Business Matters

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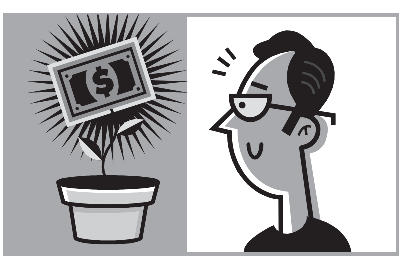
TAXATION

The RRSP Decision

For most taxpayers, the registered retirement savings plan (RRSP) is an effective vehicle for immediate tax savings. Not only does an RRSP serve as a tax shelter, by allowing investment income to grow tax-free, it also allows you to deduct your contributions from taxes payable.



RRSPs are an attractive investment. But like all investments, there are pros and cons to consider in view of your specific circumstances and financial goals.

The Pros...

An RRSP is a formal arrangement that allows you to invest in “qualied investments” that are designated as “registered” for retirement purposes. Some of the advantages of this investment include:

- Your RRSP contributions reduce your taxable income and, therefore, reduce the income taxes payable in the year the deduction is claimed. This allows a greater amount to be invested than if unregistered investments are made. You can continue to contribute until December 31 of the year in which you turn 69, at which time the plan “matures”. If you cannot contribute because of your age, you can still contribute to your spouse's or common-law partner's RRSP until the end of the year in which he or she turns 69.
- Your investment in your RRSP can be as little or as much (within the contribution limits set by the CRA) as you can afford to save. Generally, the amount you can contribute to your own RRSP or to your spouse's or common-law partner's RRSP for a given tax year is determined by your RRSP deduction limit. Called your “contribution room”, this amount is indicated on your latest Notice of Assessment or Notice of Reassessment.
- A variety of investments can be held in an RRSP, including mutual funds, GICs, stocks, bonds and cash.
- Certain types of payments (e.g., transfers of funds between registered

plans) can be transferred directly to your RRSP on a tax-free basis rather than receiving the amounts currently and being subject to tax on it in the year received. The RRSP deduction limit is not reduced by these transferred amounts.

- If you are unable to contribute the maximum amount allowed in any year, you may carry forward the unused portion and contribute in a future year up to the amount of your contribution room for that year. Deferring contributions until a year in which you are in a higher tax bracket will produce better tax savings and may result in higher returns.

- Any interest, dividends or capital gains that are earned within your RRSP plan are not taxed until they are withdrawn from the plan. This can result in substantial savings in taxes if your income (and marginal tax rate) is lower at the time you make withdrawals for your retirement.

- RRSP funds can be a source of "emergency" funds if the need arises in a year in which your income is particularly low but the withdrawal must be added to your income and will be fully taxable in that year. Note that it is not possible to repay these withdrawals unless you use your current RRSP deduction limit.

- In certain circumstances, you can borrow from your RRSP to purchase a house or for educational purposes using the Home Buyers' Plan or the Lifelong Learning Plan without paying tax on the amounts on a current basis.

- You can arrange to have RRSP contributions deducted on a regular basis from your pay cheque or bank account. Having a "forced savings" program will help ensure that you contribute the maximum amount in a given year.

- The growth in tax-deferred RRSP investments can create a substantial retirement fund. For example, contributing $500 per month from the age of 25 to 65 with only a 5 % return on your investments would accumulate $763,010. Of that amount, $523,010 would be investment earnings.

- In the event of death, RRSPs can be transferred to a spouse's or common-law partner's RRSP on a tax-free basis. That is, the balance within the RRSP is not deemed to be taxable income to the deceased taxpayer. Rather, your spouse or common-law partner will pay tax on any RRSP withdrawals or tax on the full amount of the remaining RRSP at the time of his/her death.

- The 2005 Federal Budget eliminated the previously set foreign content limit of 30% for RRSPs. This means 100% of the book value (original cost) of your RRSP can be foreign content. While this allows you more international diversification opportunities, it is important to remember that the foreign content is only one portion of a well-diversified portfolio.

The Cons...

