

Ryan Lamontagne Inc

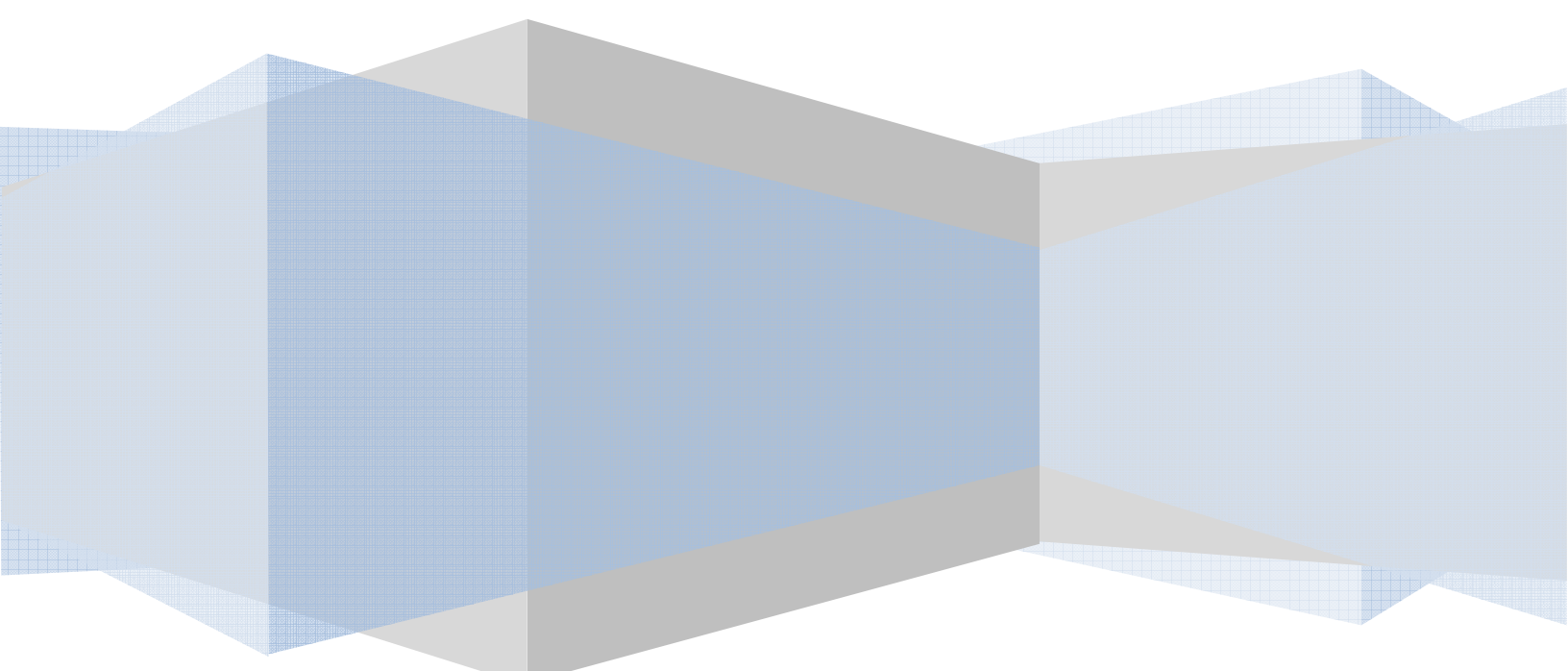


RYANLAMONTAGNE

Self-Employment and the Taxman

Introductory Concepts in Tax Minimization

David Burnie



Ryan Lamontagne Inc.

Ryan Lamontagne Inc. is Ottawa's largest fee-for-service financial planning firm. We specialize in wealth management strategies for emerging affluent families. We work with business owners, executives, professionals and retirees to maximize their financial well-being.

A key advantage of your relationship with Ryan Lamontagne Inc. is that you gain access to professionals who are qualified to provide expert advice on every facet of the financial planning process. Our broad range of expertise means we can provide you with customized solutions that consider your complete financial picture, not just one aspect of it.

