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THE Quarterly Dividend

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Your guide to income tax & financial planning

FAST TRACK

Business Meals and Entertainment Expenses

For the past twenty years the Income Tax Act has mandated that only one-half of expenditures businesses incur on meals, drinks and entertainment are deductible for income tax purposes.

The amount is determined

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Confidentiality or Non-Disclosure Agreements

It would not be an exaggeration to say that all successful business relationships depend upon the establishment and maintenance of trust between the parties. And that one of the building blocks of trust is the ability of each party to maintain confidentiality to the "outside world" about what is going on between them.

In many cases the existence of confidentiality is a given particularly when professionals are involved. They belong to Associations with applicable Codes of Ethics guidelines outlining what standards need be adhered to.

In other cases it is simply implied between the parties and just generally expected. And in still other cases, confidentiality is more formalized by having the parties sign a confidentiality or non-disclosure agreement laying out just what areas are covered, the rights and obligations of each party and of course legal remedies if someone gets out of line.

Here is what you should know about such agreements.

What: a confidentiality agreement is a legal contract between at least two parties outlining certain information that they wish to share and restrict amongst themselves;

Who and when: some examples where confidentiality agreements are common include (a) between lawyers and other professionals and their clients concerning matters upon which they have been asked to advise or perform services, (b) employers and employees who may be privy to certain information through the performance of their jobs and the corporation's "trade secrets" that could threaten its very existence if exposed to third parties, and (c) companies and sub-contractors regarding certain information they may acquire while carrying out their assignments;

Why: confidentiality agreements are drawn up under a wide variety of circumstances depending upon the parties and the information they are protecting. They may cover financial information provided to the company's bankers, investors, suppliers and customers, existing and future technology being used or contemplated by the company, and other business issues such as manufacturing processes, customer lists, and employee remuneration;

How: confidentiality agreement contracts must be in writing, define the information that will be considered "confidential", the parties being covered, the particular uses to which the parties may put this information, the period of time covered by the agreement, and remedies to be enforced should the confidentiality be breached.

Examples: confidentiality agreements are very common (a) when a person with a new idea or unpatented invention wants to pursue his dream of bringing his creation to market. He will protect himself from having those working on the project taking his concept and developing it on their own without authorization or payment. He will enter into confidentiality agreements every step of the way to insure that he keeps control and ownership of the venture; and (b) when a business owner wishes to "test the waters" to determine whether any potential investor might be interested in acquiring or investing in his company. He will prepare financial statements and other information for presentation to interested parties. They then become privy to certain information that could, should the investment never materialize, jeopardize the business owner's corporate viability. He will make sure signed confidentiality agreements are in place for all parties, including their agents before any information is divulged.

Compliments of

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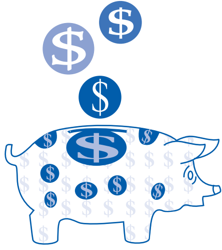


to be the lesser of (a) the amount actually paid and (b) an amount that it would be reasonable to have paid.

So if the directors and management of ABC Corporation decide to “wine and dine” a potential new client the company is restricted to deducting 50% of the lesser of the $250 bottle of wine that was served that evening and some other amount that the company might have to one day explain to an auditor was a reasonable expenditure in the circumstances. Fortunately, this question very rarely comes up in audit. Should the matter ever go to court, most judges are loath to try and tell business owners how they should be conducting their affairs and how much they should spend in wooing new customers. They routinely fall back on the fifty percent rule as the path of least resistance.

The obvious simplicity of

Income Tax Integration

When "Tax Reform" was first introduced many years ago, it was the stated policy of Parliament that income earned and taxed "personally" would result in the same (or close to) the taxes applicable for the same income when taxed in a corporation.

Let's see if they have reached their goal.

To make the analysis as comparative as possible corporate earnings after income taxes have been fully distributed to the shareholder via "eligible dividends" in the case of investment income and "non-eligible dividends" in the case of employment/business income.

Erin has the opportunity of earning investment income through a corporation, Erin Investments Inc., or taking the income "personally" and declare the income on her personal income tax return.

The table below summarizes her investment income and her taxable income under both scenarios. You will note that the corporate "taxes owing" of $11715 (a) is less than $500 more than the personal "taxes owing" of $11225 (b). Not only that, there is still $3097 available in corporate "refundable dividend tax on hand" which can be utilized when the corporation issues additional dividends to Erin.

Conclusion: Earning investment income through a corporation is marginally better than earning the same income "personally".

