

# Tax Tips for Small Business

Webinar Presentation



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# Presenter



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- We have more than 60 offices strategically located in urban and rural markets throughout Canada
- More than 3,800 team members and 650 partners dedicated to delivering the right solutions for you

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- China
- Credit Unions
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- Forestry
- Manufacturing
- Mining
- Not-For-Profit
- Oilfield Services
- Private Enterprise
- Professionals
- Public Companies
- Public Sector
- Real Estate & Construction

# Today's Objective

Help you understand how taxation works for your business.

Provide useful tips to make the filing process easier for you.



# Agenda

I. Business Structures

II. Should You Incorporate?

III. Business Profits

IV. Capital Cost Allowance

V. Automobile Expenses

VI. Home Office Expenses

VII. Income Splitting

VIII. Administration – Tax Regulations

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# I. Business Structures

- Sole Proprietorship:
  - Unincorporated business
  - Owner pays personal tax on profits from business
- Partnership:
  - Unincorporated business
  - Multiple owners share in profit and liability of business
- Corporation:
  - Legal entity that is separate and distinct from owners
  - Same rights and responsibilities of a person



# Sole Proprietorship: An Overview

## Advantages

- Losses can be used to offset against other income for taxes
- Lower administrative costs

## Disadvantages

- No advantageous tax rates
- Personal liability

# How Much Tax Do You Pay?

- Depends on which personal tax bracket you fall into:

2016	
\$0 - \$11,474	0%
\$11,475 - \$15,843	15%
\$15,844 - \$44,601	26%
\$44,602 - \$45,282	28%
\$45,283 - \$90,563	33.5%
\$90,564 - \$127,430	39%
\$127,431 - \$140,388	41%
\$140,389 - \$200,000	44%
\$200,000 and up	48%

2017	
\$0 - \$11,635	0%
\$11,636 - \$16,065	15%
\$16,066 - \$45,225	26%
\$45,226 - \$45,916	28%
\$45,917 - \$91,831	33.5%
\$91,832 - \$129,214	39%
\$129,215 - \$142,353	41%
\$142,354 - \$202,800	44%
\$202,800 and up	48%

# How Much Tax Do You Pay?

- Canada Pension Plan Contributions
  - Responsible for both employee and employer contributions
  - In 2016 pay 9.9% on income in excess of \$3,500 to a maximum of \$54,900 (\$5,089)
- Can chose to pay Employment Insurance premiums.

# What Do You Pay Tax On?

- Business profits for the fiscal period
- In your first year of operation your fiscal period will be from the date you start operations to December 31<sup>st</sup>
- In subsequent years it will be for the period from January 1<sup>st</sup> to December 31<sup>st</sup>

## When Do You Pay?

- All tax must be paid by April 30<sup>th</sup>
- If the tax owing on your return in either of the two preceding taxation years is greater than \$3,000 you will be required to make quarterly installment payments
- CRA will advise you of the amounts to pay

## When Do You Pay?

- Payments are due on March 15<sup>th</sup>, June 15<sup>th</sup>, September 15<sup>th</sup>, and December 15<sup>th</sup>.
- Failure to make installments as required or to pay the tax owing by April 30<sup>th</sup> result in interest charges:
  - Current interest rate is 5% compound daily

# Partnership: An Overview

## Advantages



- Similar to advantages of sole proprietorship
- Ability to choose split of profit (%) from year to year

## Disadvantages



- Personal liability
- Partnership disputes

# Partnership

- Partners determine the share of profits to be allocated to each partner
- Must ensure that the allocation is reasonable:
  - Take into account amount of capital each partner has invested
  - Take into account the effort expended by each partner



# Corporation: An Overview

## Advantages



- Limited liability
- Favourable tax rates
- Ability to defer taxes
- Potential tax advantages on sale

## Disadvantages



- Higher administrative costs
- Limited use of losses
- Still may require personal guarantees on financing

