Business Advisory Letter

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It's really no secret that North America is aging…demographically speaking. The Baby Boomers are nearing retirement age. Ask any market research company, or self proclaimed marketing prophet/author. There will definitely be a mass exodus from the workforce over the next 15 years.

As it is with the general population, so it is with business owners. Despite the many young entrepreneurs spawned by the dot com explosion, the vast number of business owners are still Baby Boomers. These captains of small and medium sized enterprises are, whether they like it or not, nearing the point in their lives where they must consider their own mortality. Although many of them would (and will) stay at the helm until the end of the voyage, others hear the siren call of leisure and travel.

Jumping from your own ship, however, is somewhat different than accepting the token time piece and precious parachute of a lifetime of employment. Who will look after my baby? How can this business possibly survive without me? Who will take care of my loyal people? How do I get my money out without strapping the company? Will I have enough?

Our article on *Succession Planning for the Business Owner* will give you an idea on how we approach these issues. We recognize that retirement is a bitter sweet reality for many of our clients. To that end we have developed, with the help of the other members of Integrated Business Professionals, a solution for Business Succession that addresses all of the needs of the retiring business owner. Retirement can be well managed.

Whose Money Is It explores some of the tax troubles unwary business owners will create when they forget who actually owns the corporate assets. CCRA auditors have no sympathy for those who try to take advantage of their company, intentionally or not.

We are very pleased to introduce Brad Bembridge and our newest division, Oxford Technology Group. Brad is a Systems Engineer who specializes in computer network design and maintenance. His article *A Secure State of Mind* provides guidance on the protection of that most valuable of business assets…data. Now that Brad has completely redesigned our own network system he is available to our clients to service their network design and maintenance needs.

Finally, it is very unseemly and ungracious for well-to-do people to complain about taxes. After all, they should be thankful that this great country has given them the opportunity to be successful. *Look Who's Not Coming to Dinner* is a return salvo from those who have taken the brunt of society's sour grapes, and have paid handsomely for the privilege.

We hope you enjoy this issue of BusinessAdvisory Letter.

Brent

IN THIS ISSUE

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VMSW IS A MEMBER OF INTEGRATED BUSINESS PROFESSIONALS
an alignment of core business advisors

In the Firm

In the Firm

The first four months of every calendar year are the busiest at VMSW. The largest portion of our corporate year end engagements are December 31. Add to that the T4's and personal tax returns, and you have what we call the "season".

The end of the "season" is a welcome event for our team. As tradition dictates we again gathered in celebration on April 30, rejoicing in our new found freedom. Spring has arrived.

VMSW staff continue to develop their skills.

Lee-Ann Butler, Denise Ball and Karen Raymond recently attended a Simply Accounting Workshop to learn the enhancements offered by version 9.0 and 9.0 Pro.

Greg Bruce has enrolled in the In-Depth Tax Course offered by the Canadian Institute of Chartered Accountants. This two year course is the premier training ground for income tax specialists in Canada.

Shaun Swanton returns to the University of Waterloo to resume his Masters of Accounting Studies.

Kim Hough has been appointed to the Computer Support Group as our resource in Quickbooks Accounting software.

Dino Micacchi and Jean Shippey have been appointed as Senior Business Advisors for Business Development Group. Dino will concentrate on Strategic Planning while Jean heads up the Business Development Academy.

In keeping with our community service objectives, Mark Warnick has been elected to the Board of Directors of the Ingersoll Golf & Country Club.

Brent VanParys is a member of the organizing committee for the 50th anniversary of the Norwich District High School. Former students of NDHS are asked to spread the news and are invited to contact Brent for more information on "Fifty Years of Knights Tales".

We have several new people to welcome to the firm.

Jenny Hahn joins the Woodstock office as a Client Accountant. Jenny has a background in public accounting and private business accounting and administration.

Ed Lamers signed on to the Woodstock office as a temporary team member. Ed will return to Wilfrid Laurier University to complete his studies and return to VMSW in the fall to commence his articling requirements in his quest for the Chartered Accountant designation.

We offer a hearty congratulations to Deb Finch on the birth of her daughter, Macey. Deb will return after a suitable period of mother-daughter bonding.