Source	Interest	Actual Dividends	Taxable Dividends	Div Tax Credit	Foreign Income	Withhold Tax	Capital Gains	Taxable Income	Taxes Owing	
	16,400	15,690	21,652	3,252	5,350	766	15,380 tax @ 50%			
Personal	16,400		21,652		5,350		7,690	51,092	**11,225**	**(a)**
Corp	16,400	15,690			5,350		7 ,690	45,130	**11,715**	**(b)**

Now let us consider whether business income is taxed more favourably "personally" or through a corporation.
Let's say Erin runs a retail purse store and earns an income after expenses but before management salaries of $50000.

Source	Interest	Actual Dividends	Taxable Dividends	Div Tax Credit	Foreign Income	Withhold Tax	Capital Gains	Taxable Income	Taxes Owing	
** Personal								50,000	**8,862**	**(c)**
Corp								50,000	**7,750**	
Personal		42,250	49,855	5,494				49,855	**1,515**	
									9,265	**(d)**

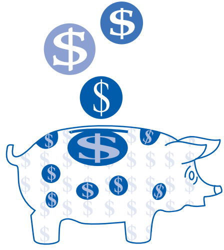
** not including CPP contributions see below

The above table summarizes her business/employment income and her taxable income under both scenarios. You will note that the corporate "taxes owing" of $9265 (d) is less than $500 more than the personal "taxes owing" of $8862 (c). But the analysis changes drastically when the required Canada Pension Plan contributions (both employer and employee portions) totalling $4604 are recognized. This increases the tax bill to $12763. (it is not a straight "add on" as one-half of the CPP payment is eligible as a non-refundable tax credit.)

Conclusion: It depends upon whether you consider payments into the CPP as a tax. If you don't, and think of it as "encouraging retirement savings" then the comparable figure of $8862 makes earning business/employment income personally marginally better than earning the same income through a corporation.

The opposite is also true. If you think that paying into the CPP is a form of disguised taxation forcing people to save for a government "pension" when they are perfectly capable of looking after themselves without government prodding, then earning business/employment income through a corporation is considerably better than earning the same income personally.

Final Conclusion: Parliament has achieved its goal of achieving "integration" from a purely dollars and cents point of view. However few decisions are so "clear-cut" that this is the only consideration. There will always be individual circumstances that must be taken into account.



the rule makes it an easy target for audit. What clouds the issue are the many exceptions that have been recognized over time.

Here is a list of the most common exemptions. If a company can place itself in a position to fall within at least one of them, its taxable income can be reduced significantly as the fifty percent deductibility becomes one hundred percent deductibility and tax savings result.

(a) companies in the food and entertainment industry are obviously exempt; (b) expenditures made regarding a fund-raising event to benefit a registered charity; (c) the flow-through provision that occurs when a lawyer, for example, takes a client to lunch and picks up the tab. If he follows the example outlined above he will be entitled to the fifty percent expense. But if he identifies the meal expense as a "disbursement" for which he is

Reconciling Items

Accountants are big on reconciling two (or more) sets of numbers. How does list "A" compare with list "B"? What items are included on one and not on the other, and why? What are the differences, if any, between amounts recorded on one list under a particular caption, and the amount shown in the other under the same heading?

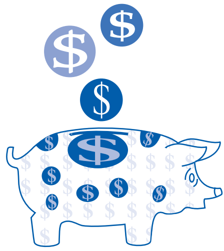
One example is the "bank reconciliation" that is prepared at the end of the month whereby the "correct" bank balance is determined by examining "outstanding" deposits and cheques to reflect them in the account as if they had been deposited or cleared before month's end.

Other examples are the revenue and expense "accruals" that are added to the accounts to better reflect the "true picture" of the company at the end of an accounting cycle.

A third example is the recognition that some revenues, expenses, gains and losses are recognized for accounting purposes but are adjusted "in" or "out" for income tax purposes. You start with the accounting net income figure as shown on the company's financial statements and "add back" or deduct income and expense items that are either not allowed for income tax purposes or that must be adjusted to agree with the provisions of the Income Tax Act. The final determination is termed "income for income tax purposes" and it applies to corporations, sole proprietorships and partnerships alike.

