked either because the taxpayer had less experience in preparing returns or was too "caught up" in his own situation to be able to weigh all the available scenarios.

Everyone Has Their Waterloo

Back in the early 1970's there was a best selling book entitled the "Peter Principle". The author's thesis was that each one of us advances in our careers and other endeavours just as far as we can until we reach the one "brick wall" that will allow us to advance no further. Thus, if you have been working at the same company for a while, and have gradually been given promotions up to the position of Vice-President, that will be as far as you will advance in your career, even if you were to leave that company and "start over" with another organization. The Principle maintains that there is something "inside" each of us that inevitably holds us back. Whatever "it" may be for you will be different from whatever "it" will be for me. Whatever the "it" was in the first company, will be replaced by another "it" in the new company. You will not necessarily have to deal with the same "it" as you experienced before, but you can expect its occurrence in some form or other.

To the extent that this hypothesis is correct, it would explain how almost everyone has at least one "would have, could have, should have" episode at sometime in their lives. If things had broken just a little differently, a certain long-sought after goal would have been attained, and who knows what would have happened after that?

The important part is not that you did not reach your goal or whatever you desired that was just beyond your grasp, it is how you react to the disappointment during the ensuing days, weeks and even years thereafter.

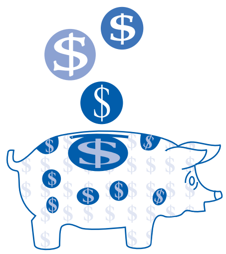
At one extreme is Charlie Chaplin in the movie, *The Tramp*. Toward the end of the movie he realizes that he will never win the heart of the love of his life, Mary Pickford. He is heartbroken, but only for a brief moment. He then picks himself up, straightens his tie and hat, does a little jig and grabs his walking stick to go out in search of someone new. The audience will never know what happens after. Is Charlie just putting on a brave face to conceal his true feelings, or is he so optimistic by nature that his credo might be "when one door slams in your face, another opens up with a fresh opportunity".

It may not be possible to be quite so positive in real life. Depending upon how long you have been pursuing your dream, the final realization that it is never to be, can take some getting used to.

At the other extreme is the professional help that the individual suffering with the loss may choose to avail himself. Many a therapist has made a good living helping their patients learn how to cope with their disappointment. They attempt to ease their clients through their loss all the while trying to prevent the devastation they are feeling from upsetting other aspects of their lives.

Perhaps what the individual needs is somewhere between the two. Some time alone or with a close friend or a "good cry" can do wonders. It allows him the chance to work through his feelings at his own pace without having to explain the way he feels to well-meaning but intrusive acquaintances.

It would be too much to hope to go through life without encountering a certain number of disappointments along the way. But that should never stop you from dreaming about the future and working towards putting it into reality. Never stop "reaching for the stars". Just make sure your feet are on the ground when you do it.



How to Balance Your Bank Account

Prime Minister Harper has publicly expressed his government's concern with the financial literacy of our fellow citizens. In an effort to assist his effort to correct this situation we are offering a refresher in how to balance your bank account which is typically performed monthly as at the end of the month.

Step One: You must maintain an ongoing account register either manually in a ledger, on a computer program or bank chequebook where you record each cheque that you write and any deposit that you make to your bank account. Write that balance here $ ______________

Step Two: When you receive a summary of your bank transactions either on-line or via a bank statement, subtract any bank service charges or fees that have not previously been recorded in your ongoing account register and add any items such as interest received that you may have missed recording in your account register +/- ____________

This is your adjusted account register balance $ ______________

Step Three: Record your on-line month-end or bank statement balance here $ ______________

Step Four: Add any deposits not shown on this statement + ______________

Step Five: List and total all cheques that you have written and released but have not cleared the bank as at the date of this statement. These are termed "oustanding cheques". Subtract this total - ______________

This balance should match your adjusted account register balance above $ ______________

If there are any discrepancies between the two balances they must be investigated otherwise the difference will continue uncorrected into the next month.

issue you the formal invoice for services rendered, it is incumbent upon the Agency to issue you the Re-Assessment within a reasonable period of time. There is always the possibility that your case will "slip through the cracks" and they will inadvertently "forget" to issue the Re-Assessment that has been prepared by the auditor. In that case, you will not owe them anything.

If after some time has elapsed and they "remember" you, it is likely that interest will be charged for the time from when the income taxes were originally due to the date of the Notice. You might be able to argue that interest should only be charged for the period up to some reasonable time after the completion of the audit, and if the Agency took too long to issue the Notice of Re-Assessment, you the taxpayer, should not be charged "extra" and have to pay for their inefficiency.

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