SUMMER 2014

THE Quarterly Dividend

Vol. 23 No. 3 Your guide to income tax & financial planning

FAST TRACK

Everything Old is New Again

In recent years the Canada Revenue Agency has sent out annual letters to "selected" taxpayers reminding them of their obligations to comply with the Income Tax Act. In the guise of wanting to "assist" small business owners, commission salespeople, and those owing rental properties in income tax "compliance" they continue to point out time and again that only expenses

In this Issue:

The Income Tax Balance Sheet

The Income Tax Balance Sheet Accountants are often asked by clients to look at financial statements of corporations that they are considering purchasing with an eye towards recommending how they might structure the "deal".

There are typically two ways of acquiring an on-going business. The current owner can sell his existing assets, including goodwill, to the purchaser who will take them over and absorb them into his current operations. Or the current owner can agree to sell the shares of his existing company complete with all of its underlying ownership of assets and liabilities.

Prospective buyers may not always understand the nuances involved in the transaction. They are busy concentrating on the dollar amount of the purchase and how they will be able to come up with the downpayment. They are already preparing in their minds the changes they will initiate in the business when they take over. But as much as these are important, so equally is the structure of the business they are assuming.

In situations where the parties agree to the sale of shares, the amount offered as the purchase price for those shares cannot simply be determined by looking at the company's financial statements and making a determination of "what the company is worth". The purchaser must dig deeper and come up with the "tax balance sheet" of the corporation under consideration. For when shares are bought, all of their income tax values are transferred right along with the inventory and accounts payable.

It goes beyond simply looking at the previous year's corporate income tax return to determine whether there is a "loss carry forward" and the undepreciated capital cost balances of their assets. It means taking the time to recast the balance sheet along income tax lines.

The accompanying "income tax balance sheet" gives an example of the kinds of events in a company's history that can result in there being vast differences between the balances that show up on the company's financial statements and those that are reflected on the corporate income tax return.

Many of the differences arise from the way depreciation or amortization of capital assets has been "handled" for accounting and income tax purposes. But inventory valuation, the amounts recognized as accounts receivable and payable and other factors particular to the company under consideration must all be analyzed.

Consider this "rule of thumb". In the marketplace of the purchase and sale of existing businesses, there are usually more sellers than buyers. This means that the purchaser has time on his side. He should spend it wisely by constructing an "income tax balance sheet" and finding out as much as he can about the company. This will help him decide if he wants to go ahead with the purchase and how he might structure the deal to his advantage.

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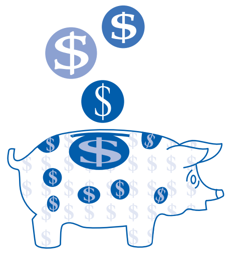


The Income Tax Balance Sheet (cont'd)

Jack is considering purchasing an existing company and was offered a copy of the company's balance sheet as at May 31, 2014.

He did some additional investigating to reconstruct an income tax balance sheet at the same date. Here is what he found:

	Company's Fin Records $	Company's Fin Records $	Company's Tax Records $	Company's Tax Records $
(a) Cash	2416		2416	
(b) A/R	13300		10000	
(c) Inventory	15569		15000	
(d) Goodwill	14000		12066	
(d) Office Equip	20000		20000	
(d) Acc Amort - Office		12000		8480
(d) Tools	15000		15000	
(d) Acc Amort - Tools		15000		15000
(d) Auto	42000		33900	
(d) Acc Amort - Auto		17694		19780
(a) Operating Bank Loan		20000		20000
(e) A/P		15000		9522
(a) Long- term Loan		20000		20000
(f) Due to Shareholder		12178		12440
(a) Share Capital		100		100
(g) Retained Earnings		10313		3000
	122285	122285	108382	108322

