

Business Advisory Letter

The Trusted Advisor

As business owners, we are constantly evaluating our relationships with those companies that supply us with goods and services. For every different product or service we purchase there is one attribute or characteristic of our supplier that we consider to be the most important. When we conclude whether a particular supplier is good, bad or otherwise, we typically rely on one specific measure of their performance. For example, in the case of a fuel supplier the criteria may simply be price. For a supplier of steel it may be consistency of quality. For seed, yield rules. While the other measures of performance will influence our level of satisfaction with a supplier, a good or substandard result in this one critical factor will make or break the relationship.

At a recent conference hosted by the Canadian Institute of Chartered Accountants we were asked to choose the attribute of a chartered accountant that was most important to our clients. We were given a list of possibilities, each of which could have been the correct answer. There is one trait, however, that clients value most when evaluating their relationship with their accountant.

Let's see if you agree. The choices are:

- (a) My accountant delivers on time
- (b) My accountant is a person/firm of high integrity
- (c) My accountant responds quickly
- (d) My accountant provides excellent value for money
- (e) My accountant understands my business/industry

As you can see, each of these is a desirable characteristic in an accountant. But there is one trait, according to a survey of business owners, which sets an excellent accountant apart from the rest:

My accountant responds quickly!

For the most part, the other traits on the list are a given. To even be in the running for excellence an accountant must have (a), (b), (d) and (e). But to be truly excellent, to be indispensable, to be bragged about and to be worthy of referral to other business owners, an accountant MUST be responsive.

And rightly so. Many business issues require quick action. By the time a business owner calls his accountant he has already spent considerable time plotting his strategy. He looks to his

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The Trusted Advisor...Continued

accountant for more information, for alternative solutions, for consequences or barriers, for counseling or simply for a reasoned, informed opinion. To be a valuable resource the accountant must either be immediately available, or respond at his or her earliest opportunity. If more information is required, the accountant must produce that information quickly to enable the client to solve his problem without delay.

In the Partner Performance section of our Client Feedback questionnaire we ask you to rate your engagement partner's responsiveness. To date we have received an average rating of 4.7 out of a possible 5, or 94%. While we consider this to be a very positive result, we are not necessarily satisfied. If this truly is the critical factor in our relationships with our clients, then we will do all we can to push this rating towards 100%.

A quick response demonstrates that we care; that we recognize you rely upon us for our advice and that you need our assistance now. A quick response says we know your time is valuable. It shows that we want to play an important role in your business, and we are truly interested in your success. A quick response means we value your business and we are striving to earn the most coveted status in the realm of client-professional relationships, that of the Trusted Advisor.♦

In the Firm

VMSW team members continue to develop their skills!

Greg Bruce has completed the first leg of the CICA In-Depth Tax Course and is on his way to becoming a tax specialist.

Pam King will be writing the Uniform Final Examinations in early October, the final step in her pursuit of the Chartered Accountant's designation.

Shaun Swanton returns to University of Waterloo to complete his 4th year in the Honours Arts Chartered Accountancy Studies Co-op program. Shaun will rejoin the firm in January for an 8 month co-op term.

Jessica Losier has completed the XP Front Page 2002 Level 1 & Level 2 course and the Corel Draw 10 Level 1 course. These software programs are used for our internally generated graphics and the development of our website.

Lee-Ann Butler has been elected as Secretary of Woodstock Minor Hockey Association. This is her first year on the board.

Welcome to the Firm!

Mary McMurchy joins the Norwich office as the new Client Service Coordinator. Mary is the current secretary of the Norwich United Church. She holds a Bachelor of Arts degree from the University of Waterloo and is a member of the board of directors of the Dr. Russell M Hall Medical Centre in Norwich.♦

Taxation

Foreign Reporting Requirements

Do you have bank accounts or other investments outside of Canada? Make sure you are familiar with the foreign reporting requirements. The penalties for failing to report can be harsh.

