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Business Matters

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TAXATION

In-House Benefits

Employers wishing to reward employees for a "job well done" should check first with their Chartered Accountant to make sure the reward is not taxable to the employee.

Generous, well-intentioned employers are often surprised to discover the value of many rewards is reduced because the reward is taxable to the employee. Employees, on the other hand, are often disappointed and discount the value of the benefit received because, in their minds, anything taxable is not a real benefit. Indeed, employees may perceive the "reward" as a means by which the employer can avoid giving pay increases.

Unfortunately, in truth, employers have very little leeway to provide incentives that are not taxable to employees. The following list, though not all-inclusive, provides an idea of the administrative position of the Canada Revenue Agency (CRA).

- Gifts of cash or near-cash (such as gift certificates) are taxable.
- Gifts that are neither cash nor near-cash, but have an annual value greater than $500 will have tax applied to the amount in excess of the $500 limit.
- Gifts to recognize service are not taxable as long as they are not given more than once every five years. In the event the service-reward amount is given in the same year as cash or near-cash gifts, the two amounts are treated as separate items, thereby avoiding the $500-per-annum threshold.

Immaterial value is a subjective notion.

Even the Shirt off Your Back?

One would think an achievement or service award bearing a company logo but of immaterial value such as a coffee cup or a T-shirt would not attract income tax; however, the CRA leaves the door open for possible taxation by indicating that the concept of immaterial value is subjective. The CRA takes the position that such awards should be valued at an amount the employee could get for the item if sold immediately after receipt. For instance, an outstanding employee of the Canadian Football League rewarded with a team jersey signed by all the players of a Grey Cup championship team could have received an item with a value far in excess of the immaterial cost of the jersey.

The Grinch Who Taxes Christmas?

The next time your employer holds a picnic or holiday party take pity on the planner who may be under pressure to keep the cost per employee under $100 because CRA administrative practice stipulates that a cost below $100 is not a taxable benefit. However, if the expenditure exceeds $100 per employee, the entire amount may become taxable to the employees. For those generous employers wishing to include spouses and children, the $100 ceiling is not hard to break.

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Club Memberships

Club memberships and fees are taxable in the hands of the employee member if the club is primarily used for personal wining, dining and sports activities. On the other hand, if the employer receives the primary benefit and the employee does not participate sufficiently to be considered to have received a benefit then there may be no taxable benefit to the employee. If, by way of example, a business owns a club membership and an employee uses it to entertain company clients or management meets there to discuss business issues, then no individual employee would be deemed to have received a taxable benefit. Good management would suggest that use of the facilities for corporate functions be documented to establish the corporation as the primary user and to prove that employees are not receiving benefits.

Flying High

Frequent-flyer points were a contentious issue between employees/employers and CRA until an understanding was reached in 2009. Before 2009 employees who used their own credit cards to gain points while on company business were considered to be earning a taxable benefit. In 2009 the CRA conceded that the use of personal credit cards to pay for company business would not be considered a taxable benefit as long as:

- the employee did not receive cash for the points
- management did not provide the card as an alternative to remuneration
- there was no intention to avoid taxes.

Employees and employers should be aware, however, that, if the employer owns the credit card and distributes the accumulated points as a reward to employees, the value of the reward will be perceived as a taxable benefit to the employee.

Withholding Taxes

Benefits taxable in the hands of the employee are subject to deductions at source. The general guideline is as follows:

If the gift is taxable, both income tax and the Canada Pension Plan contribution must be calculated, deducted and remitted. Should the employee receive cash, income tax, CPP and Employment Insurance must be calculated, deducted and remitted. (Naturally, the employer must remit its share of CPP and EI.) Gift certificates (near-cash benefits) are not considered cash for purpose of the EI calculation and thus only income tax and CPP are calculated, deducted and remitted.

