madan
CHARTERED ACCOUNTANT

5113 Heritage Hills Blvd.
Mississauga, ON L5R 2C6
Telephone: 905.268.0150
Facsimile: 905.507.9193

Email: amadan@madanca.com
Website: www.madanca.com

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TAXATION

Additional Tax Savings through the TFSA

A Tax Free Savings Account (TFSA) can be used together with your RRSP or RRIF to shelter more investment income from tax.

As you prepare to file your 2010 personal income tax, you may ask: Is there another means of reducing tax on income other than the RRSP?

TFSAs and RRSPs

The answer, of course, is a resounding “YES.” It is the Tax Free Savings Account (TFSA). When you contribute to an RRSP you get a deduction that relates to your “earned income” in the preceding year and a tax reduction based on the applicable tax rate. If you start withdrawing RRSP funds, however, they are taxed at your tax rate in the year of withdrawal. Contributions to the TFSA, on the other hand, are not tax deductible and do not, therefore, create an instant tax savings as does the RRSP contribution. The TFSA does, however, offer the opportunity to those who have already contributed their annual limit to their RRSP to set aside an additional amount and shelter any investment income (capital gains, interest and dividends) earned on those funds. Withdrawals are tax free. As with RRSPs, losses in a TFSA are not tax deductible. No capital gains tax is paid at the death of the account holder. Unlike RRSPs, the property in a TFSA can be used to secure a loan.

Unused contribution room can be carried forward indefinitely.

Any resident over the age of 18 can contribute up to $5,000 per year. (This limit may be indexed based on a formula that relates to the increase in the Consumer Price Index and so is intended to grow with inflation. However, the potential increase is rounded to the nearest $500 and may therefore be nil.) If you cease to be a Canadian resident, you may continue to hold the TFSA but cannot add to it. Unused TFSA room is carried forward indefinitely. Withdrawals from a TFSA in a year are added to TFSA room *in the next year*. Excess contributions are subject to a penalty of 1% per month.

It is important to note that the income attribution rules do not apply if a person provides funds to enable his or her spouse or common-law partner to contribute to a TFSA.

Different Ways to Contribute

There are three types of TFSAs: deposit, annuity contract and arrangement in trust. TFSAs can be issued by banks, insurance companies, credit unions and trust companies. The eligible types of investment are generally the same as for an RRSP: cash, mutual funds, securities listed on a recognized stock exchange, guaranteed investment certificates (GICs), bonds and certain shares of small business corporations. Foreign funds can be contributed but their value in Canadian dollars cannot exceed the $5,000 limit. The TFSA can be managed by an institution or self-directed in the same way as an RRSP.

Recent Problems

The TFSA was introduced effective January 1, 2009. Some contributors were reassessed for 2009 as a result of confusion on two main issues: the transfer of a TFSA from one institution to another institution, and how the TFSA worked with respect to withdrawals and recontributions.

With regard to the first issue, some taxpayers were initially penalized by the Canada Revenue Agency (CRA) for taking funds out of one institution by cash or cheque then opening an account at another institution. The CRA considered the transfer and deposit to be opening a new TFSA account. The CRA considered this to be a separate contribution subject to the $5,000 yearly limit and thus an overcontribution. The CRA applied the 1%-per-month penalty on the amount over the $5,000 personal contribution limit.

The TFSA is not like an investment account.

The second issue arose because taxpayers believed the TFSA was like an investment account to which they could deposit up to $5,000, remove funds then redeposit them provided the amount in the account never exceeded $5,000, at any time. Unfortunately, the CRA considered this activity to be overcontributing based on the following logic.

Suppose the taxpayer deposits $5,000 on May 2 and on September 30 withdraws $3,000 to leave a balance of $2,000. If, however, on October 25 the taxpayer deposits $3,000 to top the account back up to the $5,000 limit, the CRA will consider this deposit to be a $3,000 overcontribution and levy the 1% monthly penalty.

As indicated above, funds withdrawn may be redeposited only in the following year after the contribution room has been increased. CRA will remind you each year as to the accumulated room available for contribution.