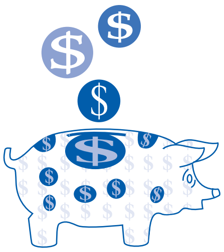
Explanation of Differences	What it Means to Possible Purchaser
(a) these figures are "typically" the same for financial statement presentation as income taxes	Jack will accept "as is"
(b) company is recognizing certain "sales" for financial statement purposes that they are not showing for income tax purposes	Is company showing higher A/R to make itself look "better"?
(c) income tax inventory must be lesser of cost and fair market value while inventory for financial statements can be calculated using other costing methods	Noted. Not likely to "make or break" purchase decision
(d) capital cost allowance rates and methods must be consistent with Income Tax Act while depreciation need only "make sense" in the company circumstances	Noted. Not likely to "make or break" purchase decision
(e) contingent liabilities are not recognized for income tax purposes	Details about contingencies will be very important
(f) cannot be in a "receivable" position for income tax purposes otherwise there is share holder appropriation	How did the company keep shareholder "on side"?
(g) may differ significantly depending on "net incomes" and dividend distributions over the years	This will affect how purchasers will be able to withdraw funds from the company in the future

related to the conduct of their ongoing affairs can be claimed on their income tax returns.

The Agency believes that taxpayers, in general, are not law-abiding citizens who will take any opportunity they can to record incorrect information on their income tax returns to try to "get away" with paying less tax than what is required in the Income Tax Act (and what the Agency feels is warranted). They believe that the taxpayer is guilty until proven innocent when it comes to income tax matters, which has led to a kind of "bunker" mentality where every transaction entered into by the taxpayer is scrutinized under a "them vs. us" microscope.

This attitude was exhibited once again when the Agency announced its "new" initiative to Small Business Compliance in January, 2014. In truth, they had nothing new to offer.

As announced, there are three components: (a) the Agency will go through its data base and identify "high risk" taxpayers who are likely to be cheating on their income tax returns. This is something that has been going on for several years as a "pilot project" but will now continue as an ongoing policy of the Agency. They choose to call it



Having conducted the analysis, Jack must now determine whether he wants to pursue the purchase of this company. If the answer is "yes", he must then consider whether to purchase its shares or its assets, and, of course, the price he is willing to pay. Only then can he enter into meaningful negotiations with the seller to see if a deal can be reached.

"taxpayer education" rather than "taxpayer intimidation" which is what it really is. After the first few letters have been received, knowledgeable taxpayers who understand how the Income Tax Act "works" take these letters for what they are and quickly set them aside; (b) the Agency will hire "liaison officers" to advise small business owners and others how to fill out the forms and comply with the paperwork and red tape that the Agency has created!! In truth, the Agency has been offering free advice over the telephone for years and the system appears to be working just fine. If it "ain't broke, don't fix it" would seem to be applicable here. Maybe if they had figured out ways to make it easier for Canadians to conduct their businesses all along, this would never have been seen as a "problem" that had to specifically be addressed; and (c) the Agency will require tax return preparers to register with them. This will likely be done in the same manner in which it was approached when it came to the assigning of registration numbers to tax preparers who wanted to submit their clients' information electronically to the tax department. Virtually all interested tax preparers were accepted and assigned a registration number. There

The Pathway to Success

It is a sad but true that successful entrepreneurs do not always have the requisite skills to permit the growth of their ventures beyond a certain stage of development (see accompanying table). They may have been good at going from "conception to inception" but then "hit a wall" once the business has reached a certain level of sales or requires a workforce that is too large and unwieldy for one person to be able to manage. They then must then decide how they want to proceed. Will they be satisfied with maintaining the "status quo" or do they want to try to take the business to the next level?

Although there is no right or wrong answer, if they choose "growth", they will have to relinquish personal control over most facets of the company and hire individuals with the right skill set to take over day-to-day operations. Here is a taste of what they can expect:

(a) the company will not be able to operate as it did in the past. It will not be enough to be an industry follower but will have to anticipate changes in the marketplace and perhaps even initiate them;

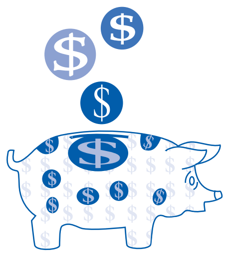
(b) the people who have been with the company thus far may not have the necessary skills to lead it going forward. It will not be pleasant to part ways with them but keeping them on for "old times sake" will not be doing you or them any favours. The company will have to become more bureaucratic and streamlined. Some long-term employees will resent the new tasks that they will now have to perform while reporting to new managers and supervisors. If they can adapt, fine. If not, you will know soon enough;

