Myth Breaker Handbook

WORD OF ADVICE – Explore all the different options of setting up and/or incorporating your business. Get advice and input from different professionals before you go ahead. I have seen too many times businesses or contractors either set up as a sole proprietor or incorporate, get their GST number and WCB, and forget about the rest. This then ends them in big tax trouble. In past years I have had single contractor tax bills from $12,000 to $49,000 which could have been avoided with up front planning.

Take the time, go through this booklet, set up a system that suits you, one that you will use; then the hard work is done. Now all you have to do is follow your system; make money and pay less tax.

I hope this booklet sheds some light and helps you plan so you can pay less tax.

Good luck and all the best in your business.

J.Thomas

Contractor vs Employee

A contractor is someone who owns their own business, equipment and tools and works for more than one customer doing the work they do through their business. Not receiving a wage but negotiating a contract price and receiving payment upon invoicing the customer.

An employee is someone who works for a business and is paid a regular wage. If you are using the equipment, given specific tasks or direction, working specified hours, working for a continuous period of time for the same business you are an employee not a contractor.

Why Incorporate?

Most people incorporate for tax savings, liability issues and/or for creating investment for the business by selling shares.

Incorporation to protect yourself from liability – talk to a lawyer to get more specifics on the liability of a limited business or corporation as the laws have changed and shareholders may not necessarily be protected from liability.

Steps for forming a corporation

1. Develop articles of incorporation; who are the directors, what shares types will you have, where will the books be located, etc. (Look for these forms online from your provincial or territorial government, usually department of community and corporate affairs or go see a lawyer).

2. Once the paper is complete either by you or by a lawyer; your business is incorporated and registered at the Department of Community & Corporate Affairs Department of your provincial or territorial government.

3. Once you have received the certificate of incorporation with your corporate number you apply for a Business Number from the Canada Revenue Agency (CRA). This is your GST, corporate, payroll number.

4. Apply for WCB if it is required for your industry. To know if it is a requirement for your industry talk to the WCB personnel. (WCB will need your Business Number, if you have not received it you can phone it in later.)

5. If you are in a province that requires PST or HST talk to the government personnel in order to get that setup for your business.

6. Get the business insurance required by your industry and required by law. Eg. Vehicle insurance, liability insurance, etc.

7. Set up your bookkeeping system so you maximize your corporate and/or personal tax advantages.

8. Get a travel log for keeping track of kilometers for the business use of your vehicle.

9. Set up your invoicing system, ensuring your GST number appears on each invoice.

10. Determine what you need for personal expenses monthly and set up your payroll for yourself and for any employees you are hiring at start up. Determine whether you will be paying monthly, biweekly, etc. (TD1 forms need to be filled out for each employee).

Incorporating Tips

1. Ensure that you create Class A, B and C shares (at least 3 types of shares) or more for future allocation of those shares that can be distributed to others, a spouse or children later in your life.

2. Ensure that you do not put any restrictions on your corporation limiting you from adding additional services or products as your business grows.

3. Minutes of the corporation (these are a record of your meetings) – you have to have meetings for the following:
   a. To decide what the business is going to do;
   b. When it issues dividends;
   c. When it adds other services or products;
   d. When it adds new shareholders;
   e. Annual general meeting at year end to discuss and review financials; Etc.
   (Ensure you know what meetings are required each year)

4. All the meetings have to have minutes taken and a minute book has to be kept. Even if you are the only shareholder, you have to have a meeting with yourself and keep minutes. Your lawyer can keep the minute book for you or you can keep it yourself.

Tax savings

Incorporating can give you tax savings as corporations are generally taxed at 15%, whereas if you are making money in your business your personal tax can be higher (depending on the province or territory).

If the time is right to incorporate for your business and personal needs proper tax planning in the initial stages will save you both for your business and personal taxes.

Planning your specific payroll each month can lower your corporate tax. Additional monies you may need personally can be combined with payroll, dividends and shareholder's loan to ensure your personal tax is optimized. Creating a balance between your corporate and personal tax will get you your best tax advantage. Seek out advice on maximizing your tax advantages when you start, not after you are already in business and throughout the year, as after year it could be too late.

