Business Matters

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TAXATION

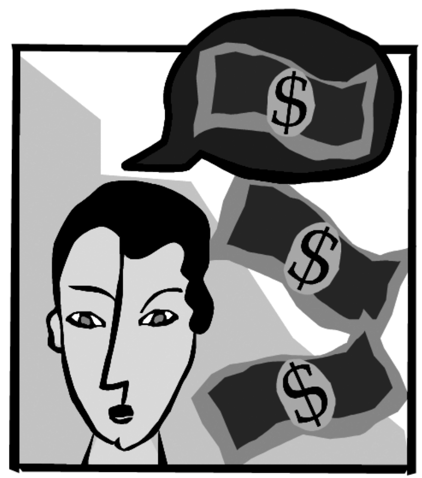
Employee/Shareholder Loans

Employees and owner/managers often receive loans from their employers or companies or otherwise become indebted to them. While most times these loans can be very beneficial, other times they may inadvertently trigger adverse income tax consequences. To avoid tax surprises for your 2004 filing, make sure your loan is properly structured.

Employee Loans

If you receive a no-interest, low-interest or any other loan from the company that employs you, you are deemed to have received a taxable benefit for that year. The benefit is added to your taxable income based on the Canada Revenue Agency's (CRA) prescribed interest for the period the loan was outstanding, less any interest paid by you before 30 days after the end of the year, i.e., by January 30th of the following year.

If the company provides a home purchase loan or a home relocation loan, the amount of the benefit is the lesser of the prescribed interest rate for the current period and the prescribed interest rate at the time the loan was made. In this case, the loan is considered a new loan after five years. In addition, the benefit on the first $25,000 of a home relocation loan is deductible in arriving at taxable income for up to five years if you moved at least 40 kilometres closer to your new work location and the loan was used to purchase a house.



Shareholder Loans

If you are also a shareholder of the company, you must consider the tax implications of the shareholder loan rules in the *Income Tax Act* in addition to the taxable benefit for low-interest loans discussed above.

The purpose of the shareholder loan rules is to prevent shareholders from continuously advancing funds to themselves in the form of loans with no intention of repaying them. If these rules were not in place, the loans would, in effect, be tax-free and a means to eliminate the shareholder's personal tax liability on salary or dividend payments.

Repayment of Shareholder Loans

Like most owner/managers, you are likely aware that if your shareholder loan is repaid within one year from the end of the corporation's taxation year in which it was made, it is not taxed in your hands.

However, did you know that it is also possible for a loan to be outstanding for longer than 12 months without its being included in income? For example, say your corporation has an August 31, 2004 year-end and it makes a loan to you as its major shareholder on September 14, 2004. In order for this amount not to be included in your taxable income, you must repay the loan by August 31, 2006. This provides a period of almost two years to repay the loan without adverse tax consequences.

If you do not repay the loan within this time period, it is included in your income as at the time the loan was made; however, you may reverse any interest benefit included in a previous year's income. This reversal avoids a double tax situation where you would be taxed once for including the loan in income and again for the taxable benefit.

In addition, where the entire loan has been included in your income, you can receive a deduction for subsequent repayments. However, proceed with caution. The tax consequences could be significant if the CRA considers the loan and repayment to be a "series of loans and repayments". Generally, if the shareholder only makes a temporary repayment of the loan and then borrows again shortly thereafter, the CRA will not allow the deduction.

Non-taxable Loans

Traditionally, the rules have allowed corporations to loan money to individual shareholders in certain limited cases. Non-taxable loans include those made:

- in the ordinary course of business;
- to purchase previously unissued shares from the corporation;
- to purchase an automobile to be used for employment purposes; and
- to purchase a home.

Each of these loans must have *bona fide* arrangements for the repayment of the loan within a reasonable time. With the exception of loans made in the ordinary course of business, the borrower must also be an employee of the corporation.

The shareholder loan rules do not apply to employee-shareholders who deal at arm's length with the corporation and who, together with related persons, own less than 10% of the shares of any class of the corporation. This provides an exception for many employees who are minority shareholders.