(c) the company will establish its own internal culture and develop routines that make sense according to the new demands that are being put upon it each day. It will require a certain flexibility and adaptability if it is to succeed;

(d) decision making and responses to outside pressures that previously were attended to quickly and efficiently will now take longer. More people will have input and each will have his own agenda as to what path the company should take. Corporate politics can threaten the very existence of the company. Experienced managers can work in this type of environment and will have to be trusted to steer the company to where you want it to go;

(e) you, as founder, will want to be kept in the loop of all that is going on in the company. Try to keep a perspective that concentrates on the big picture and not the small issues and problems that come up each day. You do not want to be involved in all decision making, only important matters that affect corporate long-term viability; and

(f) do not lose sight of what got you there in the first place. If your entrepreneurship allowed you to enter the marketplace many years back, encourage it in your company as it goes forward. Maintain your enthusiasm for innovation and unique problem solving. Harness this energy in those who come to work with you. It will allow you the best chance to grow from strength to strength within the company in the years ahead.



was no special screening of applicants or any verification as to their particular qualifications, even though some practitioners tried to claim otherwise to their unsuspecting clients.

The Agency will track the submissions of individual registrants to determine whether their filings are particularly "error prone". If so, the preparers themselves will be investigated for their acquiescence with their clients' "misrepresentations" and audited/educated to assure future compliance with the Agency's interpretations of the Act and how items are to reported. Once again, this is nothing new. The Canada Revenue Agency has had similar powers "on the books" since 1999 and has not hesitated to extend individual taxpayer audits to those who submitted the returns on their behalf.

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.

The Right Leader at the Right Time

	Stage of Business	Major Challenges	Req'd Leadership Skills
(a)	Start- up	developing product, market, securing financing, employees	visionary, high energy salesmanship
(b)	Survival	developing growth strategies identifying strengths and weaknesses	content/tech expertise opportunistic
(c)	Growth	refining policies and procedures puting right people in place	systematic thinking solid management
(d)	Institutional	expanding/protecting "brand" having fun	focus on big picture delegator

Working Retirees

It is estimated that over one-half of all retirees choose to continue working once they have reached "retirement age". In many cases the choice is dictated by necessity as they find it more expensive than they had imagined to continue living in the manner in which they had become accustomed.

Others see working beyond retirement age as an opportunity to get paid while exploring certain avenues that they had never had a chance to consider in earlier years. While still others miss the camaraderie that they had enjoyed while working and crave the social atmosphere they became used to during their working years.

Whatever the motive, researchers have identified four "personality" traits exhibited by working retirees. As you approach retirement age consider to which group you belong. This will allow you to transition yourself as you find a particular niche where you will be most comfortable. Like anything else in life, some planning can go a long way to make your "golden years" more productive and satisfying.

The four traits are as follows: (a) *caring contributors* - these retirees want to give back to the communities in which they have been living. They typically work for non-profit organizations, often for little or no pay; (b) *earnest earners* - people who belong in this category need the money to continue living the lifestyle to which they have become accustomed. They are not usually all too happy about having to work, but enjoy the "extras" that would not be possible without the extra paycheque; (c) *life balancers* - members of this group continue working for the continuation of the social interactions they enjoyed while working over the years. They often find themselves in the same companies where they worked "before" but usually working in another capacity to the one they had worked previously. The new responsibilities are typically less stressful and less demanding. An added bonus is that younger employees frequently "look up" to them and value the experience they bring to the job; and (d) *driven achievers* - this group should never had agreed to retirement in the first place. Their history as workaholics never afforded them the luxury of planning for their "later years". They believe that they are still at the top of their game and that time has not slowed them down for a moment. If they had been entrepreneurs or owners of small businesses before, they cannot stand the thought of working for someone else and taking orders from them. They have never thought about "slowing down" and are best left alone to continue working much as they have been for their entire lives.