# How Much Tax Does It Pay?

- In Saskatchewan (2016):
  - 12.50% on the first \$500,000 of its active business profits
  - 27% on active income over \$500,001
  - 50.67% on interest and inactive income



# What Does It Pay Tax On?

- On its profits for the fiscal period
  - Revenues less expenses
- Corporations can select any year-end that they want:
  - Try and match it to the cycle of your business
  - Have your year-end at a slower time
  - Can take advantage of deferral

## When Does It Pay Its Tax?

- Tax must be **PAID** within 3 months of the end of the company's year end
- Tax returns must be **FILED** within 6 months
- Quarterly installments if previous year tax >\$3k
  - Due the end of each quarter
  - CRA does not send statements
  - Interest charges if installments not made or taxes not paid within the 3 month deadline

# Getting Corporate Funds into Your Personal Hands

- As a shareholder you cannot take funds or assets from the corporation without accounting for them on your personal tax return.
  - Doing so can result in significant penalties!
  - In some situations the amount may be taxed personally with no deduction to the corporation!



# Getting Corporate Funds into Your Personal Hands

- You cannot borrow funds from your corporation without adverse tax consequences:
  - Except in limited circumstances the loan must be repaid within one taxation year or it will be included in your personal income
  - Deemed interest benefits for the period of time the loan is outstanding (currently 1%)

# Valid Payments to Shareholders

- A. Repayment of shareholder loans
  - Tax Free
- B. Salary
  - Subject to income tax and CPP withholding
  - Not subject to EI if the shareholder owns > 40% of the voting shares of the corporation
  - Salary cannot be changed to loan repayment at end of year (court precedent)

# Valid Payments to Shareholders

- C. Dividends
  - Not subject to source deductions when paid out
  - Individual is responsible for personal tax on T1
  - Dividends are not deductible to the corporation
  - Dividends do not form part of earned income for RRSP purposes



# Should You Pay Salary or Dividends?

- Payment of at least some salary can be desirable so that you are eligible to make CPP and RRSP contributions



# 2016 Marginal Personal Income Tax Rates

<b>Income bracket</b>									
	\$0	\$11,475	\$15,844	\$44,602	\$45,283	\$90,564	\$127,431	\$140,389	\$200,001
	to	to	to	to	to	to	to	to	and
	<u>\$11,474</u>	<u>\$15,843</u>	<u>\$44,601</u>	<u>\$45,282</u>	<u>\$90,563</u>	<u>\$127,430</u>	<u>\$140,388</u>	<u>\$200,000</u>	up
Salary, business, interest & rental income	0.00%	15.00%	26.00%	28.00%	33.50%	39.00%	41.00%	44.00%	48.00%
Dividend income - non-eligible	0.00%	5.24%	14.17%	16.51%	22.94%	29.38%	31.72%	35.23%	39.91%
Dividend income - eligible	0.00%	-0.03%	-0.03%	2.76%	10.32%	17.91%	20.67%	24.81%	30.33%
Capital gains	0.00%	7.50%	13.00%	14.00%	16.75%	19.50%	20.50%	22.00%	24.00%

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## II. Should You Incorporate?

- Depends on your individual situation
- Major tax benefit is the tax *deferral* that you receive:
  - i.e. pay 12.50% tax in the corporation compared to the 48% you would pay personally if you were taxed at the high rate
  - Larger after-tax pool to invest
- On sale of shares, capital gains may arise
  - Sale of shares may qualify for small business capital gains exemption (maximum lifetime amount of \$824,176)

# Should You Incorporate?

- Only makes sense if you are taxed in the middle or high tax bracket personally
  - Low Brackets                      0% - 28%
  - Middle Brackets                    33.5% - 39%
  - High Brackets                      41% - 48%

# Should You Incorporate?

- In order for the funds to be taxed in the corporation, funds must remain in the corporation
  - If you need to draw all the funds out of the corporation for your personal living expenses incorporating does not make sense