Here is a list of the more common reconciling items and why they are included:

Reconciling Item	Explanation
Net income for the year	The "accounting" determination of income or loss on the company's financial statements
Add: Provision for income taxes	The estimated income tax liability on the company's recorded income for the year
Add: Amortization expense	The company's annual allocation to expense of a portion of the cost of assets employed in the business (both tangible and intangible)
Add: Gain/loss on disposal of assets, taxable capital gains	These have already been included in the net income figure above. They will be treated "differently" for income tax purposes
Add: Charitable and political donations	These are not deductible (here) as they are not incurred for the purpose of gaining or producing income
Add: Scientific research expenditures (if expensed)	Internal research and development costs are sometimes capitalized other times expensed. There are special provisions in the Act that address these expenditures
Add: Other non- deductible expenses	Club dues and fees, 50% of meals and entertainment expenses, etc. that may be accceptable for financial statements but not for income tax purposes
Less: Mirror images of items listed above	Capital cost allowance re amortization, allowable capital losses, scientific research expenditures, etc.
Less: Non- taxable dividends	To the extent they have been included in financial statement income
Less: Income from subsidiaries or affiliates	This income is reported in the financial statements of the legal entities involved
Less: Other deductions	Adjustments as required in the circumstances
Income for income tax purposes	Amount upon which the tax rate is applied



billing the client, he will up the ante and be entitled to the full expense. The client, however, is saddled with the fifty percent deduction; (d) amounts that are included as a "taxable benefit" to an employee; (e) company-wide functions where food, beverages or entertainment are available to all employees, such as the annual Christmas party; (f) items consumed while traveling (presumably on business) but only on airplanes, trains or buses. Ships and boats do not meet the exemption; and (g) long-haul truck drivers who are allowed to deduct eighty percent of expenses incurred while away from home for a specified period and distance.

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The Loneliest Man in Town

In the literature the romantic story of small business finds a would-be entrepreneur honing his skills in the family basement building up his capabilities and refining his practices. It is an ongoing struggle but our hero sticks doggedly to his mission, ultimately to find limited success as a reward for the hard work, focus, and strategy put into the venture. What is rarely mentioned is that for some this is as far as he will ever go. He eventually runs out of time, money and patience. And that is the end of his story.

Other would-be entrepreneurs, however, succeed and go to the next level. They obtain outside backers to help finance their projects, for it is rare for the small businessman himself to have sufficient capital on his own to get very far.

In both groups the first wave of success gives the owner/entrepreneur a certain feeling of optimism and expectation for growth. However, once this first rush is over, the amount of time until his second wave of success appears will spell the difference between someone who continues to stay motivated from someone who must eventually throw in the towel.

What sets apart the entrepreneur who "runs out of gas" early on from another who is able to stick it out for the longer haul? In many cases, it is the quality of the investors he is able to attract, as investors can be seen as falling into two distinct groups.

The first group called Group A tends to be investors who believe that since they have laid out good money to finance the entrepreneur to go from stage one to stage two, they are entitled to results. While they support this particular entrepreneur, for the moment, they are not "wedded" to him for the long-run. They are not above pulling their investment funds if satisfactory results are not forthcoming in the immediate future.

The second group of investors, Group B, tends to be willing to "bet" on the entrepreneur himself and stick with him over the long-run, even if positive results take somewhat longer than anticipated or never materialize at all.

The entrepreneur himself would rather be backed by investors in Group B rather than those in Group A. Any entrepreneur would rather associate with investors who are supportive, patient, and brimming with confidence that his leadership will lead all concerned to where they want to go. He can afford to proceed slowly while choosing a strategy that is geared for long-term success.

No entrepreneur wants to work with investors who grow impatient waiting for positive results from quarter to quarter, expecting certain results within some pre-determined amount of time all the while offering "advice" on how he should be going about the business.

Unfortunately, however, the entrepreneur may not have the luxury of picking the investors who will be putting the funds into his venture. And this makes him the loneliest man in town. If Group A investors express interest in his project, should he take the money and run or perhaps hold out for Group B type investors who will make the road ahead more enjoyable?

Many would think that he should take the first group who comes along with the resources to invest in his undertaking. He cannot reach the next level without them so even if investors from Group A appear on the horizon and it means selling his soul to get further along in his venture, he should just bite the bullet and accept the good (the money) with the bad (the relentless pressure they will bring to bear for immediate results and a return on their investment).

Others might think that he should be more choosey and wait for investors to appear who understand and appreciate what he is trying to accomplish and who are comfortable with the way he wants to proceed.

In a perfect world, the entrepreneur has time on his side. He can wait for Group B investors to show up. However, in the real world, it may just happen that Group A investors come along first with no guarantee that Group B investors may ever approach him. So that with a desire to cut the time line between successes and a healthy desire to get ahead, he will accept these investors in an effort to keep up his momentum. He might think that he might one day be able to change them from Group A's to Group B's but that is sometime off and he himself wants to keep going.

Of course there is no right or wrong answer. How long you wait before taking Group A's financing all the while holding out for the approach of a Group B that may never come along, is a risk that only the would-be entrepreneur can take. But it can be a make or break decision that he will have to live with the rest of his life.

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