Canadian taxpayers are liable for income taxes on their world-wide income, including income from investments held outside Canada such as bank accounts, real property and shares of foreign corporations. For many years, the federal government has been concerned that large amounts of offshore income was not being reported. To discourage taxpayers from concealing assets offshore in foreign trusts, corporations or other investments, there are now additional reporting requirements for various foreign investments.

The filing requirement is applicable for taxation years that begin after 1997 for Canadian resident individuals, corporations (including investment holding companies), trusts, and partnerships that hold certain property outside of Canada with a total cost amount of more than \$100,000.

The \$100,000 Threshold

If at any time during the year, the total cost amount of specified foreign property that you own (or in which you hold a beneficial interest) exceeds \$100,000 (in Canadian dollars), you must complete an information return in addition to the applicable tax return. Titled "Foreign Income Verification Statement", Form T1135 is intended to ensure that we all pay our fair share of income taxes. Note reporting is required even if you only held investments with a cost in excess of \$100,000 for a very short period of time in the year, such as a few days.

Using the form's check-the-box format, you must indicate the total cost range and location of different categories of your foreign property investments as well as the total income that you reported on your tax return in the year from these assets. Even if you did not receive income from these investments during the year, the information return must still be filed.

It is important to add up the cost amount of each foreign property that you own to determine if at any time during the year, the total exceeds \$100,000. For example, if you have \$35,000 on deposit in the United States as well as own shares in a non-resident corporation with a cost amount of \$75,000, you must file the statement since the total cost amount of all foreign properties owned is \$110,000.

Specified Foreign Property

Specified foreign property includes property such as:

- Funds in foreign bank accounts.
- Land and buildings located outside Canada, such as foreign rental property.
- Shares of non-resident corporations (even if held by a Canadian stockbroker).
- Debts owed to the Canadian taxpayer by non-residents.
- An interest in a partnership where non-residents control more than 90 per cent of the profit or loss and the partnership holds specified foreign property.
- An interest in a non-resident trust.
- Patents, copyrights or trademarks held outside Canada.

You do not have to report information about property held for personal use such as vacation property used primarily as your personal residence, and listed personal property such as works of art, jewellery, rare folios, rare manuscripts and rare books, stamps and coins. Also excluded in the definition of specified foreign property are interests in Canadian-based investments such as Canadian mutual funds or Canadian pension arrangements (e.g., RPPs or RRSPs) that hold foreign investments, interests in a U.S. Individual Retirement Account (IRA), and foreign property that is used or held exclusively in an active business.

There are exceptions for shares or indebtedness in foreign corporations that are "foreign affiliates" since other more complex reporting is required in respect of these investments. Generally, a foreign affiliate is a corporation in which your equity percentage is at least 1% and the equity percentage that you and all related persons own is not less than 10%.

Gifts and Inheritances

If you acquired a foreign investment by gift or inheritance, your cost is generally the fair market value at the time you received it. In addition to your own safe keeping of the relevant documents for this property, you should also give copies to your chartered accountant.

Indebtedness Owed by Non-residents

You must report all amounts owed to you by a non-resident person, such as promissory notes, bonds, commercial paper, loans and mortgages. However, you do not have to include indebtedness owed to you by a foreign affiliate as it is subject to the foreign affiliate reporting discussed above.

Converting Foreign Dollars

To convert the cost amount of the property or income received on a foreign property, you should use the exchange rate that was in effect at the time of the transaction. If you receive income throughout the year from the property, you can use an average rate for the year.

Be Sure to File on Time

Form T1135 must be filed annually on or before the due date of your income tax return or the partnership information return in the case of a partnership, even if you do not have income to report from any of your foreign investments. Failure to complete and file this information return can result in substantial penalties. If the CCRA views a failure to file as intentional, the penalties can be more substantial.

