STARTING A SMALL BUSINESS 2016

ADVICE.
INSIGHT.
OPPORTUNITIES.

KINGSTON
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INTRODUCTION

This guide to *Starting a Small Business* has been written by Kingston Ross Pasnak LLP Chartered Professional Accountants ("KRP"). We have a history of serving owner-managed businesses since 1945 and are able to provide specialized support, while establishing a close relationship with the business and its owners.

BUILDING CONFIDENCE, DOING THINGS DIFFERENTLY, EXCEPTIONAL VALUE AND THINKING BEYOND CONVENTIONAL BORDERS; THESE ARE THE CORNERSTONES OF KINGSTON ROSS PASNAK LLP.

Who We Are

Client-focused and unabashedly entrepreneurial, KRP is amongst the largest independent full-service accounting firms in the province. We're driven to provide the personalized advice our clients require to maintain a competitive edge… while ensuring "small-firm" responsiveness. Our strength is our ability to offer expertise beyond the ledger.

The experience of 16 partners and the hard work of over 110 people is the foundation to KRP's extraordinary services, and lasting relationships. KRP was ranked 26th in Canada's Accounting Top 30 by The Bottom Line magazine, April 2014. This reflects our ability to provide clients with a full range of accounting and related services that can impact your success.

While accounting, auditing and tax remain core services, we have a full range of professional expertise and experience to provide our clients a full spectrum of financial and business support services, including:

- Business case/plan development
- Business management
- Business process/internal control reviews
- Business valuations
- Financial and strategic planning
- Financial litigation support
- Forensic accounting
- Internal audit
- Management consulting
- Mergers and acquisitions

By choosing KRP, you get the agility, the perspective and the responsiveness that comes from having senior partners and managers firmly rooted in the province we serve – and directly engaged with every client we represent. We pride ourselves in being innovative: by providing counsel tailored to each client's unique situation.

International Reach

Kingston Ross Pasnak LLP is a member of a worldwide affiliation of independent accounting firms known as DFK International. DFK International is a major international association of independent accounting firms and business advisors that has been meeting the needs of clients with interests in a vast number of countries for over 50 years. The association has over 300 offices across the world. This connection enables us to support clients in every aspect of international taxation, business consulting and any other matters regardless of where business needs or opportunities occur.

We have experience in the following industries:

- Agriculture and Agribusiness
- Engineering and Construction
- Financial, Investment and Professional Services
- First Nations and First Nations Economic Development
- Forestry
- Government
- Health and Human Services
- Heavy and Light Industrial
- Hospitality and Entertainment
- Manufacturing and Processing
- Media and Telecommunications
- Oil, Gas and Energy Exploration Services
- Real Estate and Land Development
- Technology and Advanced Technology
- Transportation
- Wholesale, Retail and Distribution

OUR SERVICES

KRP has had the opportunity to work with a broad range of private and public sector companies and organizations. This has enabled us to develop expertise in many different practice areas, including:

Accounting, Auditing and Advisory Services

- Year-end financial statements
- Compliance audits
- Financial analysis
- Budgets – corporate and personal
- Cash flow projection
- Government reporting requirements
- Profitability analysis
- Financial planning

Due Diligence

- Due diligence reviews for purchase and sale of businesses
- Due diligence reviews for creditors

Financial Litigation Support

- Business valuations
- Fairness opinions
- Damage quantification
- Personal injury claims
- Shareholder disputes
- Arbitration/mediation
- Intellectual property disputes
- Expert witness testimony

Business and Brokerage Services

- Find buyers and vendors for businesses
- Taxation services
- Business valuations

Consulting and Special Projects

- Business case/plan development
- Capital projects and public-private partnerships
- Forensic accounting
- Special investigations – civil and criminal
- Risk management and corporate governance
- Internal control reviews
- Business process re-engineering
- Compliance and program audits
- Strategic planning
- Interim financial management and staffing
- Internal audit co-sourcing and outsourcing
- Financial analysis, forecasts and projections

Tax Consulting

- Corporate and personal tax
- Cross-border taxation issues
- Estate and inheritance planning
- Management and planning
- Corporate reorganization
- Family trusts
- Commodity tax services
- Goods and Services Tax planning and consulting
- Charitable status planning

As well, we prepare annually in excess of 2,000 personal income tax returns for our clients.

We hope that this booklet will be useful in establishing your small business and to illustrate the many different ways KRP can contribute to the success of your small business. We look forward to the opportunity to provide our services to your organization.