# Should You Incorporate?

- “If I start as an unincorporated business can I decide to transfer my business to a corporation later?”
  - Yes
  - Relatively easy to do
  - Can be done with no immediate tax consequences

# Should You Incorporate?

- “If I start as an incorporated business and decide that I would rather operate as an unincorporated business, can I do this?”
  - It can be done but may be a rather costly conversion from a tax point of view



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## III. Business Profits

- *General rule:* A business can claim all expenses incurred for the purpose of gaining or producing income
  - Start with accounting income and make adjustments
  - Must be reasonable in the circumstances

# Business Profits: Common Adjustments

- Donations
  - Sole Proprietorship or Partnership:
    - Donations are not deductible in calculating business profits
    - Donations can be claimed on your personal tax return as a tax credit.
  - Incorporated business:
    - The claim for donations is limited to 75% of the net income of the corporation.

# Business Profits: Common Adjustments

- Political contributions
  - Not deductible as a business expense for tax
  - If a contribution is made to a federal party you may be entitled to a tax credit
  
- Club dues
  - Not deductible if for a sporting, recreational or dining facility
  - For example, golf club memberships not deductible

# Business Profits: Common Adjustments



- Meals and entertainment expenses
  - Only 50% of these expenses are deductible for tax purposes
  - Can only be deducted if incurred to earn income
  - Similar rule for GST
  - Examples
    - Business lunches, drinks when entertaining clients, tickets to football games, tickets to concerts, etc.

# Business Profits: Common Adjustments

- Canada Revenue Agency interest
  - Not deductible for income tax purposes
- Depreciation/Capital Cost Allowance
  - Depreciation that you calculate for accounting purposes may not be equal to the CCA that you calculate for tax purposes

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## IV. Capital Cost Allowance (CCA)

- Assets are put into specified classes which provide for depreciation at a specified rate.

Description	CCA Class	CCA Rate
Buildings (used for manufacturing)	Class 1	10%
Buildings (other non-residential)	Class 1	6%
Computers	Class 50	55%
Computer Software	Class 12	100%
Office Equipment	Class 8	20%
Furniture	Class 8	20%
Vehicles	Class 10 or 10.1	30%
Eligible Capital Property (new in '17)	Class 14.1	5%



# Capital Cost Allowance

- Most classes are calculated on a declining balance method
- All assets which fall into a particular class are grouped together and CCA is calculated on the pool of assets
- Most additions are subject to the half year rule
- Claims are prorated for short year ends

# Capital Cost Allowance

- When assets are disposed of, the **lower of cost and proceeds** are removed from the pool
- If ALL assets are removed from the CCA pool, you may have to deal with a *terminal loss* or *recapture*

# Capital Cost Allowance

- Example:
  - Year end is December 31<sup>st</sup>
  - Purchase a photocopier on November 15<sup>th</sup> for \$3,000
  - Year of purchase ½ rate rule in a 20% class
  - CCA is \$300 in year 1
  - CCA is \$540 in year 2
  - CCA is \$432 in year 3

# Conversion of Personal Assets to Business Assets

- Determine fair market value of the assets
- If unincorporated show as a contribution to the business
- If incorporated sell the asset to the corporation for fair market value or transfer on a tax-deferred basis (seek professional guidance)

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# Automobiles: Unincorporated Business

- Claim business portion of your automobile expenses:
  - Eligible expenses include gas, repairs and maintenance, license, insurance, interest on car loan, lease payments, CCA on automobile.