Security

A Secure State of Mind

If yours is like most businesses, your reliance on computer systems has increased to the point where you may not be able to operate without them. Computer systems and the data they produce and store are integral to today's business processes. Your computer system also connects your business to the rest of the world through the internet and by e-mail. The internet and e-mail also connect the rest of the world to you….and your company's precious data.

As computer technology grows in complexity, so do the data security risks to your organization. These risks take many forms, most notably Computer Viruses, Internet Penetration and Internal Network Security Breeches. Your computer network should contain safeguards to protect your company from each of these potentially debilitating risks.

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Computer Viruses
Computer viruses range from minor itches in your system to crippling data destroyers which will render your computers useless. Virus protection software will help to prevent the infection and further propagation of viruses.

There are two basic methods to deploy virus protection software.

A single license install requires the software to be loaded on each system separately. This method is useful and effective in a smaller network where the majority of systems are in the same proximity. A single license install requires setup for each machine and constant monitoring for virus updates.

The second method is in the form of corporate virus software. More convenient than the single license, this software is located on your network server and can be set up to automatically install virus software and updates on any workstation that logs on to your network. Corporate software can be set to perform a daily virus update check and if required, download the newest software updates. This type of system monitors the entire corporate network and reports current virus protection levels and any viruses encountered for every machine. The corporate virus software can be easily configured to send email, pager, or network alerts when viruses are encountered. Also available is a virus scan for mail servers, which, when setup correctly, not only reduces viruses but also joke or garbage email from entering your network.

Internet Penetration
Internet penetration is a growing security issue that plagues many companies. Without the Internet, your company is competitively disadvantaged. With the Internet, your company assumes a significant degree of data security risk.

One of the best ways to protect your company network is to install a Firewall. A Firewall is a device that allows your internal network to use the resources of the Internet, but restricts access by unauthorized users.

Several different Firewall products are on the market today. Your challenge is to decide what options you require (or will require in the future) and the security level you feel is adequate for your network.

Your decision should consider:
- does the Firewall support NAT (Network Address Translation)
- or PAT (Port Address Translation),
- or PPTP (Point to Point Tunnelling Protocol),
- or VPN (Virtual Private Networks)
- the encryption levels available
- the configurable options available
- the support from vendor, and
- if your company has multiple locations, are multiple devices able to be setup in Branch Tunnel configuration (this is more cost effective than the traditional Frame relay of ISDN solutions).

The cost of a Firewall can vary substantially depending on the number of options your company requires. However, if your network is exposed to the Internet, this is no place to scrimp. The Firewall is your first layer of protection against "hacker" access to even your most confidential corporate data.

A "Home or Small Business" Firewall is not adequate for a corporate network. These are usually mass-produced and come pre-configured, with little additional configuration options. During your Firewall purchase investigation you are well-advised to consult with someone knowledgeable in the field.

Internal Network Security Breech
Internal network security is sometimes overlooked in the design of a computer network. It is believed that "90% of all security breeches are performed within the organization or derived from information given from an internal source."

As a minimum, your internal network security policies should include the following:
- Require strong passwords at least six characters in length, both upper and lowercase and special ($%^$) characters,
- Require password changes every 60 days,
- Ensure proper permissions are set on your workstations and network drives
- Keep your network server(s) in secure locations, with limited access.
- Discourage employees from revealing their passwords to anyone

The data produced and stored by your computer systems is critical to the success of your company. It is not sufficient merely to pay lip service to computer security. If you approach these security issues as you would any other important process in your business you will minimize your computer risks, freeing your time to concentrate on the things that create growth and profit.

Brad Bembridge is a Systems Engineer with Oxford Technology Group, the Computer Network Design and Maintenance division of VanParys Micacchi Shippey & Warnick LLP

Whose Money Is It?

Sometimes owner/managers may inadvertently treat the company as just another pocket to reach into for funds However, when it's time to meet with their chartered accountant to prepare their corporate and personal tax returns, the problems arising from not segregating their corporate and personal financial transactions soon blossom into time-consuming tasks and sometimes unwelcome tax surprises.