NATURE OF BUSINESS ENTITY

When starting a business, it is first necessary to choose the type of business entity. There are three basic types of business entities, and a fourth (the Joint Venture) that is a hybrid:

a) **A proprietorship:** With a proprietorship, the business is carried on as an extension of the individual's affairs. All business income and expenses are reported on the individual's personal income tax return and the business will normally have a December 31st year-end.

b) **A partnership:** A partnership is two or more parties carrying on business with a view to profit. The net income and losses from the partnership flow through to the partners' tax returns. A partnership will normally have a December 31st year-end as well. A partnership is used when more than one individual is involved and they want to share net income for an indefinite period. Assets will be owned by the partnership. A partnership interest can be held by an individual or a corporation.

c) **A joint venture:** A joint venture is when two or more parties come together for a specific project. It is commonly used in real estate development. Unlike a partnership, where it is the partnership that owns the business assets, each venturer owns an undivided interest directly in any business assets; reporting only their share of the income and expenses. It is NOT considered a separate entity for tax or GST purposes. A joint venture interest can be held personally, through a partnership, or through a corporation.

d) **A corporation:** A corporation is a distinct entity from the individual's personal affairs. All income and expenses are reported on a separate corporate tax return. The individual is taxed only on the funds received from the corporation.

This booklet has been prepared to discuss only the steps required to start a corporate entity, however many of the following procedures will be the same for a proprietorship and a partnership.

If losses are expected for the first couple of years of operations, the individual should consider a proprietorship or a partnership, as these losses will be included on their personal tax return and applied to income from other sources. This will reduce their total taxable income and thus the amount of personal tax paid. Once the business becomes profitable, it may be incorporated at that time.

We strongly encourage individuals considering incorporating their existing business to contact their professional tax advisor prior to taking any steps as there may be a significant tax liability triggered if the proper tax election forms are not filed. If the business is being established for a specific project, a joint venture should be considered.

INCORPORATION

The first step in starting your business is incorporation. By incorporating, you will be creating a new corporate entity. This entity will be distinct and separate from your personal finances.

We strongly recommend that you have a lawyer incorporate your company. The legal fees for a simple incorporation will cost approximately $750-$1,250. Given the many legal aspects of this first step, the cost of this professional advice will be mitigated by the avoidance of possible problems in the future.

If you have more than one shareholder involved in the corporation, we recommend that you have your lawyer draft a unanimous shareholders agreement. This agreement governs how the shareholders will carry on the business, including things such as the rules for winding up the corporation, and how the assets will be withdrawn and distributed among the shareholders. The agreement also sets out what will happen in the event of the death, disablement or bankruptcy of a shareholder. In addition, the agreement provides rules for conflict resolution among shareholders as well as "shotgun" (buy/sell) rules in the event a dispute cannot be resolved. These rules are designed to ensure the continuation of the corporation in the event of shareholder disputes or problems arise.

Once incorporated, it generally means that the corporation has limited liability. Limited liability means that if legal or financial problems arise in the corporation, the creditors do not have a claim on the shareholders' personal assets. There are a few exceptions that should be noted with respect to a corporation's limited liability:

- The limited liability does not apply for professional corporations. In Alberta, lawyers, accountants, dentists, doctors, chiropractors and a few other professionals are able to incorporate and offer their services through a professional corporation. With a professional corporation, there is no legal protection to the individual who has incorporated. For instance, if a doctor is successfully sued for malpractice, his personal assets may be claimed.
- The directors of a corporation are held personally responsible for unremitted source deductions and GST amounts. For instance, if income tax, EI and CPP are being withheld at source from the corporation's payroll and GST is collected on sales, the corporation is considered to hold these amounts in trust for the government. If the amounts are not paid, the government may make a claim against the director's personal assets. It is then up to the individual to demonstrate that they carried out their duties as a director with due care and attention in order to successfully defend against such action.
- In many instances, banks will require personal guarantees from shareholders before loans will be given to the corporation. Liability will not be limited in these situations. This is discussed further in a later section of this booklet.

Incorporation also allows for income splitting between family members. For instance, a corporation can be incorporated with the individual's spouse or children as shareholders. With this arrangement, dividends can be paid on the shares to the spouse, thereby providing them with income. This is especially useful if a spouse is not earning income from other sources and any income received would be taxed at a lower marginal rate. This arrangement is commonly referred to as income splitting. It is important to note that income splitting with a minor child is subject to certain limitations that may make income splitting disadvantageous. However; each situation would need to be evaluated on its own merits.