Note, however, that for a loan to meet the above exceptions, it must be received by virtue of the individual's employment and not because of the individual's shareholdings. This has generally been interpreted to mean that similar loans must be available to other employees who are not shareholders or related to shareholders. To complicate matters more, it would appear that if the owner/manager is the sole employee of a company and wants the borrowings not to be taxable, he or she will have to prove that the loan is a loan which would otherwise be available to non-shareholder employees. This, of course, could be an onerous task.

Since most small companies do not loan funds to non-shareholder employees, this supports the CRA's position that the owner/manager is likely receiving the loan as a shareholder, not as an employee. In this case, the shareholder would have to include the loan in income, unless it is repaid within one year from the end of the corporation's year.

Minimize Your Tax Risk

Be wary: the risk you take in receiving loans from the corporation could be very costly.

If your shareholder's loan is included in income, your tax liability for the year in which the loan was made could be substantial.

If you are an owner/manager or shareholder who is considering making a loan to yourself in your capacity as an employee of your company, talk to your chartered accountant before you proceed.

As part of your year-end planning, make sure you have cleared shareholder receivables to ensure there are no negative consequences as a result of the shareholder loan rules.

Before You Take that Loan

Whether you are an employee, owner/manager or shareholder, discuss your plans with your chartered accountant before you take a loan from your employer or company. If the loan is not properly structured, the costs could be far more than you anticipated. ■

GST/HST across Canada

Whether your province participates in GST or HST, the reporting requirements are the same.

In most provinces and in the territories, GST registrants collect the 7% GST and file their net tax remittance or claim a refund on a periodic basis, taking into account the input credits (ITC) that can be claimed.

However, registrants in Newfoundland and Labrador, New Brunswick, and Nova Scotia collect the 15% HST (Harmonized Sales Tax), which includes both the GST (7%) and a provincial component (8%). In these "harmonized" provinces, registrants report their net tax, including GST and HST. If they also charge tax to customers in provinces that do not participate in the HST, they do not have to separate the GST and HST collected but rather add together the 7% GST and 15% HST collected on taxable supplies and report the amount as one consolidated figure on the return.

But what if your business is a GST registrant located outside the harmonized provinces and you find a market niche in one or more of the harmonized provinces? In this instance, these invoices must include the 15% HST on the sale of taxable supplies to customers in those provinces. When you file your GST return, you would then include the GST and HST collected to make a single determination of your net tax, including all tax collectible or collected during the reporting period and all input tax credits claimed. A breakdown of the GST and HST is not required.

Service businesses are usually required to charge the taxes based upon where the services are performed. Thus, if consulting work were completed in say, Manitoba, and the end results e-mailed to Nova Scotia, then the 7% GST would apply. If the same work were performed in Nova Scotia, then the 15% HST would be included on the invoice.

Similarly, if you are a GST registrant located outside the harmonized provinces that purchases taxable goods from a company located in one of those provinces and the goods are delivered to you in a harmonized province, you would pay the 15% HST on these goods. You would then claim the full amount of the HST paid as an ITC credit when filing your GST return.

If your business is expanding across Canada, make sure you are familiar with the GST and HST rules that apply in the various provinces. ■

The Savings Add Up

Looking for ways to improve the bottom line without having to make significant outlays? Here are some tried and true methods that just might work for your business.

Human Resources

Happy employees are productive employees. Employees who love what they are doing and feel appreciated ensure a healthy profit margin.

- Reward employees for implementing cost saving ideas, improving customer satisfaction or increasing market share. A reward could be as simple as a coveted parking space for a month.
- Provide monthly or quarterly incentives to top achievers in sales. Incentive programs not only increase

a company's sales but also encourage a healthy competition to improve performance.

- Recognize the exceptional performance of individual employees, such as rewarding the employee of the month or presenting an award at a "town hall" meeting.
- Hire the right people. Look at the work styles, attitudes and abilities of your stellar performers. Focus your hiring program on finding candidates with the same traits. These people will integrate well with the existing team and reduce staff turnover. Word of mouth and referrals from employees are proven ways to attract the right people.
- Cross train. Do not let your business be hamstrung because one person is on holidays or on sick leave, or decides to move on. Make sure employees know how to do each other's job. For highly specialized jobs, consider rotating the various tasks until two or more people know the job well. Backing up positions can help reduce costs while ensuring operations continue smoothly during a temporary absence or replacement of employees.