CAUTION

You cannot just take money out of the bank in an incorporated business as you can do in a sole proprietor business. Taking money out a corporation/limited company has to be in the form of a paycheck to you from the business, the repayment of a shareholder's loan or a dividend.

If you take money out in any other way it may be classed as management fees and you could be looking at a big tax bill personally.

Business Number/GST Number

Your business number is the number that is used for all aspects of your business. It is a nine digit number assigned by the CRA, the numbers following the nine digit number determine whether it is for GST, payroll, expediting, corporate tax, etc.

The most common are:
12345 6789 **RT0001** – GST
12345 6789 **RP0001** – Payroll
12345 6789 **RC0001** – Corporate
12345 6789 **RM0001** – Import/Export
12345 6789 **RZ0001** – Information Returns

Myth Breaker Section

1. WCB – WCB cannot be covered by someone else's business when you are a contractor. You have to get your own WCB under your own business.

2. Using your home shop as a shop for your business: If you are a sole proprietor, a portion of your home expenses are used as a deduction against your personal income tax. If your business is a corporation then the same applies, a portion of your home expenses are used as a deduction against your personal income tax if you are an employee of the corporation and the corporation issues you a T2200 employment expenses form with your T4.

3. If your shop is attached to your house it should not be owned by the business. A shop/shed is best owned by the business if it is on skids and therefore it is moveable or if it is a separate building; there

still may be restrictions. If you rent the shop to the business the rent is an expense of the business and the rental income is income on your personal tax.

If the shop is attached to your personal house and you claim it as owned by the corporation, when you sell your personal house there will have to be a split of your property as part of the home (the shop) is owned by the corporation which is a separate entity and part of is owned by you personally. It can cause many complications.

4. Quads – quads can be a business asset if they are solely used for the business. If they are only used for a portion of the business only the portion used for the business can be expensed by the business. If you rent the quad to the business the rent is an expense of the business and you personally claim the rent as income on your personal tax.

   If you use the quad for personal and it is owned by the business then a portion of the expenses are a taxable benefit to you as an employee of the business.

5. If you are incorporated, the business may purchase life insurance for the shareholders. The beneficiary of the life insurance is then the corporation, not you or your spouse, etc. personally. You need to ensure you have a will to ensure that the business' assets including the life insurance go to the beneficiary of your choice.

6. The majority of businesses have to submit their payroll remittance on a monthly basis. (Payroll remittance is the CPP, EI and tax that are taken off your employee's checks each paycheck as well as the corresponding employer portions.) The CRA can give permission to a business to submit yearly, bi-annually or quarterly. If you want to do this you need to get a ruling from the CRA.

7. You don't have to have an accountant do your taxes or your corporate tax, you can do them yourself. Corporate tax is called a T2 and there is software available to do it yourself just like there is software to do your personal tax. If you are a sole proprietor your taxes are done with your personal tax on the T1 personal tax form.

8. Audits by the CRA are chosen randomly not on the basis of who did your taxes or whether you did them yourself. There are some things that will trigger an audit; if you don't submit the required GST, payroll or taxes on a regular basis and on time; if you have outrageous expenses that don't pertain to the business; or if items don't match with your other submissions. Those are the common reasons but generally an audit is a random choosing in any given year.

9. If you use your personal vehicle for business you have to keep a travel log of the kilometers used for business and total kilometers used throughout the year. You then claim a portion of the expenses depending on how much of the vehicle is used for the business. Not using one can result in no expense allowed for business use of a vehicle.

   You can choose to use a simplified method for keeping a travel log – keep a log book for the one complete year to establish a business use base and then after that you keep a three month sample log book. If the vehicle is solely used for business purposes it is recommended that you use a travel log book in this way.

10. If your business pays the expenses of your personal vehicle **AND** pays you a kilometer rate you will be charged a taxable benefit as that is above reasonable reimbursement for vehicle expenses. The business claims a percentage of vehicle expenses depending on the travel log kilometers kept by you for business use of a personal vehicle **OR** it pays you a kilometer rate not both. A travel log is necessary in all cases.