Private Client Service (PCS) is a comprehensive financial planning and wealth management programme designed to keep clients on track with respect to achieving all of their financial objectives. This program combines all of the critical financial planning elements into one convenient and effective package. The programme includes the following:

Financial Review

We start the process with a detailed review of your personal financial situation that includes the following: cash flow statement and net worth statement, retirement plan, life insurance needs, investment and tax planning strategies, and estate matters. Based on your goals and objectives, we will then recommend financial strategies and changes to your current financial situation that will enable you to achieve your financial objectives.

Tax Services *

Our Advanced Tax Planning service is designed to ensure that you are taking advantage of every available deduction and that your financial affairs are organized in the most tax efficient manner. This service package also includes the preparation and electronic filing of your personal tax return.

Investment Counselling

We will assess your financial needs, future expectations and tolerance for risk. On that basis, a personalized portfolio is developed using a strategic asset allocation model. We will design a portfolio that will, in the longer term, maximize returns and minimize risk, using the inherent properties of the various asset types.

Plan Implementation

Once the financial plan has been finalized, we will assist with the implementation of the financial strategies and facilitate any changes that are required.

Investment Management Services *

We also provide a cost effective and comprehensive on-going asset management services including, portfolio re-balancing, and consolidated reporting for all assets under administration.

Ongoing Review

Your Financial Planner is available throughout the year for any questions or changes. On your anniversary, we will update your current financial situation, review your progress with respect to achieving desired objectives, and suggest modifications or new strategies that may be appropriate.

Reporting

We will advise you of any legislative changes, new financial strategies or seminars that we present that may be of interest.

* Certain restrictions and limitations apply.

David Burnie, CFP, MBA

Enjoying 16 years in the financial services industry, David is a principal and resident partner at Ryan Lamontagne Inc. His areas of practice include transition and severance planning, personal & corporate taxation, estate and investment counselling. Considered a tax-planning specialist, David provides comprehensive planning for professionals, the self-employed and closely held corporations. David is considered an experienced and entertaining orator and has facilitated hundreds of presentations to a wide cross-section of audiences, for both public and private sector organizations in Canada. An author, media resource, and keynote speaker, David is a fluent authority for matters of financial education, compensation transparency & professional ethics. David holds a Masters degree in Business Administration and is formally an adjunct professor at Algonquin College. Presently, David is the managing director of National Review Workshops and has been appointed by FPSC to be a CFP® Brand Ambassador.

Introduction

Income tax was a temporary measure instituted by the Government of Canada in 1917. This measure, however, has lost its temporary nature and has become a permanent fixture in our financial life. The Income Tax Act provides each Canadian taxpayer with opportunities to arrange their financial affairs in such a manner as to reduce the amount of income taxes that they pay. There are many legal ways to reduce income taxes. Canadian business owners unfortunately do not often take full advantage of these opportunities. This introductory workshop has been designed to make individuals aware of some of the mechanisms available to reduce one's income tax payable when they are self-employed.

Understanding how to effectively merge personal income tax strategies with business strategies in order to reduce the amount of income tax we pay, involves an understanding of how our tax system operates, and which tax rates are applicable to us. It is important to have a basic understanding of the difference between your marginal rate and the small business rate. Not all income is treated equally in the eyes of the government, and it is significant in tax planning to be aware of your potential opportunity to choose tax-preferred income.

Learning Objectives

1. To have a detailed understanding of the three types of business structures.
2. To gain a basic understanding of tax planning concepts that may be utilized by a self-employed taxpayer or the owner/manager of a closely held corporation.

Agenda

- Introduction
- Income tax in Canada - Rules of the game
- Choosing a business structure that is right for you
- Structuring the closely held corporation
- Essential tax-planning for the owner manager
- Using a HoldCo
- Seven pitfalls of poor planning and preparation
- Conclusion
- Questions

Income tax in Canada - Rules of the game

Canadian Tax System based on Residency and not Citizenship

- Residents and deemed residents must report and may be subject to tax on worldwide income.
- Non-residents may be taxed on income earned in Canada, including employment and business income and taxable capital gains on Canadian property.
- In cases of dual residency, tax treaties determine residency for tax purposes, which could lead to a departure tax.
- In addition to the Federal Income Tax Act, each of the Provinces and Territories has also enacted their own separate legislation to tax personal income.