ROLE OF YOUR ACCOUNTANT

Generally, your accountant will prepare your financial statements for the year-end and prepare your federal and provincial corporate tax returns. These documents usually must be filed within six months of the corporation's chosen year-end. Your accountant will attach a report outlining their role in preparing the financial statements. There are primarily three different types of written reports that your accountant can attach:

a) **Notice to Reader Engagement:** With this type of engagement, the accountant's role is limited to compiling the financial documents and preparing the financial statements. The accountant has not done any work to determine if the representations made in the financial statements are valid or that generally accepted accounting principles are followed. In preparing financial statements under this engagement, users are cautioned that the financial statements may not necessarily be useful for their purposes. This type of report is generally used when the only users of the financial statements are the shareholders and the taxation authorities.

b) **Review Engagement:** With this type of engagement, the accountant prepares the financial statements with the mandate of determining whether the representations appear plausible. The accountant must acquire a level of knowledge about the business and then determine if the representations made in the financial statements are in congruence with their knowledge of the business and are in accordance with generally accepted accounting principles. This type of report is appropriate when there are other potential users of the financial statements such as a bank or a minority shareholder.

c) **Audit Engagement:** Through an audit, the accountant will perform detailed testing and analyze the corporation's systems to ensure that the representations made in the financial statements are materially correct and presented in accordance with generally accepted accounting principles.

Depending on the existence of financing, the number of transactions and the level of involvement of the shareholders, most small businesses generally require either a Notice to Reader or Review Engagement.

If financing is required, as it is in most cases, the bank will need to review the financial statements annually to assess the corporation's ability to repay the loan. Generally, the banks will not accept any engagement lower than a Review. If the business requires external financing, the standard engagement prepared is a Review Engagement.

Despite the existence of financing, if there are a significant number of transactions or the involvement of employees, a Review Engagement is generally prepared. Through the limited analysis, the accountant can get a feel for the business and often identify any major problems that are not being detected by the owner.

Each level of engagement provides an increased level of assurance to the users of the financial statements. To provide this increased assurance, the accountant must increase the level of work and the accounting fees increase accordingly. Fees are dependent on the nature of each business, size of the business, number of transactions and the proficiency of the bookkeeping by the owner; there is no set fee for each level of engagement. In estimating the fees, it is necessary to review your business venture with the accountant. They will be able to provide a range for the fees, excluding any problems that may arise in preparing the financial statements.

WHY SHOULD ONE INCORPORATE

There are a number of reasons why one should incorporate. We have listed a few of the more common scenarios that may make it beneficial to incorporate and operate your business as a limited company:

a) **Creditor protection:** As noted previously, a proprietorship does not offer any protection in the event the business is sued. All of your personal assets are at stake. Of course, business insurance will mitigate this risk somewhat.

   However, if a limited company is successfully sued, the creditors can only access the corporate assets and not any of the shareholder's personal assets.

b) **Tax deferral – Saving more than Spending:** If the business is generating sufficient income so that the proprietor does not need to draw all of it out to meet personal expenses, there is an opportunity to defer tax using the low corporate tax rates.

   We have attached Schedules I and II to illustrate the current tax rates and the benefit of this tax deferral.

c) **Pay Down Corporate Debt:** Similar to the tax deferral obtained through the calculation above, if a business is incorporated, the income will be taxed inside the corporation at a lower rate. The result is more after-tax cash to repay corporate debt.

d) **Income Splitting:** If a spouse is a shareholder of a limited company, dividends can be paid on their shares to divert some income to them. This income will be taxed as investment income.

   The benefit of paying minor children dividends from an active company has been substantially reduced due to legislation that taxes dividends to minor children at the highest marginal rate.

e) **Capital Gains Deduction:** The $824,176 capital gains exemption on the sale of shares: If a business is sold, the taxpayer may be entitled to shelter $824,176 of the capital gain from tax so long as they are selling shares. If the proprietor is selling business assets, this exemption will not apply.

THE STARTING BLOCKS

a) **Open a bank account:** As stated, the corporation is its own distinct entity. A bank account should be opened in the name of the corporation. This bank account should be used to receive all business deposits and pay all business expenses. You will need to take your incorporation certificate and Articles of Incorporation to the bank in order to open a business account.

b) **Choose a year-end:** All individuals pay tax on the calendar year basis (January 1 to December 31).
Corporations generally have the ability to choose a fiscal year-end anytime within 365 days of starting operations. Once the corporation has chosen a year-end, the corporation will record its income from operations in that period. The financial statements will be prepared at that date and the tax returns will include all income or losses incurred to the date. In choosing a year-end, we recommend the following factors be considered:

   i. Is the year-end suitable for any business cycles that may occur? For instance, if the business is very busy through the summer, it is probably not wise to choose a year ended July 31, as it will unnecessarily burden your staff that would otherwise be busy through that period. As well, the business may be carrying large amounts of accounts receivable, inventory and operating loans through that period and the owner does not want that shown in the year-end financial statements (large fluctuations at certain times of the year may distort the operating ratios which are reviewed by the bank).

   ii. Are there any potential deferrals of income? In choosing a year-end in the latter half of the year (July through December), there are potential deferral options available to the owner. These will be explained further in the Traps & Tips section of the booklet.

c) **Buying business assets:** When buying assets that are used exclusively in the business, such as machinery or real estate, the corporation should hold the asset. There are two basic types of assets: tangible and intangible. In purchasing either type of asset, there is no tax deduction for the corporation upon purchase as the asset has a long-term life.