Talk to your Chartered Accountant

As Canada's tax system is a self-assessment system, our government relies on individuals, corporations, and trusts to properly report all of their world-wide income and properly claim only those expenses and tax credits as allowed in the Income Tax Act. If you own or have beneficial interests in foreign property, be sure to discuss these holdings with your chartered accountant to ensure you do not encounter future tax difficulties. ♦

Management **The Family Business**

As the owner/manager's family and business grow, the spouse and children often become employees of the business.

When family members are involved in the day-to-day operations of the business, conflicts can arise between the founding members of the company who worked hard to establish and nurture the business and the younger members of the family who may have new ideas, new energies and different management strategies. Apart from the generation gap, constantly being in the family circle and not segregating business life from home life can also create tension and conflict. The stresses within a family business can cost dearly if family/business members do not address issues on a timely basis.

In an arm's length business, the owners and employees work towards achieving goals with the knowledge that their personal efforts will be rewarded. In a family business, those same desires are often augmented with family dynamics that, at times, create difficulties that could affect the company's ability to sustain working capital, maintain quality employees, and move the business forward.

Typically, many family-run businesses have trouble addressing operational problems because:

- A formal plan for leadership succession does not exist.
- The original founders of the business have all their assets tied up in the business.
- Family members have not contributed equally in effort and/or finances and there is no written agreement as to how each is to be compensated.
- Some family members want to take over operations immediately, while others are unsure as to what role, if any, they wish to assume in the business.
- Quarrels amongst family members over matters such as responsibilities or compensation distract the founders so that they find themselves concentrating on family matters rather than tending to business.

The end result of family discord is too often lost business opportunities. In many instances, uncertainty may lead to a downturn in business that in turn creates longer-term difficulties both emotionally and financially for the current and future owners.

Here are some tips that can help you deal with family business concerns and issues.

Get to the root of the problem

A family member may fail to follow instructions, meet targets, or be unable to manage the responsibilities of a job. Arm's-length employees are more likely to explain why they were unable to do so, whereas family employees may be hesitant to say anything because their bosses are also part of the family. Try to remove the business of the family from the family business and encourage open discussions and suggestions for resolution. Address problems as soon as possible so as to avoid their becoming even bigger problems.

Get everyone involved in the decision-making process

Too often the decisions made in a family run business are made by those traditionally seen as the power brokers. This could be Mom and Dad or one of their adult children who has worked in the business for a long time. If everyone acquiesces to the perceived power, not only do the silent members of the family lose opportunities, but others may be taking on responsibilities by default. Older entrepreneurs may actually wish to turn over the responsibility of running the business but may not be provided an opportunity if all family members are not involved.

Try to ensure that management meetings include every member of the family who is involved in the business to avoid a top-down management style. These meetings are an opportunity for every family member to receive feedback and to learn from the experience of the current management.

Formalize the process

In that families do not have instructions for their day-to-day lives, family members in the business may adopt an informal approach in their business dealings. Have clear criteria for selecting and promoting family members. To ensure that all family members understand their responsibilities, obligations and rewards, document what is expected or promised. This practice avoids any misunderstandings as well as provides a basis on which decisions such as compensation can be made. Family members should have the same accountability as any other employee in the business.

Know when you need outside expertise

Trying to resolve business problems that involve family can be difficult because sometimes if you solve the business problem, you can create a family problem....and conversely, if you solve a family problem, you may create a business problem. Know when you need outside expertise to assist in determining family needs, arriving at solutions and setting goals and time frames for their achievement. An outside party can guide the entire family in making a decision that, if not acceptable to all, is at least a workable compromise.

Sometimes business growth will necessitate looking outside the company for professional management or technical expertise. In some instances, a family business may need to consider hiring a bridge manager to help the company through a time of dramatic change in the business such as when an heir must assume a senior position before he or she has gained sufficient experience or when family members are fighting for control of the business.