Self Assessment System

- Under the self assessment system, every Taxpayer is entitled by law to organize their financial affairs in such a way as to reduce the amount of tax they pay.
- It is perfectly legal for a Taxpayer to engage in the activity of tax planning to minimize the amount of taxes paid, as long as they keep their planning activities within the limits of the law.
- Tax avoidance is the activity of manipulating the tax system to obtain a tax benefit in a way in which the system was not intended (described in more detail below).

Role of CRA

- Canada Revenue Agency's role is to administer and enforce the Income Tax Act. CRA does not make the tax laws. The Income Tax Act and the Provincial equivalents are enacted and amended by Parliament.
- CRA is responsible *only* for the assessment and collection of personal taxes. CRA does this on behalf of the Federal Government and all of the Provincial and Territorial Governments except the Province of Quebec.
- The Province of Quebec is the only jurisdiction to administer its own separate revenue assessment and collection system.

T1 General Income Tax and Benefit Return

- Individuals must file and pay balances by April 30th.
- Self employed individuals and their spouses file by June 15th but balances due must be paid by April 30th.

T2 Corporation Income Tax Return

- Taxes due 90 days after fiscal year end.
- File 180 days after fiscal year-end.

What about the T4 and T5 ... GST?

Marginal Tax Rates vs. Effective (Average) Tax Rates

- Marginal Tax Rate is the rate of tax applied to a Taxpayers next dollar of ordinary income.
- Effective Tax Rate is the average amount of tax paid.

What is the average rate of tax paid by the average Canadian Taxpayer?

<i>Note-thresholds are indexed annually by CPI to avoid "bracket creep"</i>	<u>Ordinary Income</u>	<u>Eligible Canadian Dividend Income</u>	<u>Non-Eligible Canadian Dividend Income</u>	<u>All Capital Gains Regardless of Origin</u>
Above (29%)				
Between (26%)				
Between (22%)				
Less than (15%)				

Choosing a business structure that is right for you

Sole Proprietorships

- Unlimited Liability

How is a Sole Proprietorship Created?

How the Income Tax Act Views Sole Proprietorships

- Under the Income Tax Act, the net income of the business (basically revenue less expenses) is the income of the sole proprietor.
- The net income of the business is taxable to the proprietor for the year it is earned, regardless if they leave cash in the business bank account and does not make any withdrawals.
- Any property used by the business of a sole proprietor is considered to be the property of the sole proprietor.
- Capital gains or losses on the disposal of property used in the business are treated exactly the same as capital gains or losses on any property owned by an individual.
- The sole proprietor can pay a salary to anyone other than themselves, including a spouse, common-law partner, or children, for employment in the business provided that the work was necessary and the salary was reasonable for work performed.

Who Should Establish a Sole Proprietorship?
What is REOP?

Partnerships

Establishing a General Partnership

- A general partnership is the simplest form of partnership, and it can come into existence without any legal formalities, simply by the action of two or more people carrying out business activities together with a view to a profit.
- A general partnership consists only of general partners. General partners are those who are entitled to take an active role in managing the business, and who have unlimited personal liability for the debts and obligations of the partnership.
- A person who became a partner without realizing it could be surprised when they are called upon to cover debts incurred by the partnership.

The Partnership as an Entity or an Aggregate

- There are two ways to view a partnership: either as an entity or as an aggregate.
 - As an entity, a partnership is separate and apart from its partners. This view is most accurate when the partnership is dealing with outsiders. For example, the partnership acts as an entity when it enters into a contract, sells partnership property or hires employees.
 - As an aggregate, a partnership is a collection of individuals or proprietors engaged in the same business. This view predominates in the liability imposed on a partner.

Partnership Capital

- The default rules say that all partnership capital must be shared equally by the partners.
- However, in many cases the partners will have contributed different amounts of capital, or provided different levels of effort in increasing the capital assets of the company.
- For these reasons, most partnership agreements provide for an alternate allocation of capital. It may cover:
 - how much each partner is initially required to contribute
 - how much a new partner would be required to contribute upon admittance to the firm
 - how any requirements for new capital will be handled
 - entitlements to capital upon dissolution of the partnership or withdrawal of a single partner

Partner Roles and Responsibilities

- By using the partnership agreement to delegate the decision-making abilities, the partners are not escaping their unlimited liability.
- If partners can prove that one partner was acting outside of his approved authority in making a particular decision that indebted the partnership, the remaining partners may have legal recourse to recover their loss from the erring partner.