A look at some of the common transactions that can create difficulties for owner/managers and their tax advisors may help you better plan for the current tax year. Keep in mind that these are also the areas that pique the CCRA's interest when searching for elusive tax dollars.

- The owner/manager takes funds from the company without declaring the funds as income. While the funds may be considered an advance on account of salaries and dividends, sometimes they will be viewed as a loan. The chartered accountant must determine the proper classification for each amount that the owner/manager withdraws from the company. Unless the funds are borrowed for one of the purposes that is allowed under the Income Tax Act, the full amount of the loan is included in income and as such is taxable to the owner/manager. There is an exception to the income inclusion if the loan is repaid within one year from the end of the corporation's fiscal year. Note that the company must have adequate documentation to substantiate that the loan meets the allowed purpose under the Act. If the owner/manager receives a loan or advance from the company for some period in the year, interest has not been charged and the loan has not been included in income, the CCRA will consider the interest to be a taxable benefit and calculate it at the CCRA's prescribed interest rate.

- The owner/manager charges business meals and entertainment to the company. However, for these expenses to be deductible, they must be supported with proper receipts. It is advisable to indicate on each receipt, the names of the clients and the business purpose of the expense. For items such as season tickets to sporting events, extra care should be exercised to ensure that the client's name and business purpose are documented.

- The owner/manager will often have access to a company vehicle. Whether the company owns or leases the vehicle, it is important to keep proper records so that your chartered accountant can maximize the allowable deductions for the business use of the vehicle. It is advisable to keep records in an automobile log of the kilometers driven for business and personal purposes. The personal use of the vehicle is a taxable benefit that must be reported. The GST must also be remitted on the amount of the benefit. Where the company owns the vehicle, there are also restrictions on the maximum capital cost allowance that the company may claim. Where the automobile is leased, there are restrictions on the amount of the lease payments that the company can deduct. Similarly, there are restrictions on the amount of the GST input tax credits that the company may claim on the vehicle, whether owned or leased by the company.

- Where the owner/manager uses other company assets for personal purposes, a taxable benefit must also be reported. An example would be the personal use of a company-owned residence.

- The owner/manager is often a director of the company and as such needs to be aware of the personal liability for withholdings. If the company fails to remit GST and provincial sales taxes or employee source deductions such as income tax, Employment Insurance or Canada Pension Plan on a timely basis, the company will incur interest charges and penalties. However, if the company is in financial difficulty and unable to make these payments, the director can be held personally liable for the amounts outstanding.

- The company makes loans to third parties or purchases investments. Make sure you have the appropriate documentation for the loans and investments, such as the loan agreement, share certificates, and cancelled cheques to ensure that in the event of a failed investment, some recovery may be available. If these investments decline in value and the investments were not made for an income-producing purpose, any loss will be denied.

- The owner/manager sometimes draws money to pay a spouse for services performed for the company. As these funds may be attributed to the owner/manager and thereby increase your personal taxable income, you should ensure that the salary is paid directly to your spouse. Consider also that since your spouse may be in a lower tax bracket, the tax liability will be less.

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Whose Money Is It?...continued

Often the company will pay the owner/manager's credit card bills. If you do not have the appropriate documentation to show which expenses are corporate and which are personal, this will not only create difficulties when your financial statements and tax returns are prepared but also cause additional problems if there is a tax audit.

The owner/manager sometimes declares a bonus without regard for when it must be paid. In order for the bonus to be deductible to the company, it must be paid within 179 days after the company's year-end. If it is paid after that time, the company may not claim the deduction in the year the amounts were accrued, a situation that will result in a greater corporate income tax liability in that year. While the company can claim the deduction at the time the bonus is subsequently paid, this deduction is only allowed in the later year.

Get Professional Advice

Finding the appropriate tax planning strategies that will help minimize corporate and personal taxes can be challenging in today's complex taxation environment. Meet with your chartered accountant throughout the year to discuss your personal and company financial strategies to ensure that the personal and corporate transactions you carry out do not result in unanticipated tax consequences. Your chartered accountant can help you review your financial structuring and advise on the timing and other requirements that can ensure a favourable tax treatment.

Look Who's Not Coming to Dinner!