Meetings

Poorly planned meetings can gobble up time and resources. As a first step, make sure you have a clear objective. What do you hope to accomplish in the meeting?

- Set an agenda and timetable and stick to it. Distribute the agenda to staff well before the meeting to allow participants to prepare. When possible, schedule matters brought up at meetings that are outside the agenda for discussion at the next meeting. This will also give others time to prepare their thoughts and gather research on new issues or problems.
- Do not automatically invite everyone to a meeting. Determine who is necessary for achieving the meeting objective. After the meeting, distribute copies of the action plan or minutes to others.

Shipping and Couriers

Stay current with market prices and alternative delivery systems.

- Let suppliers know you are reviewing your costs. Review their terms of credit. Review your company's packaging and processes. How are your competitors packaging and delivering their products?
- Look for ways to reduce packaging weight and thus shipping costs. Are you using the most cost-efficient containers and packing?
- Review your arrangements with shipping and delivery providers. Consolidating by area or type of shipment could give you the leverage to negotiate volume discounts.
- Make same day and overnight deliveries the exception rather than the rule. Provide enough lead-time in the production cycle to allow delivery within two or three business days.
- Take advantage of PC-based information. Many courier and shipping companies offer software or web-based programs to encourage the use of their company's services. These programs provide useful information such as automatic quotes, shipping rates and carriers. Some provide ways to avoid excess freight or labour costs and information on how certain items must be packaged to stay within the limits of the carrier's or international regulations.

Utilities

Be energy smart. The high costs of heating and lighting are strong motivators for finding cost-saving measures. For example, lighting can typically account for 30 per cent of a company's electricity use.

- Replace or retrofit lighting. While the initial outlay for replacing or retrofitting fixtures may seem high, the latest technology makes it possible for fewer fixtures to deliver the same or better quality lighting along with long-term energy savings.
- Replace older fluorescent ceiling lights with more efficient lower wattage fluorescent lights. When bulbs need to be replaced, clean the diffusers and reflectors in the fixtures.
- Replace incandescent bulbs with compact fluorescent bulbs. While they cost more, the expense is quickly recovered with a reduction in your electricity costs and less frequent replacement as these bulbs last longer.
- Install occupancy sensors that automatically shut off the lights in storage areas, conference rooms and washrooms when not in use. Consider energy-saving photocell sensors for daylight dimming at window areas.
- Install programmable thermostats to automatically adjust the heating or air conditioning during non-business hours.

Streamline your Costs

Whether your business is large, small or somewhere in between, the pennies found in streamlining your costs soon add up to dollars saved. ■

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The Retiree as Entrepreneur

When circumstances force early retirement or a package deal provides the funds to pursue a dream, many over-50s think about becoming entrepreneurs.

Retirement is a major transition at any age. But when individuals retire early, particularly with large settlement packages, they are sometimes tempted to go into business. Whether the motivation is a need for additional income or new challenges or the realization of a lifelong dream, do you have what it takes to be an owner/manager?

Are you an Entrepreneur?

What motivates you? What makes you happy? Will your business idea require you to broaden your skills or develop new skills? Are you prepared to work hard? Do you work well on your own or would you prefer working with others?

Identify your drivers, your strengths, your weaknesses and your ability to tough it out through the difficult times that are the norm in running any business. If you have only recently come out of a forced retirement, make sure you have taken sufficient time to restore your confidence, explore your options and solidify your plans.

Do you Know the Business?

The best business is one that you know well. Many retirees become consultants in the industry in which they worked. Others may turn a lifetime hobby into a business venture. Sometimes individuals who have never been in business before will recognize a market niche and be quite successful. But too often budding entrepreneurs jump into a business without doing the proper research and planning. Starting up a business in a sector with which you are unfamiliar presents a high risk of failure. Build on what you already have.

Have you Prepared a Business Plan?