# Automobiles: Incorporated Business

- *Option 1:* Keep vehicle in your personal name and get reimbursed by the corporation on a kilometre basis for business use:
  - Limited to \$0.54 on the first 5,000 kilometres and \$0.48 thereafter (2016)
  - Reimbursement does not have to be included in your personal income
  - Deductible to the corporation

# Automobiles: Incorporated Business

- *Option 2:* Keep vehicle in your personal name and get paid a flat monthly allowance for the business use of your vehicle
  - Deductible to the corporation
  - Must be included in your personal income
  - You can claim auto expenses against the income on your personal tax return



# Automobiles: Incorporated Business

- *Option 3:* Company owns the vehicle
  - Company can claim operating expenses and capital cost allowance on the vehicle
  - A benefit will be included in your personal income if the vehicle is available for your personal use
    - Can be quite expensive

# Automobiles: General Guidelines

- Keep a log to support the business use
- Limits on expenses for 2016:
  - Capital cost allowance
    - Addition limited to \$30,000 plus PST and GST
  - Interest expense
    - Limited to the lesser of the total interest paid and \$10 × the number of days for which interest was paid
  - Lease expense
    - Limited to \$800/month plus PST and GST based on lease signing date

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## VI. Home Office Expenses

- Unincorporated business:
  - To claim, you must meet one of the following tests:
    - The work space is your principal place of business, or
    - The work space is used exclusively for the purpose of earning income from business and is used on a regular and continuous basis for meeting the clients or customers of your business.

# Home Office Expenses

- Incorporated business:
  - Must be principal place of business
  - Determine business use and charge to corporation



# Home Office Expenses

Description	Employees	Commissioned Sales People	Self-Employed
Rent	Yes	Yes	Yes
Utilities	Yes	Yes	Yes
Repairs & Maintenance	Yes	Yes	Yes
Telephone	Yes	Yes	Yes
Supplies	Yes	Yes	Yes
Home Insurance	No	Yes	Yes
Property Taxes	No	Yes	Yes
Mortgage Interest	No	No	Yes
Capital Cost Allowance	No	No	Yes

# Home Office Expenses

- Limited to business use
  - Based on square footage
- Cannot be used to create or increase a loss from the business
  - If cannot be utilized in the current year can carry forward

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## VII. Income Splitting

- Why?
  - To allocate income to family members who may be taxed in a lower tax bracket
- How?
  - Pay salaries to family members
    - Must be reasonable for the service they are providing
    - Generally scrutinized by CRA

# Income Splitting

- If business is incorporated, there may be other opportunities to income split by having family members as shareholders
  - Allows for the payment of dividends

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## VIII. Administration – Tax Registrations

- Canada Revenue Agency: Business Number Registration
  - GST
  - Payroll
  - Corporate tax account



- Provincial Sales Tax



- Workers Compensation



# Tax Registrations

- GST
  - Generally file quarterly
  - Can elect to file monthly or annually
- Payroll Source Deductions
  - Required to withhold and remit income tax, Canada Pension and Employment Insurance from salary payments

# Tax Registrations

- As employer you have to pay employers portion of Canada Pension and Employment Insurance.
  - CPP: match employee's contribution
  - EI: match 1.4 times employee's contribution
- Source deductions must remitted monthly to CRA – deadline is the 15<sup>th</sup> of each month
- Must prepare and file T4s – deadline is February 28<sup>th</sup>

# Tax Registrations

- Provincial Sales Tax
  - 5% (Saskatchewan)
  - Generally collected on goods and some services
  - Different than GST - no input tax credits for the PST that you pay
  - Commission for acting as a collection agent
  - May file annually, quarterly, or monthly

# Tax Registrations

- Worker's Compensation
  - Based on wages and the category that the employee falls into
  - File form annually - due February 28<sup>th</sup>



# Administrative Tips

- Keep a mileage log
- Put CRA deadlines in your calendar
- Keep your records for 7 years
- Keep business and personal expenses separate
- Set yourself a budget and monitor frequently
- Be descriptive in your bookkeeping

# Recap

Help you understand how taxation works for your business.

- Understand business structures and taxation for each
- Getting company money into your hands (salary, dividend)
- Whether or not incorporation may work for your business
- Common business expenses (CCA, automobile, home office)
- Administrative items to help you navigate CRA and books



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Questions?

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