Employer Responsibility

The end of the calendar year is close. Employers should review gifts and incentives provided during the year to determine whether employee remuneration must be adjusted for benefits taxable to the employee. If it was the employer's intention to provide gifts in the last month of the year, now is the time to consider how best to structure the gifts to say "thank you" to employees without impacting their pay cheques. Employers should also remember that February 28, 2011, is the last day for sending out T-4s to employees.

For employers needing guidance determining which benefits are taxable, your Chartered Accountant might just be your new BFF.

MONEYSAVER

It's Just Good Business

Successful collection of receivables can often be a matter of knowing how to manage client behaviour.

Has your business had to:

- inform clients that there are no discounts for cash payment
- negotiate with clients who belittle your product to obtain a reduced invoice
- wait 90 days for payment after you paid the 13% HST on the amount invoiced
- point out that post-dated cheques for an invoice due 30 days after receipt is not acceptable
- learn that a client has gone into receivership soon after your last shipment?

Nothing is more frustrating to owner/managers than doing the work and not receiving payment for a job completed.

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The majority of owner/managers act on good faith and a handshake. They believe that once the job is completed the customer will be happy to pay quickly. When cheques are not received owner/managers may rationalize the non-payment by saying they are too busy to follow up or that the client always pays.

Reluctance to bill on a timely basis or go after overdue payments is an administrative weakness that plagues most owner/managers as they move on to the next job. In a world of 13% HST, rising costs and stagnant sales, owner/managers should make billing and collecting number one on the "To-Do List" each day.

Minimize Misunderstandings

To reduce potential misunderstandings never commence a job until the contract is signed. The contract should include the method and schedule of payments. Asking a client for a deposit is a sure-fire way to measure the client's sincerity. Consider asking for a deposit at least equal to the HST on the final invoice. If the client does not pay the invoice within 30 days, your business will at least be able to use the client's cash to pay the HST you are required to remit.

Enhance Collection Procedures

Collection starts once the contract, job or service is finished; invoices should: be submitted immediately upon completion; stipulate the terms of payment; and state that failure to pay the invoice will result in interest charges. Send the invoice by email. Although the interest rate that can be charged is only limited by the usury laws, good business practice suggests a reasonable rate. Remember: if you are reluctant to charge interest, you must accept that a delinquent client reduces your cash flow. As a result, it will be you who must borrow operational funds and pay the interest, not the client.

Telephone customers for all receivables uncollected by day 20 after invoice presentation. The client can discuss any outstanding issues and still has time to prepare payment. Document your discussion.

If you have not received payment within 10 days after the 30-day term, call the customer. Find out why payment has not been made and negotiate a date when you can expect to receive the cheque. Document your discussion.

Cut Your Losses

If payment has not been received and the client has not provided an alternative payment plan, consider the following:

a) Do not take on any additional work from this client on credit.
b) Write the first pre-collection letter to put the debtor on notice that legal proceedings may follow if payment is not received.
c) If the amount is sufficient to justify the costs, you may wish to turn to paralegals or lawyers to determine whether liens can be placed against property or, if the receivable was a service, whether it is possible to attach the debtor's customers.
d) Many provincial Small Claims Courts have award limits high enough to encourage legal action against debtors.

Check Client Payment History

A positive payment history may mean nothing for the future if a client falls on hard times. A client's payment history should be studied and compared to recent behaviour. If necessary, run a credit check or ask competitors about their payment experience with the client. If payments are falling behind, address the issue with the client. Provide the opportunity to explain difficulties and, if possible, offer alternative payment options and a credit limit.

If you must sue, sue only a client who can pay.

Is it Worth Going to Court?

Legal proceedings are a last resort. They are time-consuming and expensive and in the end you may not receive your funds. You will certainly lose the client. Remember: only sue someone who can pay.

Incentives May Reduce Losses

It is almost impossible to avoid some losses in the course of doing business. Losses can, however, be reduced by providing incentives for prompt payment. Consider offering:

- a percentage discount for payment within 10 days
- debit-card payment at the time of presentation to reduce the paper work and time required to process cheque payment
- credit-card payment that will build the client's reward points.