   In terms of tangible assets, there are two key types: depreciable and non-depreciable. If the asset is a depreciable asset, such as building or machinery, the cost of the asset can be deducted over a number of years in the form of tax depreciation (otherwise known as capital cost allowance or “CCA”). The amount of the tax deduction is prescribed by Canada Revenue Agency (“CRA”) in the Income Tax Act. For instance, your building will generally be deductible at a rate of 4% of the cost per year on a declining balance. The cost of the building that has not been deducted is known as the undepreciated capital cost.

   Assets, such as land, are not depreciated. The reasoning behind this is that value of the asset will not likely diminish with use over a period of time. When a capital asset is eventually sold, the cost of the asset is subtracted from the proceeds. Any excess proceeds over cost is a capital gain, half of which is taxable and the other half may potentially be able to be paid out tax-free to the owners.

   Intangible assets, such as customer lists and goodwill, similar to depreciable tangible assets, have ¾’s of their cost deducted over a number of years at a rate of 7%.

   If the business asset is owned before the business is incorporated, the individual should consider transferring the ownership of the asset to the corporation. Before doing this, professional advice should be sought, as there is the potential of creating income subject to tax on the individual’s personal tax return.

   When transferring assets into the corporation, CRA takes the position that a sale at fair market value is occurring. If the fair market value exceeds the cost or undepreciated capital cost, income will be created. Even though no cash is actually changing hands between the individual and the corporation, the asset is still valued at fair market value. The shareholder is deemed to have taken back a shareholder loan from the corporation equal to the value of the asset. If the asset has recently been purchased and the fair value of the asset does not exceed its cost, then there are likely no tax implications on the transfer.

A shareholder loan can be repaid from the corporation to the shareholder tax-free. This loan to the corporation is the shareholder's tax paid dollars and is not taxed again on withdrawal. Loans from shareholders to the corporation do not have to be interest bearing or have any specified terms of repayment.

In the Traps & Tips section, we discuss tax implications if the individual owes the corporation money.

d) **Filing with CRA:** One of the initial steps is filing a form RC1(E) with CRA; this form registers the corporation on their records. In turn, CRA will provide the corporation with a corporate tax account number, payroll account number and a GST number.

e) **Bookkeeping:** Whether you prefer to prepare your ledgers manually or using an accounting software package is entirely your choice. If your business involves many transactions, there may be time savings to learning a computer accounting package and maintaining your records on the computer. Our firm does provide computer consulting services to assist you in choosing a suitable accounting package, installing it on your computer and teaching you the basics about the software.

   When a sale is made, the entire amount should be recorded in the ledgers. If the cash is not yet received, an entry should be made to accounts receivable. When the account receivable is eventually collected, the cash is deposited in the bank and the accounts receivable account is reduced accordingly. At all times, you should have an accounts receivable list which details who owes the corporation money and how much. This list should be reviewed frequently to ensure collections are being pursued and any uncollectible accounts are written off to a bad debt expense account.

   On the other side, as purchase invoices are received, the corporation should make an entry to accounts payable and expense the goods purchased. Once the corporation pays the account, the accounts payable should be reduced accordingly and there will be a reduction in the bank account. As with the accounts receivable, there should be an accounts payable list prepared which details who the corporation owes money to and how much.

   At the end of every month, the cash ledger account should be reconciled to the bank statement to ensure that all cash transactions have been recorded in the ledgers. Items such as bank charges and interest should be charged to the appropriate expense account when reconciling. In reconciling the cash ledger account, the bank account should adjust for any differences between the actual bank balance at the end of the month and the cash ledger account at the same date. Any cheques or deposits that were incurred before the year-end date but which have not yet cleared the bank should be specifically identified.

f) **Maintaining records:** The Corporation is required to retain all invoices, receipts, sales invoices, etc. to provide evidence of a particular transaction. The receipts must be held for seven years after the year-end in case of a CRA audit.

INFORMATION REQUIRED AT THE YEAR-END

In preparing the corporation's year-end financial statements and tax returns, the following information will be required at the year-end by the accountant:

- A trial balance - this lists the amounts in all accounts and the revenue and expenses for the year. The trial balance should equal zero when totaled.
- All bank statements for the period.
- Bank reconciliation at the year-end date.
- An accounts receivable listing at the year-end date.
- A listing of inventory on hand at the year-end date and the total value of inventory.
- A capital asset listing describing the asset, when purchased and the total cost. As well, a list of all assets purchased and sold in the year.
- An accounts payable listing at the year-end date.
- A listing of all long-term loans, copies of the lending contracts and the balance at the date of the loan. As well, the interest paid on the loan during the period should be detailed.
- All statement of accounts from CRA and Alberta Revenue.
- All GST returns filed in the period.
- All insurance and property tax assessments in the year.
- All personal kilometers of a corporation owned car (if any).

