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THE Quarterly Dividend

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FAST TRACK

Happy Anniversary "New" Income Tax Act!

January 1, 2012 marks the fortieth anniversary of the "new" Income Tax Act that was passed into law by Parliament in 1971 and came into effect on January 1, 1972. It replaced the original War Time Income Tax Act that had been on the books since 1917, and so was a very big deal at the time.

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Should You Make a Charitable Donation Personally or Through Your Corporation?

Harvey Jones is the owner/manager of an incorporated business who received a telephone call one evening from his "friendly" telemarketer. On most nights Harvey, a kind and gentle man, pretends that although he answered the phone, "Mr. Jones" is not "in" at the moment and suggests that the telemarketer call back some other time. In his heart, however, he hopes that the telemarketer will ultimately take his name off the list and never call him again. He vows to himself that he will sign up for the "do not call" list, first thing the next morning.

However, what would have happened if Harvey had felt "generous" that evening and decided to make a donation to the telemarketer's charity? Harvey has two options: (a) tell the telemarketer that he will send the charity a cheque made out from the corporation's bank account and thereby establish the donation as an expense of the company, or (b) tell the telemarketer that he will send the charity a cheque from his own personal bank account and thereby establish the donation as a "personal" expenditure.

For purposes of comparison: (i) Harvey's company has revenues of $45838 and expenses other than management salary and donations of $15092; (ii) Harvey will draw the same "base" salary of $24946 under both situations; and (iii) if Harvey decides to make the donation personally, he will draw out the extra money needed for the donation from the corporation as an additional salary.

The accompanying chart outlines the income tax effect if Harvey were to make a generous donation of $4350 (Situation A) and the not-so-generous donation of $200 (Situation B).

In both situations the corporate income taxes are identical. It does not matter if Harvey's corporation makes a large or small donation. The company will pay the same corporate taxes ($231).

As we would expect, Harvey's Canada Pension Plan contributions increase as he draws a larger salary from his corporation and the amount of his personal income taxes decrease when he makes a larger charitable donation.

From this analysis, we can determine that Harvey would be better to write the cheque personally to the charity of his choice and claim the donation on his personal income tax return rather than make the donation through his corporation and have it listed as a corporate expense.

When the donation amounts are relatively minor, the difference is slight but still in favour of personal giving. As the donation amounts increase, it becomes even more "cost effective" to make donations personally rather than through a corporation.

Compliments of **Stuart Crown & Company Inc.**

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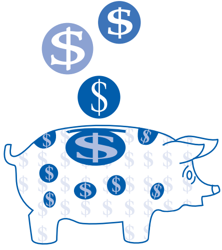


Over the years, it is unlikely that any other statue has been tinkered with so extensively as this piece of legislation. Governments have been elected and others have fallen based upon what they promised and/or didn't promise the electorate they would do in regard to the taxation of their fellow citizens. In fact, it has become almost expected that every Finance Minister will announce changes to the Act when bringing down the country's budget every spring… even though most Canadians pay scant attention to the specifics and can only sigh that their burden has once again become progressively heavier with each passing year.

The biggest change from the old Act to the new Act was the inclusion of capital gains in the determination of a taxpayer's taxable income each year. At the outset there were transition rules that made sure that only gains realized after January 1, 1972 would be taxed and that any amount that could be attributed to the time before that date would not be an income inclusion.

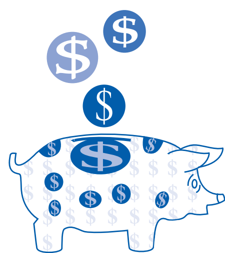
	Situation A		Situation B	
	Donation Through Corporation	Donation Made By Shareholder Personally	Donation Through Corporation	Donation Made By Shareholder Personally
Corp revenue	45,838.00	45,838.00	45,838.00	45,838.00
Corp expenses				
Shareholder's salary	24,946.00	29,296.00	29,096.00	29,296.00
Donation	**4,350.00**		**200.00**	
Other corp expenses	15,092.00	15,092.00	15,092.00	15,092.00
	44,388.00	44,388.00	44,388.00	44,388.00
Income before inc taxes	1,450.00	1,450.00	1,450.00	1,450.00
Corporate income taxes	231.00	231.00	231.00	231.00
Shareholder's				
Personal inc taxes	2,800.00	1,946.00	3,617.00	3,613.00
Can Pen Plan contrib	2,123.00	2,554.00	2,534.00	2,554.00
	4,923.00	4,500.00	6,151.00	6,167.00
Income tax effect	5,154.00	4,731.00	6,382.00	6,398.00
Difference		- 423.00		-16.00

Summary - corporate taxes - will be the same with either big donation or small donation
corporate taxes - donation limited to 75% corporation's net income
personal taxes - larger donation means less income taxes but same CPP conribution
personal taxes - donation limited to 75% of net income
Conclusion - more beneficial to make charitable donations personally rather than through a corporation.