Partnership Agreements

Default Provisions

- In the absence of a partnership agreement, a partnership will be bound by the following default provisions set out by Provincial legislation:
 - All property contributed to the partnership or purchased with partnership funds is partnership property and not available for the personal use of a partner.
 - All partners are legally entitled to share equally in the capital and profits of the business and must contribute equally towards losses. However, that legal entitlement to, and taxation of, profits are two different things.
 - Every partner may take part in the management of the partnership business, but is not required to do so.

- No partner is entitled to remuneration for acting in the partnership business.
- The consent of all partners is required to admit a new partner.
- Each partner owes a duty of loyalty to the partnership and cannot carry on any business of the same nature and competing with that of the partnership.

Dissolving a Partnership

- Under the default rules, if one of the partners retires from the partnership, dies or becomes insolvent, the partnership is dissolved. Of course, the remaining partners would be free to establish a new partnership.
- Most partnership agreements override this mandatory dissolution, and specify some arrangement for how the departing partner will be compensated in terms of a return of his share of the capital and profits earned to date.
- The default rules forbid the expulsion of a partner. Most partnership agreements provide for the expulsion of a partner upon certain conditions, including the vote of a specified majority of the other partners.

Expanding or Entering an Existing Partnership

- In the absence of a partnership agreement, the default legislation requires that all partners must consent to the admission of a new partner.
- A partnership agreement is used to specify criteria for admission. It will discuss ownership issues, i.e. how much a new partner would be required to contribute in capital, and what his interest in the partnership capital and profits will be.

Distribution of Profits and Losses

- The default rules specify that the profits and losses are to be shared equally between the partners. This arrangement is generally unsatisfactory given the differences that may occur in capital contributions, time spent managing the partnership and other factors.
- Most partnership agreements will specify an alternate allocation that takes into account both direct and indirect contributions to the firm, such as:
 - capital contributions
 - hours spent managing the firm
 - hours billed or fees collected
 - number of hours worked or billed by employees under a partner's supervision
 - number of new clients brought to the firm

How the Income Tax Act Views Partnership Income

- The Income Tax Act states that when a Taxpayer is a member of a partnership, her income and losses for a taxation year are to be computed as if:
 - the partnership was a separate person resident in Canada (ITA 96(1)(a))
 - income, losses and taxable capital gains and losses retain their character in respect

of source and nature (ITA 96(1)(f))

- the income, losses, etc. are then allocated to the partners according to their respective interests in the capital or income of the partnership (ITA 96(1)(f))

How the Income Tax Act Views a Partnership Interest

- Considered to be non-depreciable capital property, the sale or other disposition of a partnership interest may result in a capital gain.
- It can also result in a capital loss to the extent that the proceeds are less than the ACB.

How is the ACB of a Partnership Determined?

Structuring the closely held corporation

Defining a Corporation

Limited Liability
 Continuous Existence
 Separation of Management and Ownership
 Ease of Transfer of Ownership

Types of Business Corporations

Public Corporations

- A public corporation is one that:
 - has one or more classes of its shares listed on a prescribed stock exchange in Canada
 - has elected, or has been designated by CRA, to be a public corporation and, among other conditions, its shares are held by at least 150 shareholders, each of whom holds at least \$500 worth of shares (ITA 89(1))

Private Corporations

- A private corporation is one that is resident in Canada, is not a public corporation, and is not controlled directly or indirectly by one or more public corporations (ITA 89(1)).
- A Canadian-controlled private corporation (CCPC) is a Canadian private corporation that is not controlled directly or indirectly by one or more non-residents or public corporations (ITA 125(7)).