Other specific records will be reviewed depending on the nature of the corporation's business.

Having this information ready at the commencement of the engagement will greatly assist the accountant and reduce the amount of work required, thereby reducing the accounting fees.

THE GOODS AND SERVICES TAX

Most businesses, whether incorporated or not, that earn in excess of $30,000 of gross sales annually from a business are required to collect GST on their sales. If your sales are less than $30,000, you may not be required to collect GST. However, you cannot then claim input tax credits for the GST paid on your supplies and other business expenses.

In tracking your GST collected, simply record 5% of your sales. Ensure that your GST number is clearly labeled on all sales invoices so that suppliers know that you are registered for GST. The amount of GST should be broken out on the sales invoice.

In tracking the GST paid, record the GST paid on all invoices and expenditures throughout the period. The GST should be broken out clearly on all receipts.

As a requirement, GST returns are to be filed three months after the year-end for annual filers and within one month of each period for quarterly or monthly filers. A failure to file penalty will apply to any return you file late, unless there is a $0 amount owing or you are expecting a refund. This penalty is equal to 1% of the amount owing, plus 0.25% of the amount owing multiplied by the number of months the return is overdue, to a maximum of 12 months. To file GST, complete the Goods and Services Tax Return. On this form, it details the GST collected in the period and the input tax credits ("GST paid in the period"). The difference between these two amounts will be your GST owing or refundable.

In completing this form, it will require you to list your GST number. This will be assigned upon completing the form RC (1) E as discussed previously.

PAYROLL AND OTHER PROGRAMS

As stated earlier, the incorporation of the business creates an entirely new entity, separate from the personal business of the individual. The shareholder of the corporation may also become an employee of the corporation where they are paid a salary. Salary paid to you by the corporation is a deduction in the corporation as a salary expense. On the other side, it is included in the employment income of the owner and reported on their personal tax return.

When paying a salary, the corporation is responsible for remitting source deductions, being income tax, CPP and possibly EI. The corporation should generally pay the source deductions by the 3rd day of the following month in which the salary is paid; this may be required sooner depending on the size of the previous remittances. To calculate the amount of source deductions to be withheld from the payroll, you can refer to the payroll guides that will be provided to you by CRA upon obtaining a payroll account number; this guide will help calculate the amount.

In remitting CPP and EI, the corporation must remit both the employee and the employer share. The employer share of CPP is simply a matched amount of the employee's share. The employer's share of EI is 1.4 times the employee share, as calculated using the guides.

If the shareholder is drawing a salary and they own 40% or more of the shares of the corporation, they are EI exempt and no amount need be remitted for either the employee or employer's share of EI. The logic behind this policy is that, in owning greater than 40% of the shares, the individual can control their employment. If they decide to wind up the business, they will not be eligible to receive employment insurance benefits. As well, the spouse of a 40% owner should be EI exempt as well. Finally, if it is a family-run business with no one shareholder owning 40% or more of the shares, it is still possible that all family members will be EI exempt. This should be discussed with your tax advisor.

The thresholds for EI and CPP are as follows:

	2016	2015
CPP rates:		
Maximum pensionable earnings	54,900	53,600
Basic exemption	3,500	3,500
Contribution rate (employee and employer)	4.95%	4.95%
Maximum contribution per year	2,544.30	2,479.95
EI rates:		
Yearly maximum earnings	50,800	49,500
Contribution rate (employee)	1.88%	1.88%
Contribution rate (employer)	2.63%	2.63%
Employee maximum premium	955.04	930.60
Employer maximum	1,337.06	1,302.84

In filing the form RC (1) E, the corporation will receive a payroll account number. This number will be required to remit the source deductions.

If the business entity has employees who are in the specified industries, the business should be registered with the Workers' Compensation Board. Registration forms can be obtained through contacting that Board. It is recommended that all companies with any employees contact the Workers' Compensation Board to determine if they should be registered.

BUSINESS LOSSES

In the first few years of operations, it is common to incur business losses after salaries and tax depreciation is deducted. CRA has rules that allow these losses to be carried forward to be applied against future income to reduce future taxes payable. Losses may also be carried back to recover taxes paid in a prior period.

Business losses can be carried back and applied to reduce taxable income in any of the three preceding years. A reassessment for the years in which the loss was applied will be issued from CRA. In preparing the corporation's tax return, your accountant should ensure that the appropriate forms are filed and the losses are carried back.

Business losses can now be carried forward twenty years and applied to reduce taxable income of future years.