An RRSP is a way to postpone the payment of income taxes, not eliminate them. Consider also:

- You cannot claim capital losses realized on the sale of investments within your RRSP against gains on other investments you have outside of your RRSP. The only relief for these losses is that ultimately there is less in your RRSP resulting in lower withdrawals and, therefore, less tax in your retirement years.

- The special rules that exist for investment income earned outside the RRSP are not available for investments within the RRSP. These benefits include the one-half inclusion of capital gains in income, the reduced tax on dividends from Canadian corporations and the $500,000 lifetime capital gains exemption for investments in qualifying small business corporations. For this reason, in determining your overall asset mix, it is usually best to hold your interest-bearing investments in your RRSP and hold growth and/or dividend paying securities outside of your RRSP.

- There is no relief for foreign taxes withheld from foreign income earned within the RRSP. This loss of a foreign tax credit can reduce your investment returns.

- When the RRSP matures, the funds must be withdrawn in the current year, transferred to a RIFF or used to purchase an annuity. No tax is withheld on amounts transferred to a RIFF or used to purchase an annuity. However, if funds are withdrawn from your RRSP, tax will be withheld and you must include the amount withdrawn in your income for that year and likely pay additional income taxes.

- If your income is higher in your retirement years than at the time the RRSP deductions were claimed, you could end up paying more tax in retirement than you saved in the earlier years. The benefit of tax-free growth over many years often offsets this cost. For this reason, it may not be advisable to make RRSP contributions when your income is low, particularly when age 69 is approaching.

- Amounts that you contribute in a year in excess of your RRSP deduction limit may be considered excess contributions. A tax of 1% per month applies on the portion of your RRSP contribution that exceeds your RRSP deduction limit and the over-contribution limit of $2,000.

- If you have sufficient retirement income from other sources, such as the Canada Pension Plan, a registered pension plan, a deferred profit-sharing plan or real estate, you may not have to withdraw funds from your RRSP early on in your retirement. Although this may allow you to stay in a lower income tax bracket, the downside is that when the RRSP plan matures, the mandatory RIFF, annuity or withdrawal may place you in a higher income tax bracket. This increase in retirement income may cause some or all of your Old Age Security to be eliminated.

- Interest on funds borrowed for an investment in an RRSP is not tax deductible whereas interest on funds borrowed for an investment outside of an RRSP is deductible.

- RRSPs cannot be used as security by lenders. If you do use it as security, the value of the RRSP is included in your income.

- You cannot deduct the costs of investment advice or brokerage fees incurred for your RRSP investments.

Considering the pros and cons of RRSPs is the first step in determining whether you wish to commit to RRSPs as part of your investment strategy.

Managing Your Investments

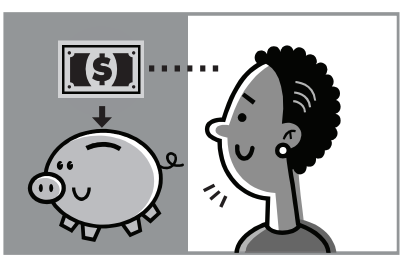
In planning for your retirement, be sure to investigate the pros and cons of the many RRSP-eligible and non-RRSP eligible products in the marketplace. Managing your investments along with minimizing your personal income taxes are important factors in determining your future income security.

Your chartered accountant can assess the income tax implications of your retirement planning and advise you on ways you can make your investment portfolio “tax-efficient”. ■

MONEYSAVER

Streamlining Costs

Finding ways to reduce costs is always in the owner/manager's sight line. Here are a few tips that can help you improve the bottom line without having to make significant outlays.



Shipping and Couriers

If you have been using the same local or regional carrier for the past few years, it may be time to have a meeting to discuss if any costs can be reduced.

- Review and analyze the volume of shipments, the timing and the locations to which the goods are shipped.

- 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?

- 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.

Travel Expenses

Review travel expenses in view of the amount of business the travel generated. If travel expenses are creeping up, it may be time to adjust, or set out, caps for accommodation and meals or to contact hotel and motel chains to find better corporate rates.

- Consider incentives to reduce expenses, such as avoiding higher-priced departure dates for air travel. The airline's discount for a weekend stay can be signicantly more than the costs of staying an additional day or two.