Using a TFSA in Conjunction with a RRIF

There is no cut-off age for contributions to a TFSA as there is for the RRSP. You cannot make an RRSP contribution after December 31 of the year in which you turn 71. Thus a taxpayer over 71 can transfer the mature RRSP into a Registered Retirement Income Fund (RRIF) and from there into a TFSA at the eligible contribution amount then applicable. The amounts withdrawn from the RRIF will be taxable but the investment income earned in the TFSA and any withdrawals will not be. The funds invested in the TFSA can continue to grow without tax consequences as they did in the RRSP and RRIF.

No Dividend Tax Credit

The dividend tax credit was designed to overcome the problem of taxing income first in the hands of the corporation that earned it, then again in the hands of the shareholder. As with dividends received in an RRSP or RRIF, dividends from qualified Canadian corporations received in a TFSA cannot make use of the dividend tax credit since they are already tax sheltered. On the other hand, if a TFSA held a GIC, the interest income would be tax free whereas if held outside of a TFSA the interest would be taxable. If you have investments both inside and outside your TFSA, it may therefore be better to hold dividend yielding investments outside and interest bearing investments inside.

Is the TFSA Right for You?

Determining whether to place your 2011 investment within an RRSP or a TFSA is a decision that should be discussed with your Chartered Accountant to determine whether there are significant benefits of choosing one vehicle over the other. The end game is to increase financial security with investment strategies that reduce the taxes paid.

MONEYSAVER

Debit Card Fraud

Debit card fraud grew by 132% in Canada between 2004 and 2009.

According to RCMP statistics, debit card fraud in Canada grew from $60 million in 2004 to $142 million in 2009. Between 2008 and 2009 alone it grew by 36.2%. And debit card use is rising. The Nilson Report, a U.S. publication for the payment systems industry, says debit card use grew from 47.7% of plastic-based purchases in 2003 to 48.9% in 2008 and is expected to grow to 67% by 2013.

Business use of debit cards is expected to grow in line with this trend. As a result, more fraud in business bank accounts and lines of credit will follow as will identity theft. The cost will be enormous not just in the actual lost money but in the lost time and redirected energy of managers to find the source of the loss and determine the cause. Bank accounts will have to be closed and others opened, new cards, new cheques, and new passwords issued. Customers and suppliers using electronic-funds transfer services will have to be notified and other arrangements made for payments. In addition, there will be "insufficient funds" charges on cheques and automatic withdrawals will be returned to suppliers.

Chip Cards by 2011

Cards with chips built in for security will be standard in the near future. These chips will be harder for thieves to read than the current magnetic strips, but your business will not be protected if the card is stolen and the PIN discovered. Furthermore, anyone in possession of the card can read the three-digit Card Verification Code (CVC) on the back of the card to make fraudulent online purchases.

How to Protect Yourself

Protecting business from debit card fraud should combine common sense with an awareness of the need for security.

First and Foremost

Never give your card and PIN to an employee. Such carelessness is even worse than signing a blank cheque because it enables the dishonest employee to see the actual amounts in the accounts. No financial institution will reimburse you for stolen funds when you have provided the electronic signature (PIN).

Do not use initials, birth dates, addresses or names as PINs.

The PIN and account numbers taken together are supposed to provide a unique identifier as distinctive as your signature. Unfortunately, the PIN is often compromised because the card owners create the number using predictable combinations such as their initials, birth dates, addresses or names of family members or pets. These PINs may be easily cracked if the thief has time to try various combinations from data found in a stolen wallet or purse.

Because using an ATM is so convenient and commonplace, it is easy to forget they still present a security problem both for the institution and for the customer. ATMs can be compromised with substituted card readers and hidden cameras that record each user's key strokes. Such improperly obtained information can be transferred to an illegally made card and used at an ATM within hours.