INCORPORATION AND ORGANIZATION QUESTIONNAIRE

1. Incorporating Jurisdiction: **Provincial or FEDERAL**
2. Name: or **Numbered Company (CANADA LTD)**
3. French Name (if any):
4. Business Name (if any):
5. Activity to be carried on under the above business name:
6. Extra-Provincial Registrations:
7. Registered Office Address:
8. Location of Principal Place of Business:
9. Mailing Address:

Contact Person:

Telephone No.:

Email:

10. Number of Directors: **Minimum 1** **Maximum 10**

11. Authorized Capital:
- Class of Share: Common A Rights: Voting, Participating, Div as Declared
 - Class of Share: Common B Rights: Voting, Participating, Div as Declared
 - Class of Share: Common C Rights: Voting, Participating, Div as Declared
 - Class of Share: Common D Rights: Voting, Participating, Div as Declared

 - Class of Share: Pfd E Rights: Non-Voting, Non-participating, redeemable for price paid, Div as declared
 - Class of Share: Pfd F Rights: Non-Voting, Non-participating, redeemable for price paid, Div as declared
 - Class of Share: Pfd G Rights: Non-Voting, Non-participating, redeemable for price paid, Div as declared
 - Class of Share: Pfd H Rights: Non-Voting, Non-participating, redeemable for price paid, Div as declared
 - Class of Share: Pfd I Rights: Non-Voting, Non-participating, redeemable for price paid, Div as declared

ORGANIZATION

1. Permanent Directors:

Full Name	Address & Postal Code (incl. Street & Postal)	Resident Canadian Yes/No
	Same as Registered Office Address	YES
	Same as Registered Office Address	YES

2. Officers:

Title	Full Name	Address & Postal Code (incl. Street & Postal)
President		Same as Registered Office Address
Secretary		Same as Registered Office Address
Treasurer		Same as Registered Office Address
Other	N/A	

3. Shareholders:

Name	Number and Class of Shares	Price Per Share
	51 Class A Common	\$.01
	49 Class A Common	\$.01
	100 Class E Pfd	\$.01
	100 Class F Pfd	\$.01
	100 Class G Pfd	\$.01

4. Banking:

Name of Bank:

Signing authority:

5. Execution of Contracts:

Signing authority:

6. Financial Year End:

Essential tax-planning for the closely held corporation

Reduced Corporate Tax Rate on the first 500k for Qualified Small Businesses (SMABUD)

- The definition for a qualified small business corporation is one that meets the following three conditions:
 - The corporation must be a CCPC.
 - All or substantially all (90%) of its assets are used in an active business carried on in Canada.
 - An active business is a business that is engaged in the adventure or concern in the nature of trade (ITA 248(1)). It does not include income from property i.e. portfolio of securities as explained later.
 - It is owned by the Taxpayer, his or her spouse or common-law partner, or a related partnership.

Capital Gains Exemption for Qualified Small Business Shares

- The \$375,000 capital gains deduction (\$750,000 capital gains exemption) may be available to any individual, but not a trust or corporation, who disposes of a qualified small business corporation share in the current taxation year. The individual must have been resident in Canada throughout the year (ITA 110.6(2.1)).
- Additionally the following four conditions must be met:
 - The corporation must be a CCPC.
 - All or substantially all (50% not 90%) of its assets are used in an active business carried on in Canada.
 - It is owned by the Taxpayer, his or her spouse or common-law partner, or a related partnership.
 - During the previous 24-month period, it was not owned by an unrelated person.
- If a Taxpayer owns shares in a holding company which held all or substantially all (at least 50%) of its assets in the form of qualified small business corporation shares, the holding company shares will be considered to be qualified small business corporation shares.
- If a Taxpayer is able to make use of the \$750,000 capital gains exemption, they are still required to report the taxable capital gains, net of allowable capital losses (including ABIL's) and net of CNIL (ITA 110.6).

- In order to prevent shareholders of a company that seeks to go public from losing out on the extra exemption, shareholders can elect a disposition for proceeds anywhere between ACB and FMV and immediate reacquisition just before the company becomes public (ITA 48.1(1)).

Restricted Activities that do not Qualify for the Exemption or SMABUD

- In deciding that some corporations should be eligible for special tax treatment, the ITA restricts the treatment to income from certain types of corporate activities.
- The three types of restricted corporate business income defined by ITA 125(7) are:
 - income of a specified investment business;
 - income from rental activities; and,
 - income of a personal services business (see below).