Keep everyone in the family informed

Running a business and participating in family life is a balancing act. To ensure that all members of the family, those participating in the business and those who do not participate, understand the successes and challenges facing the business, plan to have meetings two or more times throughout the year to summarize what has occurred in the business, what the plans are for the next few months, and the impact on the immediate family. This information will help everyone know the importance of their participation and avoid unpleasant surprises for rescheduling either family or client commitments.

Family businesses often have long operating histories and strong growth opportunities. Addressing problems, opening the lines of communication, and knowing when you need professional advice or assistance will lessen the difficulties associated with family disagreements, succession, and tax and estate planning. ♦

Taxation

Reviewing Instalment Payments

Corporations are required to make tax instalment payments at the end of each month commencing with the first month in the corporate taxation year.

The Income Tax Act provides that a corporation has three options for making instalment payments:

- 12 instalments of 1/12 of the corporation's "first instalment base" for the year
- 2 instalments of 1/12 each (based upon the corporation's "second instalment base" for the year) plus 10 instalments of 1/10 of the amount that remains after deducting the first 2 instalment payments from the first instalment base, or
- 12 instalments of 1/12 of the current year's estimated taxes.

Since a corporation can choose which of the instalment methods to use, it should choose the one that defers payments for as long as possible.

Instalment Base

Just what is the "instalment base"? The first instalment base is considered to be the tax payable for the immediate preceding taxation year and the second instalment base is the tax payable for the second preceding year.

What happens if one of the prior taxation years that are used to calculate current year instalment payments is less than 365 days? In this instance, the short year amount should be annualized to a yearly figure. If the prior period is less than 183 days, then the instalment base for that year is the greater of the annualized amount and the adjusted base for the next preceding taxation year of more than 182 days. Thus, if the calculation were based upon an 8-month period that had taxes payable of \$40,000, the instalment base would be calculated on a base of approximately \$60,000.

Instalment payments may not be required if the corporation's estimated taxes for the current year or the first instalment base are less than \$1,000.

If there has been an amalgamation of two or more corporations, then the instalment bases of all predecessor corporations are combined to determine the amount of instalments required. Similar rules apply where there has been a wind-up of a subsidiary that is at least 90% owned or there has been a non-arm's transfer of all or substantially all (generally 90% or more) of the assets of a corporation.

Regardless of which base is used to calculate the current year instalment, the current year's dividend refund will reduce the base. A dividend refund is received by a corporation that has refundable dividend taxes on hand at the rate of 1/3 of taxable dividends paid.

Estimated Taxes Payable

If your company's income taxes have been increasing annually, the most sensible method of paying your income tax instalments is to base your current year's payments on the previous two years' income tax liabilities. However, if the income tax liability of your business appears to be decreasing in the current year, why place this working capital in the hands of the CCRA?

Rather than compute your instalments on the prior years' instalment bases, it may be advantageous to calculate them on the basis of estimated income taxes payable.

There may be situations that create a lower income tax liability in the current year than in previous years that you become aware of as the fiscal year progresses such as:

- Your company may increase capital expenditures, thereby increasing capital cost allowance deductions and possibly investment tax credits
- A decrease in market share may signal a significant loss or reduction in profits, or
- A significant increase in financing may create interest expense that lowers your profit position.

Balance of Tax

A corporation is generally required to pay the balance of its corporate taxes due within two months of its corporate year-end. However, companies that are Canadian-controlled private corporations throughout the year and that claimed the small business deduction in the year or the immediately preceding year may pay by the end of the third month. This extension is available as long as the aggregate of the taxable incomes of all associated companies in the group for the immediately preceding year did not exceed the aggregate of their business limits for the purposes of the small business deduction (generally \$200,000).

The instalment bases and estimated taxes payable include the Part I taxes on income and the large corporations tax. Part IV tax on dividends received from Canadian corporations is due three months after the end of the year. No instalments are required on account of the Part IV tax liability.