How to Protect Company Assets

1. Limit your company's exposure by not linking all accounts to the debit card.
2. Reduce the withdrawal limit and the upper credit-card limit to avoid large withdrawals or purchases.
3. Change the PIN number on a regular basis. Most financial institutions allow changes over the Internet or at an ATM. Since the communication protocol is extremely secure, the probability of compromise is minimal.
4. Know the account passwords. Many owner/managers leave all online banking to a trusted employee. (If receipt and payment responsibilities are not segregated, even a trusted employee must be monitored regularly.) If you still do not know how to use your company's passwords to access your own online accounts, learn now. Failure to do so means you cannot monitor your own employees' access to company funds. Redirection of funds to phoney suppliers or simple theft could leave your company with sudden and unexpected working capital problems. You can always take legal action against the employee, of course, but what good is that if the employee cannot repay the spent money and you are in a cash-flow crisis?
5. Attach debit card purchase slips to the original invoice. You can thus distinguish between legitimate and fraudulent purchases and withdrawals in the event the debit card is stolen.

6. Store all transaction slips produced by an ATM or a Point of Sale (POS) terminal; do not leave them in the ATM — do not throw them into the trash. The printed balances indicate to the fraudster just how much remains in the account, which may be an indicator of the business's financial health.
7. Use online banking services to review your accounts daily. A good time to review your accounts is Monday morning or after a long weekend since many frauds are committed when key financial people are away or businesses are closed. If transactions are unusual and cannot be accounted for, contact the financial institution at once.
8. Never respond to email messages claiming to be from your financial institution. As a matter of policy financial institutions do not ask for account information or any other personal information by email.

Password Security

Most individuals would never consider carrying a PIN in a wallet, purse or briefcase next to a debit card because the account could be compromised in the event of loss. The increased requirement of passwords for access to accounts for everything from airlines to the Canada Revenue Agency has created a need to record this easily forgettable information in one readily accessible location.

Many business owners use applications such as Outlook to store important information. The ability to co-ordinate cell desktops and laptops with a cell phone or smart phone carried in a briefcase, jacket or purse creates a potential for not only debit card abuse but also identity theft. Owner/managers should be sure that all laptops, desktops and smart devices are secured to avoid unauthorized access. All devices and application software containing sensitive information should be password protected. In addition, all devices should shut down within a limited time when not in use. Since your smart phone may be the very means of notifying a financial institution of a lost or misappropriated debit card or other identification, these gadgets should be carried on your person at all times.

Identity Theft Protection

Many financial institutions now provide a service marketed as identity theft protection. For a fee they will contact all credit card and debit card carriers of a business or individual as soon as they receive notification that a card may have been compromised. Another means of protection is to maintain a list of numbers to call in the event documents are lost or stolen. This information should be stored on a secure online office server or a service provider that can be contacted from a cell phone.

An Ounce of Prevention . . .

Electronic information carried on laptops, smart phones, electronic organizers or on stand-alone office computers provides access to information that, if used by a criminal, can cripple an organization overnight. Careful password protection combined with vigilance when conducting transactions will limit losses to your business.

TECHNOLOGY

Recording Travel for Business

Keeping track of business travel expenses is often difficult, time consuming, and imprecise.

But failure to maintain accurate records to support cost claims in your submission to the Canada Revenue Agency (CRA) can result in embarrassing audits.

Now there are devices available that can help solve this problem. A Canadian company offers a product called ***Odotrack*** that records your mileage and produces a variety of reports for management and tax purposes. A particular bonus feature of this software is its ability to distinguish between business and personal driving time.

Compliance with CRA Rules

Compliance with tax rules regarding motor vehicles owned by employees but used for business can be a complex matter for both the employee and the employer. According to the Canada Revenue Agency, motor vehicle expenses are deductible if the employee meets ***all*** of the following conditions:

- The employee normally works away from the employer's place of business or in different locations.
- The contract of employment requires the employee to pay his or her own motor vehicle expenses.
- The employee does not receive a non-taxable allowance for motor vehicle expenses. An allowance is usually non-taxable when it is based solely on a reasonable per-kilometre rate.

- The employee has a copy of ***Form T2200, Declaration of Conditions of Employment***, completed and signed by the employer.