Specified Investment Business

- A specified investment business is a business (other than a credit union or lessor of property other than real property) whose principal purpose is to derive income from property (including interest, dividends, rents or royalties), unless:
 - the corporation employs more than five, full-time employees
 - the corporation makes use of certain managerial or administrative services provided by an associated corporation, and the first corporation could have reasonably been expected to require more than five, full-time employees if those services had not been provided (ITA 248(1), 125(7))

Personal Services Business

- Personal services business refers to services that are provided by a specified shareholder of a corporation (or a relative of that specified shareholder) to another entity, such that the specified shareholder would have otherwise been deemed to be an employee of that entity if the corporation did not exist (ITA 248(1), 125 (7)).
- Because the definition of an active business specifically excludes a personal services business, personal service income is not eligible for the small business deduction and thus it must be taxed at full corporate rates (ITA 125(7)).
- Any deductions for expenses other than salary, wages and other remuneration paid to the individual who performs the services are disallowed.

Exceptions to the Restricted Activities Rule

- An exception to three restricted activities describes above occurs if the corporation employs more than 5 full-time employees including specified shareholders, or where the services are provided to an associated corporation.

Essential tax planning for the Owner/Manager

Income Splitting

Tax Deferral

Capital Gains Exemptions for Qualified Small Business Corporations

Dividend Sprinkling

Tax Free Allowances

Dividend Income Received by a CCPC from a Public Company

Dividend Income Received by a CCPC from another CCPC

Interest, Capital Gains and Net Rental Income

Investments held by the Corporation

Using a HoldCo

Purifying the OpCo



Seven pitfalls of poor planning and preparation

1. The Four Tests

- Whether a self-employed Taxpayer is a sole proprietor, partner or the owner / manager of a corporation, the following four tests must be applied to ensure the deductibility of expenses from revenue.
- It should be noted that the CRA has attacked many sole proprietors and OpCO' s in recent years because they have not met the four tests. The classic case in point is the employee who "retires" and returns to their former employer as a "consultant".
- The leading case in respect of independent contractor status is Wiebe Door Services Ltd. v. M.N.R. (87 DTC 5025, F.C.A.). In that case, it was indicated that the following four tests must together be considered:
 - Control test – the basic issue is who determines what is done where, when and how. An employer tells an employee not only what to do but how to do it, while an independent contractor is simply told to do something or to achieve a specific result.
 - Ownership of equipment – A self-employed individual normally supplies his or her own equipment.
 - Risk of profit or loss – A self-employed individual bears the risk of realizing a loss on the job, whereas an employer assumes all of the risk of the profit or loss and the employee normally earns salaries irrespective of this result.
 - Integral part of business – If an individual is an integral part of the business, he or she may well be an employee. It is this test, which would normally make an owner-manager of an incorporated business an employee.

- Apart from the foregoing, a number of items may be important, including the following:
 - The ability of the individual to provide his or her services to someone other than the employer.
 - Whether the alleged independent contractor was a former employee or carrying out the same or similar duties.
 - Whether the individual is required to provide the services personally, or whether they can use others to provide the required services.
 - The length of the relationship: an independent contractor is normally engaged for a single task or project while an employee is engaged on an indefinite basis.
2. OpCo becomes offside
 3. Personal use of company assets
 4. Shareholder loans vs. pay advances
 5. Company share structure does not allow for optimal income splitting
 6. Expenses are not reasonable in the circumstance
 - a. AGM
 - b. spouse
 - c. children
 - d. meals and entertainment
 7. Maintenance is overlooked or delayed
 - a. GST
 - b. T2 Return
 - c. annual return to industry Canada
 - d. AGM
 - e. Minute book

Conclusion

Learning Objectives

1. To have a detailed understanding of the three types of business structures.
2. To gain a basic understanding of tax planning concepts that may be utilized by a self-employed taxpayer or the owner/manager of a closely held corporation.

Upcoming Events

1. Self-Employment and the Taxman
2. Advanced Family Estate Planning - Understanding the importance of structure
3. Preparing for Retirement - Focus on financial planning