OBTAINING FINANCING

a) **Prepare a projection of the future business operations:** Before lending any money, the bank will require the business owner to prepare a statement of cash flows over the next year or two so that they can assess if the business has the ability to repay the loan. In preparing the forecast, the owner should provide the following information:

Estimated start-up costs to initiate the business	**$ XXXXX**
Less: funds to be injected by the shareholders and other investors	**- XXXXX**
Less: estimated revenue received in the first year	**- XXXXX**
Plus: estimated costs incurred in the first year	**+ XXXXX**
Cash required to start the business	**$ XXXXX**

In preparing the cash flow, it is necessary to provide details of how the revenue will be created by multiplying the sales price by the anticipated volume. As well, detail the anticipated costs throughout each period.

b) **Business plan:** The bank will likely require the business owner to analyze the market and how the business will survive in the market place. In completing this task, the business owner should:

- Identify the competition.
- Identify their customers and why their product or service will be in demand.
- Estimate the level of market share, if possible, that the business can reasonably attain.

As well, the bank will require the business owner's knowledge of the industry and experience in the industry or the existence of any key employees.

c) **Guarantees required by the bank:** In obtaining financing, the bank may require that the business owner personally guarantee some of the debt of the corporation. The shareholder must be very careful before signing any lending agreement that involves personal guarantees.

In the event that the bank calls their loan from the corporation, they have a right to seize the personal assets of the shareholder if the corporation does not have sufficient funds to repay the debt.

If personal guarantees are required, the shareholder should ensure that they have a limited period. A personal guarantee should not extend throughout the life of the loan but rather be set at the first couple of years that the loan is in place. The owner should strive to sign a lending agreement that phases out the personal guarantees.

TRAPS AND TIPS

a) **The small business deduction:** CRA and Alberta Finance encourage small business activities. CRA gives corporations a small business deduction on the first $500,000 of taxable income earned from active operations and Alberta provides a small business deduction on the first $500,000. The current combined federal and provincial corporate tax rate (in Alberta) on the first $500,000 was approximately 14% in 2015, declining to 13.5% during 2016.

   Income in excess of $500,000 is not eligible for the small business deduction and is taxed at a rate of approximately 27% in Alberta in 2016.

   If the corporation achieves taxable income in excess of the $500,000 small business deduction limit, the corporation may choose to pay out a bonus to reduce the taxable income to $500,000.

   In doing this, the bonus will be taxed on the individual's personal return. The highest personal marginal rate in Alberta is 48% in 2016 and later years. These rates apply to income from active business operations – other types of income can be subject to higher corporate tax rates. Tax planning will need to be performed in order to determine the best course of action for you and your corporation.

b) **The deferral of income through bonuses:** CRA allows bonuses to be declared by a corporation but not paid out for 179 days after the year-end. In declaring the bonus, the corporation takes the deduction at that date. However, the bonus is not taxed until received personally.

   This issue was briefly addressed in the discussion of choosing a year-end. If the corporation has a year-end in the latter half of the year, it can declare a bonus and take an immediate deduction. However, if the bonus is paid out in January of the next calendar year, it is not taxed personally until the year it is paid. Source deductions on the salary are to be paid by the corporation as early as the 3rd day of the following month in which the bonus is paid. If the bonus is paid on January 31st, source deductions are due by February 3rd.

   For instance, assume a corporation has taxable income of $100,000 and a year-ended August 31, 2015. The corporation can declare a bonus of $100,000 at August 31, 2015 and bring taxable income to nil resulting in the corporation having no tax liability. This bonus is not paid out to the owner until January 2016 and will be included on your personal income tax return for the 2016 calendar year.

c) **When the shareholder owes the corporation money:** As discussed in an earlier section of this booklet, special provisions apply when there is a loan from the corporation to the shareholder (or a related person). There is no problem if the corporation owes the shareholder money (for example, the shareholder contributes cash to get the corporation going). The problem arises when the shareholder owes the corporation money.

   The advance or indebtedness is deemed to be income to the shareholder in the year the advance was made and it will be taxable on the individual's personal return. There is an exception to this rule where the loan is repaid by the corporate year- end following the year in which the loan was taken. If the loan is outstanding for two year-ends in a row, the amount outstanding is income to the shareholders on the date the debt arose. However, any amounts repaid will be deductible in the year of repayment.

   Where the loan is not included in the shareholder's income, there is a taxable benefit for the period in which the loan was outstanding. This benefit is to be included on the shareholder's personal tax return. The benefit can be offset by interest actually paid by the shareholder to the corporation.

   Upon preparing the financial statements, if it is discovered that the shareholder owes money to the corporation, a dividend is commonly declared in the corporation and this dividend repays the loan. The dividend is taxable on the shareholder's personal return in the year it is received.

