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THE Quarterly Dividend

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Your guide to income tax & financial planning

FAST TRACK

Crowd-funding

Over the past few years entrepreneurs with lots of ideas and little cash have shied away from approaching banks and venture capitalists to get their projects off the ground. They have turned to the internet or social media to attract numerous micro-investors who are willing to attach themselves to their project. It is termed "crowd-funding" and here is how it works:

In this Issue:

Employment vs Self-Employment

Many individuals working as employees in their jobs dream about what it would be like if they were paid as self-employed contractors. They've heard about the latters' ability to deduct expenses from their earnings for income tax purposes and wonder to themselves what life would be like if things were set up differently from the way they are now.

Conversely, there are others who have been working on a free-lance, self-employed basis who secretly wonder what they would be giving up should they seek "regular" employment.

While it is impossibe to compare qualitative aspects of jobs, given the many factors that surround their performance, it is possible from a strictly dollars and cents perspecFve to address the issues:

(a) "if my boss came to me this afternoon and asked me to switch from being an employee to someone who would be paid as a sub-contractor, how much money do I have to make to be sure that I am not losing out in the transition?" and,

(b) "if my major customer came to me this afternoon and asked me to switch from being a sub-contractor to someone who would be hired as a full-time employee, how much should I expect to be paid so that I would not experience any loss in earnings due to the changeover?"

Here are two "real-life" scenarios showing how these issues are played out daily:

(a) Bill is a pharmacist who has been working at Friendly Drug Mart for over ten years and "making" $125000 per annum.

The entire profession has recently changed due to an over-abundance of new, qualified practioners who have been licensed by the College. This has made it more attractive for Friendly to replace their salaried employees with a staff of sub-contractors. And although they like Bill and the way he does his job, "business is business" and he'll have to become a sub-contractor if he wants to continue at Friendly.

In situations such as these, Bill has to consider what prompted the "sudden" request to change his employment status. If the entire profession is headed in that direction, he will be swept up with everyone else and forced to go along with what the employer wants. While previously he had grown accustomed to a regular number of hours, he might now have to work at several different pharmacies in order to maintain this figure.

If the request to change in the working relationship was due to unique circumstances surrounding friendly, he might be able to convince management that this re-classification is only temporary and that he expects to go back to their previous arrangement when times have returned to normal.

As for the immediate future, Bill is lucky in that sub-contractor pharmacists do not incur many costs in order to "be in business". The extra expenses he will have to incur as a sub-

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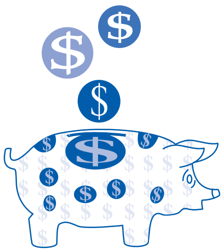


Let's say you have an invention in mind but don't have the money to get it going. You go to an entrepreneurial website where you exhibit your project/product and give some information about it, perhaps by providing a video so potential investors can easily see what you're doing and identify with it.

People see your idea and give constructive feedback. It's all about creating a community of like-minded individuals who connect with each other. After you have refined the idea, you return to the website to officially launch it. This is done by indicating how much money you think you'll need to get the project off the ground (your goal). People (your backers) who like it, "attach" themselves to your project, not as owners but as participants who contribute money for funding and for whom certain "rewards" will be given should the project successfully launch.

The owners of the website collect the money and charge a fee for hosting the site and bringing the projects and money together. (If not enough money is collected, the funds are returned to the backers and the fee is waived). They also keep track of your backers so that

contractor will not be that great. While the original question centred on the continuance of employment in the same place with the same "boss", this may no longer be an option. Bill will have to quickly establish a network of pharmacies who can regularly call upon his services. His years of experience will not be a hinderance from being hired as a sub-contractor but he may have to work longer hours and travel greater distances if he is to maintain his accustomed level of income.

Unfortunately, more often than not, the "request" to go from employee to sub-contractor is not as positive for the individual as the "request" to go the other way. The former pre-supposes the employer to have "reasons" for seeking the change beyond those that are strictly monetary. And the individual will not likely be privy to what circumstances triggered the change. He will also not likely be in a position to refuse the change no matter how the employer presents it to him.