- Plan travel itineraries well in advance so that regional customers can be visited in the same swing to reduce travel time and costs.

- Negotiate reduced rates at motels and hotels in frequently visited areas.

- Book business trips through an experienced travel agent who can find the best deals.

Equipment

New equipment purchases are frequently viewed as cost-saving solutions. While capital expenditures can save money over the long run, it is important to determine what aspects of the equipment can generate savings.

- Before buying or leasing new equipment such as photocopiers, research the various models and user reports.
- Determine the features that your business actually requires and will use. Do not buy bells and whistles that are unnecessary. For example, is a full-colour copier necessary or nice to have?
- Consider whether a repair and maintenance service package would be cost effective.

Lease Renewal

If you are leasing your business premises:

- Keep up-to-date with market prices, particularly the year before your lease comes due.
- Research lease costs for comparable office or warehouse space so that you will be prepared to present compelling reasons why the landlord should want you to stay at the same or a more reasonable rate.

Landlords want continuity of quality tenants as much as the tenants want continuity of location. And, of course, a move is disruptive and costly for any business.

Credit and Banking Costs

Credit cards, line of credit, overdraft charges and long-term loans cost real money and impact working capital.

- Detail all financial transactions by type and review the monthly costs.
- Where costs have increased, determine if changes need to be made to collection, purchasing or operational expenditures.
- If bank charges have increased, ask your financial institution if there are ways to reduce these costs. Service packages may be available.
- Make sure interest costs are appropriately allocated so that you can determine the sources and make adjustments. If, for example, most of the interest expense comes from carrying balances on credit cards, are the cards being used to finance operations? Consider using a line of credit, which can be obtained at a lower interest rate, and pay the credit card balances in full each month.

Utilities

The high cost 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.

- Determine if older equipment could be replaced with energy efficient models or if existing equipment could be economically retrotted.
- Assess whether it would be more cost effective to pay overtime and use energy when it is cheaper.
- Install timers in office and plant areas and motion sensor lighting in outside areas.
- Reduce the water heater temperature.
- If you do not have programmable thermostats, encourage staff to turn the heat down one or two degrees when they are the last ones to leave the premises. Lowering the heat is particularly cost-effective on weekends and holidays.
- Replace traditional filament light bulbs with energy-efficient bulbs or fluorescent lighting.
- Encourage employees to make a conscious effort to reduce energy costs. Post friendly reminders to help make all employees aware that their energy-conserving efforts can make a difference.

The Savings Add Up

Accounting and management software can be used to analyze costs specific to each area of your operations so that the owner/manager and employees can work together to identify where savings are possible. The savings in any one area may seem small but when several initiatives are bundled together, they can make a significant difference. ■

Can We Be Of Service To Someone You Know?

If you have friends or business associates who you think would like to receive our newsletter, please give us their names. We would be happy to send the newsletter to them with your compliments.

Before Discarding a PC

Companies typically shred documents before disposing of them but too often do not take proper measures when disposing of old PCs. Not only are there privacy and data security issues to consider, it may also be necessary to delete certain applications to avoid violating the license agreements.

When your company upgrades its computers, you may decide to sell, donate or recycle the old ones. But before handing over a PC to anyone else, you need to make sure all data is permanently deleted from the old computer. It is a well-known fact that cyber-criminals routinely target sold, donated and discarded computers because of the amount of information that can be easily retrieved.

Deleting is Easier Said than Done

Some users believe that when they go through their hard drive to delete files and then empty the recycle bin, the data is gone. However, this process simply makes the file unreadable to the operating system at that time. With a bit of work, and not much time, the files can be recovered and read. In addition, Windows often stores information such as passwords, credit card numbers and previously deleted files and e-mail without your even knowing it.

So what can you do to ensure the data cannot be retrieved? As a first step, the owner/manager should establish guidelines for preparing computers for disposal and know exactly what will happen to these old PCs.

Wiping the Hard Drive

Every time a PC is disposed of, the hard drive should be "wiped" to ensure that no data is accessible to any future owner of either the PC or the hard drive. As data can be recovered from broken disk drives, the only real method of permanently removing data is using a special software program designed for this purpose.