Many important considerations must be weighed in considering the viability of a start-up, such as the competition and potential market share, the demographics of your target customers, regulations, taxes, location, staffing, inventory, pricing, marketing, sales, operating costs and much more.

A business plan is essential. There are many resources in the library, your community and online that can help you get started on researching your market and developing a solid business plan. Find out if there are any community or government programs where you can upgrade your skills or learn new skills and network with similar people. Find out if there are any seminars available that are specifically designed for retirees who want to start a business.

Once you have drafted your business plan, your chartered accountant can assist you in developing your operating and cash flow forecasts and budgeting and ensuring your business plan has addressed the many facets to be considered.

Working with Others

A good working relationship is critical to investing capital and effort into an existing business or starting a new business with a partner or partners. Sharing experience, skills, costs, problems and the workload can make the venture more rewarding both socially and economically. On the other hand, sharing a business venture with someone else can have some hazards.

Make sure you are familiar with your potential business partner's approach to business and the experience and skills he or she can offer. How does this person set priorities? How much is he or she willing to invest in money, time and skills? Why do you think you will work well together? Have you discussed potential areas of conflict and how you will handle them? How will you set up the business? Have you considered the need for a partnership or shareholders' agreement?

If you have been approached to buy into a company, be wary. Do your due diligence as well as get professional advice. The offer may be nothing more than an attempt to obtain much needed cash flow for a sinking business. Make sure your funds are not destined to pay existing creditors. Do not invest until you have a comprehensive understanding of the operations and the potential for growth.

Base Decisions on Facts, not Emotions

Opening a restaurant, restoring old cars or making furniture — these types of hands-on businesses are often the dreams of many individuals who end one career and want to start another. Emotionally-based decisions do not have a place in investing in your future. Take off the rose-coloured glasses and do your homework. Too fast a move could mean unattainable sales, unrealistic expectations for business growth and a lack of preparedness for overcoming the inevitable challenges you will face when starting a new business.

If you are buying an existing business, be wary of a vendor who is anxious to close the sale. The vendor could pick up on your enthusiasm and help you self-promote your desires until you sell yourself on what could be a disaster. Watch out for fast-talking, high-pressure sales tactics. The individuals selling or promoting the business may harness any vulnerability you may have at this stage to make as much as they can on the sale or sales commission. If all you hear is glowing reports of how much money is to be made, be wary. If you are being pressured into making a quick decision, walk away.

Certainly, any dream is worth pursuing but if you start to wonder whether your decision is based on emotions rather than facts, it is time to go back to the drawing board. Keep focused on assessing whether going into business is a good match for your background and needs and whether your business idea truly has the potential to provide a good return on your investment.

I Can Turn it Around

Many entrepreneurs believe that they have the ability to turn around a business that is going down the tubes and restore its profitability. While many do succeed, this is an investment of time and money that requires very astute analysis and investigation.

Make sure you are thoroughly familiar with the business, know the reason for the losses and have the resources to turn it around. Ask yourself: Why has the business failed? Would my investment dollars be better spent establishing a new similar business rather than resurrecting a failing structure?

Distress purchases are generally not advisable; however, there are unique circumstances where the business has solid potential and the purchase price and terms of payment are highly favourable. Your chartered accountant can help you assess the viability of the business as well as give you professional advice on any tax advantages to be weighed in your decision.

Working Capital

Working capital is the lifeblood of all businesses. Start-up businesses need at least six months of working capital to launch their operations, introduce their products or services to the market and cover overheads. On top of operating expenses, you need to be prepared for the lapse of time between a sale and the collection of accounts receivable. If the business is seasonal, you will also need cash flow to maintain operations during these slow times.

If you are starting your business with the proceeds of a settlement, it may not be wise to invest all of it into the business. If you will need financing, again a professionally-prepared business plan is a must.

Get Professional Advice

Before pursuing that dream of having your own business, make sure you seek the advice of both your chartered accountant and your lawyer. Your chartered accountant can advise you on your business plan or analyze the financial performance and viability of a company you plan to purchase. There will also be tax planning considerations that you will need to discuss. And it goes without saying, do not sign anything without independent legal advice. ■