Franchising and the Aspiring Entrepreneur

There are essentially three ways that an aspiring entrepreneur can go into business. Each has its advantages and disadvantages: (a) start off slowly and build the business from the bottom up. This means working out of your basement and gathering clients to the point where you can ultimately afford staff and larger premises. While this is the most inexpensive way of going into business, its drawback is that it requires the would-be entrepreneur to have a great amount of patience, confidence and perseverance to be able to stick it out; (b) purchase an existing business with the hope and expectation that the income that it has historically generated for its previous owners will continue into the future and become even better under your watch. This is often an expensive way of getting into business. Besides the fact that most sellers have an inflated value of what their companies are really worth, you may find yourself much like a purchaser of a used car: a business that has been given a bright shiny coat of paint just before being put on the market but with lots of rust just below the surface that will ultimately be exposed once the previous owner is long gone; and (c) purchase a franchise with a certain name recognition in the hope that the goodwill existent in the company as a whole will spill over into your location as well. Once again these businesses tend to be "pricey" but do afford the businessman many of the tools to be able to get up and running in a very short period of time.

Franchising is a contractual agreement between two parties, a franchisor who is selling certain franchise rights and a franchisee who is purchasing these rights. Upon



Many court cases developed over the years as taxpayers tried to squeeze certain incomes into the capital gain regime, with its more favourable rate of tax, and not be forced to pay tax at the higher rate that is charged on business or property income.

As time has past, this has become less of an issue as most taxpayers now have a good idea of what constitutes a "capital" item and arrange their affairs to make sure that they will not be caught offside.

In addition, most taxpayers have by now disposed of any capital assets that they may have held on Valuation Day, as it was called. Only infrequently today do we hear about taxpayers who are still holding such shares as those issued by the Bell Telephone Co. of Canada, now called BCE Inc. They were traditionally considered to be safe investments, and so from time to time they re-surface as part of an estate or pension plan that has been around all this time.

Corporate income taxes were also affected when the new Act came into force. Here too, most of

the payment of a one-time "franchise transfer fee" and the promise to pay an ongoing "royalty fee" usually calculated as a percentage of gross sales generated by the franchise operation, the franchisee is entitled to operate a business in a specific location for a limited time under the franchisor's banner, receive assistance in determining where the franchise will be located and "how it will look", ongoing management and staff training in the "system" used by the franchisor in its daily operations, benefit from local and national advertising as well as any promotional material, and purchase franchisor products from franchisor distributors at prices that are uniform to all franchisees.

Typical Franchisee "Start-up Costs"

The following costs will be incurred by a franchisee over and above the costs he would "normally" incur to go into business.

(a) construction of "store" in conformity with franchisor's "look"

(b) annual licence fee

(c) royalties…usually calculated as a pecentage of sales revenues

(d) advertising fund…usually a factor of sales revenues

(e) pre-opening costs…training of management and staff on the ways the franchisor operates the business and set up of computer based reporting required by franchisor…usually provided by the franchisor and billed directly to the franchisee

Franchisees are motivated to make their locations as successful as possible, because, as entrepreneurs in their own right, they generate their incomes through their day-to-day operations.

Franchisors are motivated to ensure the continued success of their franchisees both through the royalty payments that accrue to them and the "advertising" inherently generated when others see that their franchise can support the financial success of its franchisees. This allows the franchisor to look for additional entrepreneurs who are willing to pay the franchise transfer fee to get on board.