Review your Tax Instalment Requirements

Be sure to monitor your income taxes payable situation carefully as the CCRA charges interest, compounded on a daily basis, on unpaid instalments. If your budget information is incorrect and your taxable income is actually equal to or greater than the previous year's amount, your company will be required to pay interest on the difference between the instalments based on historical income taxes payable and the instalments actually made. Unfortunately, the interest expense is not an allowable deduction for the purposes of calculating taxable income.

Note that an instalment that is paid before it is required will earn interest credits. If you have been late with one or more payments, try to pay future instalments early. While the CCRA will not refund interest credits, the interest credits earned on the early payments will help reduce the interest charges that have accrued from the late payments.

In addition to instalment interest, there is a penalty of 50% of the instalment interest to the extent that it exceeds the greater of \$1,000 and 25% of the interest that would be payable if no instalments had been paid.

Although in many provinces the instalment requirements parallel the Federal requirements, you should also monitor these taxes payable to avoid interest payments that may accrue on unpaid provincial taxes.

Talk to your Chartered Accountant

Your chartered accountant can help you review your corporation's tax instalments. Careful planning will not only help your company's cash flow but also reduce the erosion of the bottom line that could occur if you are assessed for non-deductible interest on overdue amounts. ♦

Succession Planning **The Human Side of Succession Planning - Part Two**

Prepared for Managing Your Resources for 2003 by David Rose, Business Management Specialist, Ontario Ministry Agriculture, Food & Rural Affairs

Train successors

How can a child take over a farm business if they don't get any training? You would not want your son or daughter to say: "Dad taught me how to work but he never taught me how to run a business".

As a parent, you are the mentor, and your child is the young entrepreneur and potentially your future business partner. Young entrepreneurs need to learn how to make good decisions and how to seek out advice they can trust. They need skills in strategic decision making, planning, communications, capital investment decisions, credit management, cost control, marketing, employee relations, and then they need to have the production skills that fit their farm. These days the business skills need to be better than the production skills.

Feed them, fertilize them or fry them. I prefer feeding. Young farm managers need a college or university education (it's also a good backup plan!). They should work for someone else to experience what being an employee feels like. They should learn that other people make mistakes, but they learn from them. They will discover that Mom and Dad have their own biases and fears. Let them experiment with another enterprise (with a fixed budget) and they will experience stress, success, failure, rationing limited capital, and critical decision making.

Train yourself for retirement

I actually advise most farmers to keep farming because there are many tax advantages for small business operators. At the same time, the "retiree" has to find a balance between being available to help and being critical to the operation. If you want freedom, you cannot afford to be critical to the day to day goings on of the operation. Here are some other points to keep in mind: stay active, and take care of your hearing and sight; explore other interests or enterprises; take up dating again (with your spouse); stay technically up to date with the changes in your industry; and try to maintain a positive attitude - tell your child what they do right! Keep yourself physically healthy and mentally sharp - you will live longer and be a much happier person to live with.

Business Agreements

Once you're sure that you want to work together, the working relationship should be formalized by a business agreement. The issues addressed by the business agreement are as follows:

Who is involved?

Who owns what assets at what values.

How decisions are made - monthly meetings, by consensus of all partners

Banking and income distribution

Areas of responsibility

Access to information (like records and financial statements)

Use of farm assets as security for personal liabilities (should not be allowed)

Conflict resolution - mediation, arbitration

Getting out - buy-sell agreements and contingency planning

Professional Advisors

Most farm transfers will involve the following professionals - an accountant, a lawyer, a banker, a financial planner, and your farm management advisor. Professional advice can be costly, but with family farms being worth several hundreds of thousands of dollars these days, you want your farm transfer to be handled properly, with a minimum amount of tax. Don't be afraid to modify your plan in the middle of the transfer process, or to change your mind about the type of business structure you choose. It's your farm and your situation.♦

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"A customer is the only critic whose opinion really counts."

Mark Twain

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