   Logic: This rule prevents owners from drawing out tax-free cash from their companies in the form of loans. The objective of this policy was to ensure all amounts received by the shareholders are taxed on their personal tax returns.

d) **Corporation owned cars (including vehicles such as sport utility vehicles and extended cab pickups):** CRA recognizes that automobiles are often required to do business. Therefore, a deduction is permitted for the lease costs, the operating costs, and the interest, if a loan is required to purchase a car. If the automobile is purchased as opposed to leased, a deduction for tax depreciation on the cost of the car is allowed, subject to certain limitations.

The government has implemented policies to prevent shareholders from owning their personal cars in the corporation and taking deductions. They catch the individual on both the cost of the car and the operating expenses by including a two-part taxable benefit on the individual's personal tax return.

Part one of the taxable benefit for the cost of the car is basically 24% of the cost of the car or 2/3 of the lease costs. For instance, if the car cost $30,000, the individual must include $7,200 (24% * 30,000) annually on their personal tax return for the car (including sales tax). Providing the car is used more than 50% for business and personal kilometers are less than 20,000/year, this amount may be able to be reduced.

As well, CRA calculates the taxable benefit for the operating costs to be $0.26 per kilometer for personal usage. For instance, if the individual drives 20,000 kilometers per year, 15,000 of which is for personal use, then the taxable benefit allocated for the operating costs is $3,900 (15,000 * $0.26). Alternatively, an individual may be able to elect to have the operating benefit calculated as 50% of the stand-by charge.

In the above examples, the total taxable benefit to be included in the individual's tax return is $11,100. Of course, CRA does allow the deduction of the operating costs, tax depreciation, interest, etc. in the corporation.

The alternative is to own the automobile personally. There will be no deduction of operating costs in the corporation. However, CRA will permit a tax-free allowance to be paid to the individual from the corporation for the business use of the car. The prescribed allowance is currently $0.54 per kilometer up to 5,000 kilometers and $0.48 per kilometer thereafter. The amount paid by the corporation in respect of this allowance is deductible in the corporation.

Looking back at the previous example but with the car owned personally, the 5,000 kilometers per year for business could be paid out as a non-taxable reimbursement to the individual. In this example, the individual would get $2,700 tax-free and the corporation would deduct $2,571.43 and receive a GST ITC of $128.57. As well, there would be NO taxable benefits.

Tip: As a general planning tip, it is normally (but not always) beneficial to hold personal use cars out of the corporation to avoid the taxable benefits. Consult your tax advisor before making any final determination.

e) **Limitation on the deduction for cars:** The government limits the deductibility of automobiles as follows:

- Only the first $30,000 of the cost of a car is included in the tax depreciation formula. Any excess is not deductible in the form of tax depreciation.
- If the car is financed, only $300 per month of interest is deductible.
- If the car is leased, only $800 per month is deductible.

f) **Salary versus dividend paid out to the shareholder:** CRA has gone to fairly extensive lengths to ensure that whether a salary is paid out of a corporation or dividends are paid out to the shareholder, the tax cost of getting that cash out is approximately equal. However, there are some general points that should be considered in your salary/dividend question:

- If only dividends are paid out, then there is no amount earned from employment. This will result in no contribution to CPP, limiting your ultimate retirement benefit. As well, it will limit your RRSP deduction room.
- If you pay out a dividend, you may be able to trigger a tax refund on investment income earned in the corporation.

Your accountant should be involved in determining the salary/dividend analysis to ensure that the optimal combination is withdrawn and all factors are considered.

g) **Operating out of the home:** In starting up a business, home-office expenses may be deductible. The allocation of the portion of total home expenses that are deductible is based on the square footage of the entire home and the square footage of the office portion of the home.

Expenses include: mortgage interest, property taxes, insurance, utilities, and rent. However, it should be noted that expenses related to the home-office workspace must not exceed your income from that business.

If you have incurred any renovations, tax depreciation taken on renovations in the home-office will result in the office portion of your home being excluded as your principle residence. On a subsequent sale of the property, the office portion will not qualify as your principle residence and be subject to capital gains.

Tip: When Capital Cost Allowance ("CCA") is claimed on the home-office portion of your home, you will normally be subject to capital gains tax on the home-office portion on the sale of your home. However, if you opt to not claim CCA, the home-office portion will continue to be treated as part of your principal residence and no capital gains tax will arise upon the sale of your home.

Home-office expenses are only deductible if the home-office is principally used to meet clients or customers on a regular basis. Therefore, if the corporation has an office elsewhere but the shareholder does do some work out of the home-office, because the home-office is not used to regularly meet customers, no amount will be deductible as a home-office expense. In addition, the office must be exclusively for business use.

If you are incorporated and you decide to operate out of your home, ensure that you investigate any increases in your property taxes, insurance and telephone bills because of the switch in use from personal to business.