The number of kilometres travelled for business purposes is important to record since it is a key part of the formula used to calculate the deductible amount. (The rest of the formula includes operating expenses, capital cost allowance and an interest cost related to the amount borrowed to purchase the vehicle.) But getting employees to keep a record of distances travelled can sometimes be difficult, even when the record is needed for filing personal income taxes or reimbursement from the employer for business travel.

Time Really Is Money

The dollar cost to employers and employees alike can be quite significant if travel expenses are not billed and reimbursed. There is not only potential for lost business revenue by not being able to cost out the travel component of a contract correctly, but also potential lost deductions to the contractor as a taxpayer.

Failure to record and report mileage can be very costly.

Consider this: If five employees working for an owner/manager each failed to record 5,000 kilometres in a year, a total of 25,000 kilometres worth of cost recovery could go down the drain. At a modest $0.46 per kilometre, the employer has lost $11,500. In addition, if one assumes (a) that the 25,000 kilometres is recoverable travel time, and (b) that 100 kilometres per hour is the average speed, a total of 250 billable hours has been lost.

The Solution

Odotrack users can simply and easily track travel distance with separate buttons for personal and business travel. (This feature is especially useful since the CRA permits a deduction only for the percentage of expenses related to earning income.) Through the use of the Global Positioning System (GPS) and the cellular data network, the device records your starting and finishing positions and automatically updates a log on a centralized server wirelessly. (A similar product called Mileage Logger is available in the U.S. Microsoft and other software manufacturers offer templates for manually recording travel data.)

Features That Will Pay Off

1. Password protection for each employee but universal access for an administrator to pull reports.
2. Ability to track specific vehicles by date and time to record the trip starting point, distance travelled, duration of the trip, and whether it was for business or pleasure.
3. Every client visit recorded at the push of a button. The employee is only required to enter the client's name. The employee or designated administrator can retrieve all information for any period in question.
4. The centralized archive function allows the preparation of year-end reports for various tax forms with ease, much as payroll software can summarize T-4 information.
5. An expense report template can be used to record expenses incurred by the employee and categorize the payment method – cash or credit card. This feature encourages the user to attach the actual invoices to ensure reimbursement.
6. Data can be recorded even in areas without wireless coverage. Upon return to the office, the data can be uploaded to the central server.
7. The system can track vehicles in real time and show whether they are moving or standing still.
8. The product hardware is handheld, has a built in rechargeable battery, and can plug into a vehicle electrical outlet to maintain its charge.
9. Purchasers are provided with reference to every pertinent income tax report required by the Federal and Quebec income tax authorities and can, with the click of a mouse, transfer the data to the appropriate form whether it is a ***TP-80 (Quebec), Income and Expenses Relating to a Business or Profession***, or the federal ***T-777 Statement of Employment Expenses***.

Definitely Worth the Investment

For about $300 per unit and a monthly fee just under $25, the service will undoubtedly pay for itself by providing more accurate billing and employee accountability.

Whether your company needs to track employee vehicle use, recover costs, extract more timely and accurate expense reports, or simply to comply with tax requirements, a travel-logging tool may fit your needs.

MANAGEMENT

When Cash is Short

Times are tough, cash is tight.

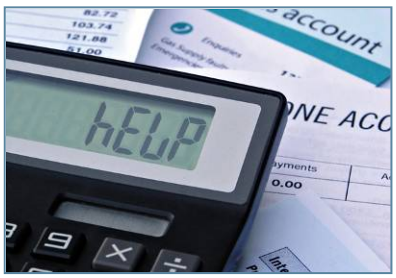
This is ***not*** the time to cut costs in an effort to reach short-term goals. You may inadvertently create unforeseen difficulties that may surprise you later.

The following list outlines what **NOT** to do when cash is short:

DO NOT:

Sign Your Life Away

Prudent debt management suggests that debt incurred for business purposes should be the only debt at risk when operating your business. When times get tough and small businesses need operating capital, financial institutions often ask for personal guarantees from the owner/manager. When one signs as an agent on behalf of a corporation, only the company assets are at risk in the event of bankruptcy; if, however, the owner/manager signs a personal guarantee for the corporate debt, he or she ***may be subject to unlimited liability***.