On the other hand,

(b) Joe is a self-employed construction contractor billing $125000 per annum. The job requires him to incur expenses over and above those that he can pass along to his customers. These amount to $20000 per year and are a cost of doing business.

If Joe were to switch from being self-employed to salaried employee, he would need to earn at least $105000 per year as an employee to be as well off after the switch than he was before.

In fact, depending upon his negotiating skills, he should demand even more money than that. He should be compensated for the fact that he can no longer "turn down" jobs that he previously had the right to refuse and the reduction in the "freedom" he previously had to book off on Wednesday afternoons to play golf with his buddies.

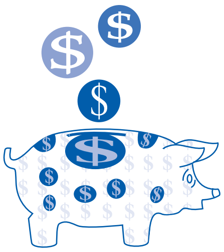
CNIL Accounts

Although you may not realize it, the Canada Revenue Agency has been keeping track of the amounts of investment inclusions and related carrying charges you have been reporting on your personal income tax returns since 1988. The net inclusions and deductions are termed the taxpayer's Cumulative Net Investment Losses or CNIL account. The balance in this account will govern to what extent you will be able to claim the $800000 "Lifetime Capital Gains Exemption".

If the amount in your CNIL account is say $50000, then your exemption will be that much lower should you realize a qualifying capital gain. In this case it would be capped at $750000.

Here are the items that will determine the balance in your CNIL account. Note that because this is termed a "Loss Account", expenses are considered "plusses" while revenues are considered "minuses"!! The dollar values to be included will match those declared on the annual income tax return filing.

PLUS SIDE	MINUS SIDE
(a) interest and financing costs	(a) interest, dividend, royalty income
(b) investment carrying costs such as management fees, advisory costs, commissions	(b) non-active net farming or fishing income
(c) rental losses	(c) rental income
(d) repayment of shareholder loans	(d) CPP death benefits
	(e) payments from a TFSA



you can keep in contact with them, giving them progress reports as the project moves along and allowing them to feel a part of the creative process. Project categories include technology, publishing, art, music, games, dance, and food. But given the inexpensive way of trying out an idea, new groupings spring up all the time.

Sounds great? But beware of the pitfalls: (a) in traditional start-ups if you do not ultimately succeed, or have modest success, relatively few people know that what you attempted did not work out as hoped. With crowdfunding, your project is much more transparent and you are open to “second guessing” by backers who may affect your ability to try again with another idea; (b) the classification of money raised through crowdfunding is an issue that has yet to be resolved. The funds contributed by backers cannot be treated as equity as no shares were issued or distributed upon receipt of funds. And they cannot be treated as a gift because this source of capital is seldom provided without at least some implied benefits being offered to backers. Finally they do not qualify as a “loan” unless you classify them very loosely as indefinite-term non-interest

Personal Services Corporations

Most taxpayers understand the difference between earning income as an employee of a company and having Canada Pension Plan, Employment Insurance and income taxes withheld by the employer before being paid a “net” wage and earning the same income by billing the company for services rendered on a “gross” basis and being responsible for the remittances to the Receiver General that are required.

But what happens when the line of demarcation between “employee” and “independent contractor” becomes blurred? This occurs when the employer and employee decide between themselves that the former can reduce his payroll costs by hiring the latter as a “free lancer”and the latter will benefit by being able to claim expenses against the “revenue” he is being paid.

In truth, the Canada Revenue Agency is way ahead of them!! The government has mandated that the above “independent contractor” must have at least two clients to qualify as a bona fide business if he is to allowed to bill for his services. No matter how he arranges his affairs as either a “sole practitioner” or corporation, the same rules apply and the penalties for non-compliance are expensive.

If the above “disguised salary” arrangement is initiated and eventually discovered, the party who had been paid as an independent contractor through a sole proprietorship will be required to reclassify the gross earnings as salary and any expenses that were claimed will be forfeited. The employer will be liable for all payroll deductions that were “overlooked” initially. There will be interest charged on all money that had not been remitted on time and penalties in situations where it can be proven the parties deliberately acted fraudulently.