APPENDIX I

TAX RATES

2015 Personal Tax Rates to Remember					
Lower Limit	Higher Limit	Ordinary Income Combined Rate	Dividend Combined Tax Rates Ineligible	Eligible	Capital Gains Combined Rate
0	11,327	0.00%	0.00%	0.00%	0.00%
11,328	18,214	15.00%	4.27%	-0.03%	7.50%
18,215	44,701	25.00%	12.84%	-0.03%	12.50%
44,702	89,401	32.00%	21.1%	9.63%	16.00%
89,402	125,000	36.00%	25.82%	15.15%	18.00%
125,001	138,586	36.50%	26.41%	15.84%	18.25%
138,587	150,000	39.50%	29.95%	19.98%	19.75%
150,001	200,000	39.75%	30.25%	20.33%	19.88%
200,001	300,000	40.00%	30.54%	20.67%	20.00%
300,001	And above	40.25%	30.84%	21.02%	20.13%

Note: With the dividend tax credit, if one earns ineligible dividends of approx. $22,375 and that is their only source of income, their personal tax payable will be $NIL. The highest marginal rate on non-eligible dividend income is 30.84% and 21.02% on eligible dividend income in 2015.

2016 Personal Tax Rates to Remember					
Lower Limit	Higher Limit	Ordinary Income Combined Rate	Dividend Combined Tax Rates Ineligible	Eligible	Capital Gains Combined Rate
0	11,474	0.00%	0.00%	0.00%	0.00%
11,475	18,451	15.00%	5.24%	-0.03%	7.50%
18,452	45,282	25.00%	13.33%	-0.03%	12.50%
45,283	90,563	30.50%	19.78%	7.56%	15.25%
90,564	125,000	36.00%	26.20%	15.15%	18.00%
125,001	140,388	38.00%	28.54%	17.91%	19.00%
140.389	150,000	41.00%	32.05%	22.05%	20.50%
150,001	200,000	42.00%	33.22%	23.43%	21.00%
200,001	300,000	47.00%	39.07%	30.33%	23.50%
300,001	And above	48.00%	40.24%	31.71%	24.00%

Note: With the dividend tax credit, if one earns ineligible dividends of approx. $22,800 and that is their only source of income, their personal tax payable will be $NIL. The highest marginal rate on ineligible dividend income is 40.24% and 31.71% on eligible dividend income in 2016.

2015 Corporate Tax Rates to Remember					
Lower Limit	Higher Limit	Federal Rate	Alberta Rate	Refundable Rate	Combined Tax Rate
Active Income					
0	500,000				14%
500,000	And above				26%
Inactive / Investment Income:					
No taxable dividends paid		34.7%	11.0%	0.00%	45.7%
Taxable dividends paid to recover refundable tax		34.7%	11.0%	-26.7%	19.0%

2016 Corporate Tax Rates to Remember					
Lower Limit	Higher Limit	Federal Rate	Alberta Rate	Refundable Rate	Combined Tax Rate
Active Income					
0	To 500,000				13.5%
500,000	And above				27%
Inactive / Investment Income					
No taxable dividends paid		38.7%	12.0%	0.00%	50.7%
Taxable dividends paid to recover refundable tax		38.7%	12.0%	-30.7%	20.0%

No changes to corporate rates are proposed after 2016 at the time of publication.

NB. Rates assume a calendar year end.

APPENDIX II

PROPRIETORSHIP VERSUS LIMITED COMPANY - 2016

Facts:

- Company earns $225,000
- Owner/Manager needs $100,000 to live on personally. This money is drawn as a wage.

Analysis:

	$ Earned as Proprietor	$ Earned as Limited Company	$ Variance
Corporate			
Business Income		225,000	
Additional Accounting Costs to file corporation		(2,500)	
CPP Burden on wage paid to owner		(2,544)	
Withdrawn as a salary		(100,000)	
Taxable business income		119,956	
Corporate Tax (13.50%)		(16,194)	
Cash left to invest in company		103,762	
Withdrawn immediately as a dividend (out of after tax profits)		(103,762)	
Cash left in company after dividend		–	–
Personal:			
Business/Employment Income	225,000	100,000	
Additional Accounting Costs to file Proprietorship	(350)	(0)	
CPP Burden	(5,088)	(2,544)	
Tax, using above personal rates	(74,505)	(24,326)	
	145,057	73,130	
Combined corporate & personal cash before dividend	145,057	176,892	31,835
Cash left personally after paying tax (before dividend)	145,057	73,130	
Cash stripped through dividend	–	103,647	
Less: tax on ineligible dividend	–	(33,331)	
Total after tax cash for personal use	145,057	143,561	1,496

APPENDIX III
OUR FIRM

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