Postpone Paying Government Withholding Taxes

All personal income tax withheld from employees for remittance to the government, Canada Pension Plan, Employment Insurance, as well as the GST or HST collected from customers are collected in trust for the government. With the current HST rate at 13% (in British Columbia, Ontario, New Brunswick, Newfoundland and Labrador but 15% in Nova Scotia) the amount collected can grow quickly. Using the GST or HST collected or employee deductions to augment current cash flow between collection and the remittance deadline is undoubtedly a widespread practice. Be aware, however, that failure to remit by the deadlines set by the various regulatory bodies will result in stiff penalties regardless of the unremitted dollar amount. ***Penalties increase with each missed deadline.*** In addition, if your business declares bankruptcy, corporate officers and directors could be held accountable and required to repay the delinquent amounts out of their own pockets.

Delay Opening the Mail

Many owner/managers have had times when cash flow was so tight and reminders in the mail so numerous that the mail was ignored. Failure to open the mail to at least find out what has to be dealt with can create additional problems even more onerous than owing money. Consider this: your insurance company may cancel its coverage; the Canada Revenue Agency and other regulatory authorities may freeze your bank accounts; regulatory authorities or creditors may notify your business that ***a sheriff will lock the doors and seize all assets***. Now you have even worse time-consuming and expensive problems that must be dealt with by your lawyer and Chartered Accountant.

Cash Personal RRSPs to Fund the Business

Using your RRSP to keep your business afloat may be available as a last resort but, before you take that step, realize the initial cost in personal-tax liability is high. If, for example, you need an additional $30,000 for the business, current legislation requires you to withdraw about $37,500. Assuming you paid yourself taxable income of $39,000 for the year, the additional $37,500 would push you into such a high tax bracket that cash-flow problems could be exacerbated later when you have to withdraw more capital to pay your higher income taxes. ***You may now be in the unenviable position of not only losing the capital gains and investment income that could have been generated from the withdrawn funds***, your future annual allowable contribution levels may not permit you to make up the losses.

Review advertising effectiveness before cutting advertising expenditures.

Cut All Promotion

Advertising and promotion are often seen as expenses that can be slashed out of operating costs. Indeed, you should ensure that frivolous advertising is eliminated. ***No advertising or promotion, however, removes your voice from the market place.*** You also need to keep existing clients informed of any changes that might affect the products they buy. This may be an opportunity to review the effectiveness of your advertising expenditures and see where it is most and least effective.

Cut Insurance Coverage

Reducing insurance coverage is another road to short-term savings. Before taking this route, however, consider the consequences. Do any loan covenants require a specific level of coverage for the assets securing the loan? If vehicles are leased, are they subject to any insurance conditions? ***Failure to maintain adequate insurance may be a breach of contract that forces loans to be called or vehicle leases to be cancelled.***

Stop Paying Premiums

Eliminating expensive life insurance premiums on key personnel, especially on you, the owner/manager, is another short-term solution that could become a long-term problem. Before taking this tactic, you should consider how stressful times can create health problems. If you are unable to continue working, you could be placing your business, your shareholders (partners), and your family in jeopardy, particularly if buyout insurance becomes inadequate as a result of a short-sighted cutback in the premiums. ***If you try to renew the insurance, medical examinations and/or higher costs may prevent you from reinstating the policy at its former level.***

Reduce Your Take-Home Pay

Reducing your own remuneration is certainly one more method of maintaining cash flow. But keep in mind that a certain level of remuneration is required for day-to-day living. Often reduced remuneration is offset by increased draws by owner/managers. At some time in the future the owner/manager must record these draws as personal taxable income with the risk of moving into a higher tax category. Perhaps personal and family income requirements should be reviewed to ***consider whether hiring family members would provide the necessary family income without raising your personal tax rate***.

DO:

Seek Advice

Maintaining control over business costs is essential in any business. The secret to controlling costs without creating higher future costs is to carefully analyze the specifics of cost cutting and determine with the assistance of your Chartered Accountant whether your current plans will be detrimental to your business in the long run.

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Richard Fulcher, CA – Author; Patricia Adamson, M.A., M.I.St. – CICA Editor.