11. Meals can be used as an expense if they are bought to have a meeting with a potential customer or current customer in order to further your business. Buying your lunch cannot be done through your business. Think of it this way – when you were paid a paycheck did your previous employer buy your lunch every day?

12. Meal allowance – you can give meal allowance to your employees if they work overtime for more than two hours right before or after normal scheduled hours of work (12hrs in a day) and it is occasional in nature (usually less than three times a week). The meal allowance must be a reasonable amount; reasonable by CRA standards is $23/meal up to $69/day.

13. Golf membership – you cannot deduct club membership dues if the main purpose of the club is dining, recreation or sporting activities. Think of it this way – would your previous employer where you were paid a wage buy your golf membership every year? Buying a round of golf for a customer to use that would ultimately increase your business with that customer is an expense of the company as it is a form of promotion. If you go golfing with them your golf round is not an expense of the business.

14. Social events – if you provide a social event for your employees such as a Christmas party the cost has to be $100 per person or less or the whole cost is taxable benefit to the employee. This cost does not include additional costs such as taxi fare, accommodations, or transportation home.

15. Gift to employees have to be for a special occasion and they have to be noncash gifts otherwise they are a taxable and have to be added to the employee's income. Gifts need to be a physical gift of an item and can be up to $500/year. Tickets to an event at a certain time and place are a gift as it has taken away the element of choice from the employee. Any cash gifts or gift cards or gift certificates are taxable gifts and have to be added to the employee's income.

16. Bonuses for work well done or in recognition of an employee's job performance are considered a reward and are a taxable benefit for the employee. An award has to be for an employment related accomplishment that has clearly defined criteria, nomination and evaluation process and a limited number of recipients. The award would then be a non-taxable benefit to the employee if it was **NOT** cash, gift card or a gift certificate.

17. Subsistence – you can pay your employees subsistence if they are gone away from home for over 36 hours. Subsistence is considered an allowance for board and lodging, this allowance has to be reasonable in nature. So reasonable allowances for board and lodging will have to depend on where the location is of the remote or special worksite.
    NOTE:
    There are two separate definitions in the case of board and lodging allowance:
    A remote location is a work location that is 80km or more away from an established community where there are essential services such as food, medical, accommodation, etc.

    A special worksite, the employee has temporary duties at this site and the distance from the employee's home prevents them from returning to their principal residence each day.

18. If you use money/borrow money from your business for personal reasons ensure that you have a proper loan agreement in place between you, the shareholder and the business. The CRA has established interest rates that can be charged and these rates are changed regularly.

19. If the business owns the RV and you use it for personal camping, ensure that you rent the RV from the business for your personal use. Phone different RV companies to get the average rental rate. It is a taxable benefit to you to use assets of the business for personal use.

20. If you are taking money directly out of your incorporated business in the form of dividends remember dividends are not an expense of the business and therefore will not lessen your corporate tax. If you take large sums of money out of your business as dividends the tax bill can get quite high. A balance between dividends and payroll is better for your personal and business tax advantage.

21. Large equipment, vehicles, tools, computers, etc. that are purchased by the business are assets of the business and therefore are amortized (depreciated) each year. Amortization (depreciation) is an expense of the business, but the large asset is not. If you get a loan to purchase the large asset the loan payments are not an expense of the business only the interest on the loan is an expense. All assets of the business have to be in the business name not your personal name.

    If they are in your personal name, sell them to the business from yourself. There are conditions on the sale of assets from you to the business so check it out with your tax preparer.

22. COVID relief is counted as income in most cases. For instance, the wage subsidy CEWS is to be included in income if you are claiming the full amount of wages. If you only claim the 25% wages then you do not have to include it in income. The loan forgiveness amount on Federal or Provincial or Territorial loans related to COVID relief is also income in the year the loan was received.