The most distinctive part of the franchise business is the fact that franchisors and franchisees operate a "vertical marketing system". This is fancy terminology for saying that the Tim Horton's donut that you enjoy in the morning with your "double, double" has been delivered by a donut manufacturer controlled by Tim Horton's head office. It is shipped directly to the local outlet where you are purchasing it at a price that has been set by the head office and over which the local entrepreneur has no control. The local franchisee is not free to find his own donut supplier and work an independent deal with him. Nor is he free to set the selling price that he will charge his customers.

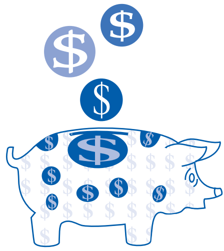
While this assures that the "quality" of donuts do not vary from location to location and that the customer can be assured of the same cost no matter which franchise he visits, the owner/manager of any particular outlet is restricted regarding how much control he actually has over two of the most important aspects of his business…the purchase price of the items he buys and the selling price of the items he sells.

If customers decide that they find the Tim Horton's donut to be too "doughy" and stop buying them, it may take head office some time to determine whether this is just a localized occurrence at one particular outlet or whether it is happening sufficiently "chain-wide" to necessitate a wholesale change in the way the raw donuts are baked and supplied to the franchisees.

Unfortunately, the local Tim Horton's franchisee will suffer until head office determines the magnitude of the problem and how it should be addressed.

Conflicts arise between franchisors and their franchisees when either side attempts to dictate, sometimes too aggressively, the terms and conditions of their franchise agreements. A relationship of mutual trust is essential to assure that while it is inevitable that the franchisor will be looking out for its own interests, it must, at least, recognize the immediate impact that will be felt by the franchisee. If he does not consider the long-term implications, he will end up suffering as well.

The accompanying table lists the kinds of issues that must be negotiated between franchisors and franchisees from the outset. Once these have been hammered out, day-to-day operations between the parties can commence and hopefully a long, successful business relationship will ensue.



the issues have long since been resolved, but from time to time corporations with certain pre-1972 surpluses decide its time to distribute these balances to their shareholders. And then income tax practitioners, many a lot younger than the new Act itself, have to scramble and research their books to determine the amount that is still available for distribution and how it will be taxed in the hands of the recipients.

So Happy Anniversary Income Tax Act from all your devotees who have spend countless hours studying your every nuance and word trying to figure out what the parliamentarians were trying to say in the first place…and then working "like crazy" trying to figure out a legal way around it.

Thanks for Your Referrals

We very much appreciate your referrals. If you know of someone who can benefit from the services we provide or who would like to receive our publication, please let us know. We will send them a copy with your compliments.

Prospective Franchisees Beware!!

Franchising is a business and you will often see the following "selling points" promoted by franchisors to encourage prospective buyers…just beware of the hype…if it "sounds too good to be true" …it probably is!!

Franchisor will claim	What it Really Means
(a) turnkey operation	already built into the franchise price
(b) financing available/assistance	franchise fee is too high for most potential buyers
(c) ongoing, comprehenisive training	expect to be billed separately
(d) guaranteed success!!!	for franchisor or franchisee?
(e) prime locations available	franchisor is probably fairly new
(f) recession resistant!!	really??
(g) join a winning team/be your own boss	sounds good…but only time will tell

Artie Chokes 2 for $1.00 at Wal-Mart!!

In honour of our twentieth year of publication, we offer the following:

Tired of constantly being broke and stuck in an unhappy marriage, a young husband decided to solve both problems by taking out a large insurance policy on his wife with himself as beneficiary. He then arranged to have her killed.

A "friend of a friend" put him in touch with mobster Artie who explained to the husband that the "going rate" for snuffing out a spouse was $5000.

The husband said that would be okay with him, except that he could only pay that amount after he collected on the insurance policy. Until then, he could offer the mobster only $1.00 as a token down payment for the services he would render.

A few days later, Artie followed the man's wife to the local Wal-Mart where he surprised her in the produce department and strangled her.

The manager of the produce department heard the commotion and went to find out what was happening. He saw Artie and the victim, but was no match for the professional killer and he was murdered as well.

Unknown to Artie, the entire turn of events was caught on the store's hidden security camera and observed by the store's security guard. He immediately called the police and Artie was caught and arrested before he could leave the store.

Under intense questioning at the police station, Artie confessed to the entire plan, including his unusual financial arrangements with the young husband who was quickly arrested.

That lead to the newspaper headline that appeared the following day. It has been reproduced above!!

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