2013 Tax Check-up for Owner managed businesses with December 31 fiscal year end

You may think it's too early to start talking about taxes, however, now is the time to fine tune those tax planning strategies you agreed on with your accountant earlier in the year, or implement some strategies that can help reduce your 2013 tax liability. Let's look at a few that you still have time to implement.

Business Income

Review your business net income to date, then do a rough calculation of taxes that would be due. As long as net income is below $500,000, it is an acceptable to estimate taxes due by multiplying the net income by 15.5%. With this information in hand, do the following

a) Compare your tax estimate to the total installments paid to Canada Revenue Agency to date. Dependent on the result, you may need to adjust your tax installments due for the rest of the year. However, if you deviate from CRA's installment schedule, try to ensure that your estimate is as accurate as possible to the actual tax that will be owed, so that you avoid non-deductible interest and penalties.
b) Split the business income by paying a salary to your spouse and/or adult children. This will only be beneficial if their marginal tax rate is lower than yours. Additionally, it will give them earned income for CPP and RRSP. Salary paid must be reasonable, and commensurate with the work performed

Business expenses

a) Purchase necessary business equipment and technology before the end of the fiscal year. This way, you will be able to claim the depreciation expense in the fiscal year. However, if you want to dispose of an asset, it is best to wait until the new fiscal year starts, since you are unable to claim depreciation in the year an asset is disposed. Additionally, if the asset has appreciated in value, there could be significant tax liabilities upon disposal.
b) Ensure the mileage log book is up to date, and can substantiate your mileage claims
c) Discuss with your accountant whether the nature of your business is suitable for a home office. If it is, then the business should take full advantage of the income tax deductions available for the home office

Salary/Dividend Mix

If you take funds from the corporation and use them for personal expenses, you must decide whether to treat the withdrawals as salary or dividend. Note: bonus payments are also classified as salary

a) Previously, if your net income exceeded $500,000, it was normal to consider accruing a bonus to reduce the net income to just below $500,000. The bonus had to be paid within 179 days after the fiscal year, and the payroll withholdings (CPP, EI, Income taxes) must be paid over to CRA by the 15th of the month following payment. In recent times, this strategy has become less attractive, given the reduction in general corporate tax rates
b) Reduce your family's tax bill by paying dividends to your spouse and adult children, as long as they are shareholders of the company, and they are in a lower marginal tax bracket than you
c) If the corporation earned investment income, and paid dividends before the fiscal year end, this could generate a tax refund on the corporate tax return
d) If dividends are paid, they should be properly documented and recorded in the company's minute book. As well, plan for the preparation of T5 slips for any dividends paid in 2013. The T5 information return must be filed with CRA on or before February 28th, 2014
e) Apart from the tax implications attributable to each choice (salary or dividend), there are other considerations that may factor in your decisions. For example, dividends are not considered earned income, and so if your compensation is solely dividends, you will not have any RRSP room. As well, if your spouse earns higher income than you, then neither of you may be eligible to claim childcare expenses on your personal tax returns
f) It is always advisable to contact your accountant and discuss these issues so that you may decide on the optimal salary/dividend mix

<u>Investments</u>

a) Review your investment portfolio mix to ensure you are getting the best after-tax returns since each type of investment income is taxed differently. Interest income is accrued and fully taxed. Dividends are taxed only when paid. When Capital gains are realized, only 50% of the gain is taxed.
b) Maximize interest expense deductions. To be deductible, interest expense must relate to debt incurred to earn business or investment income. Interest on personal debts (car loan, mortgage, RRSP contributions funding) are not deductible in the corporation. Interest on funds borrowed to invest in assets that only produce capital gains, are not deductible
c) Defer the purchase of mutual funds until after Dec 31, as many mutual funds distribute income and capital gains in December. If you purchase units just before distribution, you will be allocated a full year of the Fund's income and capital gains , resulting in your receipt of taxable income

<u>Capital Gains and Capital Losses</u>

Only 50% of capital gains and losses are included in taxable income. Capital losses are used to offset capital gains, and unused capital losses may be carried back three years or carried forward indefinitely for use in other tax years.

Review your asset /investment sales during the year to date to determine your net capital gain/loss position

a) If you realized capital gains during the year, and have no unused capital losses carried forward, consider selling assets with an accrued loss in order to offset the current year capital gains
b) If the capital losses realized in (a) above are not fully utilized in the current year, it can be used to offset capital gains realized in the previous 3 years
c) In order for a transaction in publicly traded securities to be recognized in the tax year, it has to settle during the fiscal year. In Canada it usually takes about 3 business days after the trade date in order to settle the transaction. December 23rd would generally be the last trading date if you want to have a transaction settled in 2013.
d) Ensure you contact you accountant to discuss your loss trades, as certain loss sales may be disallowed by CRA. These are known as the “stop-loss” rules.