23. Grants and subsidies – most grants or subsidies are counted as income. If you claim the expenses the grant was used to buy then the grant is income. If you don’t claim the expenses then the grant is not income, only if the expenses are the same or more than the grant. If the grant is more than the expenses then the grant is income and ensure you claim the expenses as well.

Tips for bookkeeping and maximizing tax advantage for you and your business.

1. When paying with a debit card or credit card, keep both card and till receipts. Both are needed to show payment and to capture the GST. No till receipts, no GST recorded.

2. Write down who you had the meal with for business purposes on the back of any meal receipt. This also applies for any gift cards that you give away.

3. When paying bills write the date, check number and the amount paid on the invoice or bill. Do the same when accepting payments from your customers. It helps with bookkeeping and also if there are any questions that a rise.

4. Some commonly missed expenses:
    - Pictures and film;
    - Clothing if specific to a job and not normally worn (hard hats, safety gear, etc);
    - Books;
    - Internet fees that are hidden in the telephone bill;
    - Training and education;
    - Donations;
    - Credit card interest.

5. Keep all home expenses throughout the whole year as a portion of this may be used as home office expenses on your taxes. (eg. Utilities, mortgage interest, home insurance, property taxes, electricity, heat, repairs, etc.)

6. Look at having RRSPs for you personally done through your business if you are an employee of an incorporated business. Make sure you do the best amount of RRSP for your personal retirement needs, this may not necessarily be the maximum or minimum.

7. Charitable donations can be done through your business but doing them yourself is sometimes more beneficial to your personal taxes than it would be to the business. If the business does contribute make it a sponsorship of an event instead of a donation and get the advertising promotion expense out of it. This means that the expense is 100% deduction instead of the percentage amount for a donation.

8. Medical expenses – save the receipts throughout the year for your personal income tax. An incorporated business can have a health benefit program set up for the employees of the business. This is a taxable benefit to the employees.

9. Medical travel - if you live in a small community that does not have all the medical facilities or professionals you can claim travel to get the medical attention. This could be a dentist, a chiropractor, an eye doctor, etc. What you can claim varies by province so ensure you check out the CRA website to see what you can claim. The claim is worth keeping track of these as you can claim the km rate as well as meal rate of $23.

10. Keep records for all purchases personal and business. This will help if some of the personal receipts can be used for business and it also creates a habit of keeping receipts. If you don’t have receipts but only a bank or credit card statement they may be discounted as expenses in an audit situation and you won’t be allowed to claim the GST paid which ultimately results in higher tax.

11. Keep abreast of the new tax credits or deductions that you may be able to utilize. They do change yearly. For instance, the fitness tax credit – keep the receipts of the sports and fitness activities that your children do as they are a tax credit. This amount has gone down and may be eliminated next year.

Tax Planning advice you need to get when you start up:

A. Should the vehicle be owned by the business or by you?

B. Should the business pay the expenses of the vehicle and you claim the vehicle on your taxes taking off the reimbursed amount or should you charge the business a kilometer rate?

C. Should the business (incorporated) buy life insurance for the shareholders? If you already have life insurance policies in place this may not be the best benefit for you.

D. What type of benefits can and should your business offer you or your employees?

E. What combination of shareholder’s loan, dividends and payroll should you be doing for yourself in the first year and subsequent years?

F. Should you have your GST annually, quarterly or monthly?

G. If you are in camp and need to use your own RV should it be an asset of the business or should you keep it personal?

H. What expenses can be paid by the business and what are classed as business expenses?

NOTE: Each business is unique in what it does and what expenses and income pertain to those business activities. It makes a difference whether you are a sole proprietor, a partnership or an incorporated business as to what expenses you can claim. Get as much information as you can and set your business right so that you maximize your tax situation.

Please note the information contained in this booklet is accurate at the time of printing but is subject to change without notice due to possible government regulation changes.(Printed Jan 2023) New tax changes will come after the budget so be sure to check for new updates.

TaxLink CANADA

www.taxlinkcanada.com
Email: info@taxlinkcanada.com
Phone: 867-334-5082
Joanne Thomas