Here is a very appropriate analogy on the fairness of income taxes forwarded to us by our client Gary Paret of G.R. Paret Realty Limited.

The following was printed in a small town paper in Western Canada recently:

I was having lunch at PJ's with one of my favourite clients last week and the conversation turned to the Campbell government's recent round of tax cuts.

"I'm opposed to those tax cuts," the retired college instructor declared, "because they benefit the rich. The rich get much more money back than ordinary taxpayers like you and I and that's not fair."

"But the rich pay more in the first place," I argued, "so it stands to reason that they'd get more money back."

I could tell that my friend was unimpressed by this meager argument. Even college instructors are a prisoner of the myth that the "rich" somehow get a free ride in Canada. Nothing could be further from the truth.

Let's put tax cuts in terms everyone can understand.

Suppose that everyday 10 men go to PJ's for dinner, the bill for all ten comes to $100. If it was paid the way we pay our taxes, the first four men would pay nothing; the fifth would pay $1; the sixth would pay $3; the seventh $7; the eighth $12; the ninth $18. The tenth man (the richest) would pay $59.

The 10 men ate dinner in the restaurant every day and seemed quite happy with the arrangement until the owner threw them a curve. Since you are all such good customers, he said, I'm going to reduce the cost of your daily meal by $20. Now dinner for the 10 only costs $80. The first four are unaffected. They still eat for free.

Can you figure out how to divvy up the $20 savings among the remaining six so that everyone gets his fair share?

The men realize that $20 divided by 6 is $3.33, but if they subtract that from everybody's share, then the fifth man and the sixth man would end up being paid to eat their meal.

The restaurant owner suggested that it would be fair to reduce each man's bill by roughly the same amount and he proceeded to work out the amounts each should pay. The fifth man paid nothing, the sixth pitched in $2, the seventh paid $5, the eighth paid $9, the ninth paid $12, leaving the tenth man with a bill of $52 instead of $59.

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Look Who's Not Coming to Dinner! ...continued

Outside the restaurant, the men began to compare their savings.

"I only got a dollar out of the $20," declared the sixth man pointing to the tenth, "and he got $7!"

"Yeah, that's right," exclaimed the fifth man. "I only saved a dollar, too. It's unfair that he got seven times more than me!"

"That's true," shouted the seventh man. "Why should he get $7 back when I got only $2? The wealthy get all the breaks."

"Wait a minute," yelled the first four men in unison. "We didn't get anything at all. The system exploits the poor."

The nine men surrounded the tenth and beat him up. The next night he didn't show up for dinner, so the nine sat down and ate without him. But when it came time to pay the bill, they discovered something important.

They were $52 short!

And that, boys and girls and college instructors, is how Canada's tax system works. The people who pay the highest taxes get the most benefit from a tax reduction. Tax them too much, attack them for being wealthy, and they just may not show up at the table anymore. There are lots of good restaurants in Switzerland and the Caribbean.

Succession Planning for the Business Owner

Ask business owners to list their major business challenges. In virtually every case Succession and Retirement will rank near the top. Think about it. How does a business owner actually retire?

Business owners are typically entrepreneurs. They maintain tight control over the operations of their companies. Even with a competent management team, a business owner will still call most of the shots. To simply leave is not an option. Without proper planning and preparation the loss of a key decision maker can cause major difficulties for many businesses.

Financially, business owners are often dependent on their business to fund retirement. They have a vested interest in the continued viability of the business. To secure their retirement, or to maximize the sale price, they must ensure the business is healthy and stable; capable of operating at peak performance even without their leader.

Forward-thinking business owners prepare for their retirement, or a sale, years in advance. Succession and retirement is a process that can be managed. Whether the business is to be sold, or transferred to another generation, a solid succession plan will help the owner to maximize their return as well as realize their non-financial goals.

What is Business Succession?
Business Succession is the process whereby a business owner systematically turns over operating control of the company to one or more successors, and arranges their personal affairs for retirement or other ventures. Done properly, a succession plan will groom an effective management team, create a stream of cash flow to the retiring owner, secure their legal and financial positions, structure their investments, and arrange the estate to provide maximum benefit for the family.