If the above “independent contractor” had billed his former employer through a corporation, and had previously taken advantage of the small business tax credit for companies earning less than $500000 per annum, the company will be re-classified as a “personal services corporation” and denied the small business deduction. This has the effect of increasing the federal tax rate on corporate earnings from 11% to 28%. The only deduction that is allowed from gross revenues, except in rare instances, is the salary' paid to the individual providing the services. The company will be allowed the small business deduction when it has at least five full-time employees but in the above example, this would not likely be the case.

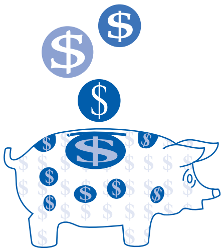
The rules can be circumvented if the owner/ shareholder of the corporation is able to secure a second or even third contract separate from the arrangement undertaken with his former employer. As long as both parties recognize that the former employee is free to work elsewhere “on his own time” it may be worth his while to pursue additional contracts to keep himself “onside” of the onerous provisions applicable to personal services contracts. While although a second revenue stream is required, there is no mention in the Act as to the magnitude of this income. If he can secure work that is only in demand sporadically throughout the year or perhaps seasonal, he can put all his earnings through a corporation that qualifies for the lower corporate tax rates.

The Canada Deposit Insurance Corporation

You've seen the brochures at your local bank and have been meaning to read them. But you never seem to have had the time. Here is a summary of the information you need to know. Also, please see accompanying example.

who: the Canada Deposit Insurance Corporation is a Federal Crown Corporation set up to protect individuals who hold their savings in banks, trust and loan companies and co-operative credit associations;

where: member institutions identify themselves by displaying the CDIC logo in the familiar outline of the Canadian flag;



bearing instruments. It will be interesting to see how securities laws will end up classifying this new arrangement for raising capital; and (c) entrepreneurs who undertake this type of financing may not be prepared for the demands of their backers. These investors may have only anted up small amounts of money, but they expect to be kept in constant contact about the status of the project, from its initial stages of development to the time it is expected to hit the market. Most entrepreneurs have enough on their plate without having to deal with these matters. They always seem to get in the way when there are more pressing matters that have to resolved before the project can be launched. Entrepreneurs may rue the day that they thought this innovative method of raising capital ever caught their attention.

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.

why: to protect the funds (within limits) depositors have placed in member financial institutions. Claims can only be made should the financial institution go bankrupt;

what: eligible deposits include: (i) saving and chequing accounts; (ii) term deposits issued by the financial institution; (iii) money orders and bank drafts; and (iv) accounts holding funds to pay realty taxes on mortgaged properties. The deposit must in payable in Canada, in Canadian currency and in the case of (ii) above be repayable no later than five years from the date of deposit. Non-eligible deposits include deposits in a foreign currency, term deposits with a maturity date more than five years from the date of deposit, corporate and government issued bonds, treasury bills and investments in mortgages, stocks or mutual funds;

when: maximum basic protection per eligible deposit classification is $100000 per depositor covering both principal and interest at any one financial institution. There is separate protection for joint bank accounts, trust accounts, RRSP's, RRIF's, TFSA's, RDSP's, RESP's and deposits that are being held in trust;

how: should a member institution fail, the CDIC will communicate with depositors to advise them when and how they will receive payment covering both principal and interest up to $100000. Registered plans will be transferred from the failed institution to another member.

Depositor	Details	$ Amount	$ Insured	$ Uninsured
Sandra	savings acct	16000		
	chequing acct	4000		
	term deposit	85000		
		105000	100000	5000
	RRSP GIC's	60000	60000	
Jack, in trust for Sandra	bank draft	5000	5000	
Jack	TFSA	118000	100000	18000
Jack and Sandra, jointly	savings	45000		
	term deposit	85000		
		130000	100000	30000

The column on the far right indicates the exposure both Jack and Sandra have to the possible collapse of the financial institution with whom they bank. Each of them should take the necessary precautions to reduce their uninsured balances to $NIL