There are two types of programs that can be used to wipe a hard drive - those that "scrub" files and folders and those that "wipe" the entire hard drive.

Software programs that "scrub" the hard drive can remove all data without disturbing the Windows operating system. The software also "bleaches" hard drives by overwriting the data on the drive with randomly selected characters to ensure that it cannot be recovered.

Other programs will delete everything on the disk by reformatting the hard drive. Unlike the scrub software, these types of programs do not allow you to pick and choose the files, applications and programs that are to be removed. Before activating the program, be sure that the hard drive contents are fully replicated because once it's gone... it's gone forever. For the PC to be usable again, the new owner will need to reinstall Windows, the drivers and the application software.

Donating or Recycling PCs

An outdated computer may be an upgrade for someone else. Contact local schools, churches and charities to find out if they could use the computers that you are going to discard. As many will not have the resources to replace deleted operating systems if the hard drive has been completely wiped, consider reinstalling the operating system or including the original copy with the PC. Some organizations may be able to use old computers to refurbish nonworking ones.

If the computers are obsolete, discard them responsibly. Computers contain hazardous materials that are detrimental to the environment. Many computer manufacturers and other companies have established programs for recycling computer hardware. Some retailers are also offering incentives such as discounts on new purchases for customers who recycle.

Take Precautions

Failure to destroy data is an invitation for unscrupulous individuals to obtain critical corporate information that could damage your business or be used for identity theft. Before selling, donating or recycling old computers, take extra precautions to make sure the hard drives are truly erased.

Also keep in mind that many electronic devices such as cell phones and PDAs also carry an immense amount of data. Similar to PCs, you need to take steps to ensure all data is erased before you donate or recycle them. For instructions on how to effectively "scrub" these devices, check the manual or the manufacturer's website. ■

Improving Accessibility

Businesses that operate out of older buildings are aware of the need to improve access to their buildings. Although local ordinances may mandate improvements, the desire for most entrepreneurs to improve access for the disabled is often also motivated by personal experience with family members, friends or business colleagues.

Perhaps it is our aging population or the inspiration of individuals, such as Rick Hansen or the Special Olympics athletes and volunteers, that has motivated the tax authorities to provide tax assistance to businesses to improve accessibility. Whatever the motivation, any assistance provided is welcome.

Improvements

Historically, improvements made to a structure, regardless of the purpose, were capitalized and the deduction was claimed against income utilizing the Capital Cost Allowance formulas provided within the *Income Tax Act*. Thus, rather than writing off a $15,000 improvement in the year improvements were made, the write-off was scheduled over a number of years. This was, and still is, a deterrent to small businesses, as the cash flow required to make these improvements is not offset by the reduced cash payout for taxable income.

With the advent of a more liberal approach to assisting both businesses and the disabled, there are now specific expenditures that are allowed as a 100 % expense against income, even though traditionally they could be viewed as capital in nature. These include:

- Ramps, either interior or exterior, that allow access for a person with mobility impairment;
- Washroom renovations that allow access to wheelchairs. This could be a large area of expenditure when one considers that access may require larger doors, larger stalls, lowering or moving wash basins and dryers and changing light switches;
- Modifications to doors and elevators to accommodate a person in a wheelchair;
- Audio and/or Braille position indicators in elevators for the visually impaired;
- Electric doors that are operational with push buttons; and
- The installation of visual fire alarms for the hearing impaired.

Transportation

Outside of the capital improvement area, the CRA is also providing incentives to help businesses, the blind and disabled bring together their respective skill sets without incurring additional costs.

Businesses that employ blind or disabled individuals and pay a reasonable allowance for travel costs to and from work, including parking at the workplace, are allowed to deduct these expenses. To add icing to the cake, employees are not required to include these amounts in their income as a taxable benefit.

Talk to Your Chartered Accountant

If it's time to renovate your premises, talk to your chartered accountant to determine the best means of ensuring that your business is able to take advantage of these tax incentives while lending a helping hand. ■