Human Resources
The operative part of succession is success. It takes the right people in the right positions to make a successful company. The human resources section of a succession plan should address the following:

- An analysis of current owner and key personnel, including behavioral profiles and skills inventories
- Design of a behavioral benchmark and detailed job description for an optimal successor
- Analysis of skills and behavioral attributes of potential successors
- Training and development plans for successors
- Recruitment for successors or supporting positions if not present in the organization

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Financial Considerations

A succession plan should coordinate the goals of the retiring owner with the financial requirements of the company. The quality of the owner's retirement is directly proportional to the stability of the company and its ability to meet its cash flow obligations.

The financial section of the plan should contain the following:

- A statement of the owner's financial requirements such as lump sum payments and continuing cash flow
- An analysis of the capacity of the company to meet those obligations
- A recommended capital structure (equity and/or debt) to ensure the company is strong and able to satisfy the retiring owner while still able to take advantage of future business opportunities
- A valuation of the company

Taxation Considerations

Succession planning naturally involves complex strategies to ensure there is a minimum amount of tax paid at every level.

The taxation section of the plan may involve:

- Share reorganizations
- Maximum use of capital gains exemption
- Residency considerations
- Holding companies
- Retiring allowances
- Tax effective cash flow

Legal Considerations

A complete succession plan will ensure all transactions are properly documented. Solid legal agreements and proper documentation will protect the interests of not only the retiring owner, but the successors who must forge ahead towards their own goals.

Legal considerations include:

- Security registrations
- Authorizations for share transactions and reorganization
- Shareholders' agreement
- Liability releases
- Release of director's obligations
- Employment contracts

Wealth Management

Once a business owner, the retiring owner now becomes an investor. They are dependent upon these financial resources for their lifestyle. A well designed succession plan must provide for the management of those resources to ensure a long and comfortable retirement.

Effective wealth management considers:

- Preservations of capital through asset allocation strategies
- Security through diversification
- Personal cash flow requirements
- Tax minimization through income splitting and investment strategies

Estate Arrangements

No succession plan is complete without provision for the welfare of a surviving spouse and family members. Such strategies concentrate on maximum estate preservation on death, hassle free access to tax effective cash flow for a surviving spouse, and efficient transfer of wealth to future generations.

Estate arrangements involve:

- Design of wills
- Use of spousal and family trusts
- Life insurance requirements
- Enduring and personal care powers of attorney

The retirement or succession of the owner is a stage in the life of a business that is inevitable. Successful businesses will plan for that day. Managed properly, the retirement of a business owner will be a new beginning. The business itself will achieve new goals under the guidance of its well-prepared successors, while the business owner embarks upon his next venture, secured by planning and forethought.

Article Contributed by Brent VanParys, CA

Strategy and Direction

PST for Farmers

PST for Farmers and Real Property Contractors

Since October 1, 2000, farmers have been able to purchase building materials, such as wood, nails, paint, etc., used to build or modernize structures used exclusively for farm purposes (e.g., barns, silos) exempt from RST. To claim the exemption, farmers must provide their suppliers with a properly completed Purchase Exemption Certificate (PEC). Contractors or other persons purchasing building materials for farm structures may also claim the exemption by providing their suppliers with a properly completed PEC. This will entail filling out a PEC form but will need to include the farmer's name and address where the structure is being built. They will need to fill one of these out each time they do a project.

Contractors do not get a Purchase Exemption Certificate from farmers, as an exemption certificate cannot be issued for real property. If a contractor does not purchase materials exempt, the farmer can apply for a rebate for materials supplied and installed by the contractor. The amount of the rebate can be the actual amount of RST (i.e., 8%) paid by the contractor on building materials supplied and installed under the terms of a written contract. Contractors are allowed to provide farmers with either copies of their actual invoices, or a signed statement outlining the amount of RST the contractor paid on the materials.

The contractor can apply for the rebate if PST was paid on goods purchased after October 1, 2000 and used for farm purposes. Copies of the invoices and proof of payment will need to be forwarded with the completed rebate form. The contractor will not include PST in the contract price to the farmer.

Article Contributed by Greg Bruce, HBBA

"We cannot adjust the wind, but we can adjust the set of the sails."
Jim Rohn

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