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Managing client payment behaviour is a critical component of every business. Constant review and follow-up provides a predictable flow of cash from receivables and decreases the cost associated with bad debts, legal proceedings and interest charges.

TECHNOLOGY

Zombies in Your Office

Zombie viruses do, in fact, act like the living dead of B-movies and rise from their graves to destroy your computer.

What do Zombies do?
When a virus infects your computer, you can usually blame a hacker's malicious program. Your own computer, however, can pick up the virus by visiting a compromised website, opening an infected e-mail or attachment over a computer network, or get it from removable media, for example a USB flash memory.

How do Zombies Behave?

To be characterised as a zombie, the virus must infect your computer, then remain dormant until certain conditions are met, such as reaching the 11th hour of the 11th day of the 11th month of the 11th year at which time the virus "awakes" and performs the function for which it has been programmed: information gathering or fraud, for instance.

What is a Botnet?

If the hacker has determined your computer will be used to launch an attack on other computers in the global Internet community, you may unwittingly have become part of a botnet, i.e. a network of unrelated computers linked by the hacker to work together to infect or gather information from other computers. (Experts indicate that as many as 100,000 computers could take part in a single botnet.) The hackers like to use linked computers because the source of the virus or worm is then difficult to trace.

How are Botnets Used?

Botnets are used to start denial-of-service attacks, send spam, capture information about bank accounts, log-in IDs and other sensitive information. They can also be used to divert income from pay-per-click advertisers by redirecting funds to a fraudulent recipient and away from the webmasters who provide the platform for the advertising.

What Happens to Victims?

If your computers have become part of a broad network of attack points, not only might your own data have been compromised but your company could also be investigated as authorities search for the culprits. Perhaps you will not be attacked; nevertheless, when you consider that upwards of 65 percent of all spam is written in English and our close neighbour to the south generates 44 percent of the world's spam, it suddenly becomes something to think about. Another scary statistic: 50–80 percent of the world's spam was sent by zombie computers. The reasons for this are twofold: many computers are capable of sending much more spam at much lower cost to the spammers, and this makes it more difficult for authorities to determine the originating source.

Install antivirus software and keep it up to date.

Zombie Repellent

The best way to keep your computer from hosting a zombie is to take preventive measures to avoid coming into contact with potential sources of zombie attacks.

- **Install antivirus software on your computer and keep it up to date.** Purchase antivirus software from a company that specializes in providing software security rather than buy shareware or once-a-year retail software that does not update the program.
- **Use only licensed operating systems and software.** Unlicensed or illegally copied versions of operating systems and software may save a couple of hundred dollars on purchase but may be more susceptible to infection, since unlicensed software often cannot be updated.

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- **Do not use more than one antivirus product.** If you think using two anitivirus products will double your protection, think again. In some cases, the two programs may interfere with each other causing your computer to become slow or even unbootable!
- **Install spyware scanners.** These will search for malicious spyware and provide a record of your Internet habits necessary to establish the appropriate security. Many antivirus products now include the ability to scan for spyware.
- **Protect your network with a firewall**. Check your antivirus software to determine whether a software firewall is included. Most network routers, including integrated cable modem routers, are considered a hardware-based firewall. Make sure yours includes the ability to encrypt your traffic, particularly over Wi-Fi, and has a strong password set to reduce the possibility of drive-by hacking (also known as war driving).
- **Use alphanumeric passwords that include symbols.** Despite constant warnings not to use passwords that are easy to decipher such as birthdates, many passwords remain all too easy to crack. A combination of letters, numbers and special characters is best, especially if no part spells a whole word or is personally identifiable. Your first name combined with your year of birth would be an example of a weak password.

Keeping the Zombie in His Grave

The hardware and software employed to prevent infection must be used in combination with good common sense. Educate yourself and your employees on the following:

- Do not open electronic messages, regardless of the medium, unless you are 100 per cent confident of the source.
- Use a virus scanner to scan the data, even if you are confident in the source and regardless of the medium, before downloading to the hard drive.
- Do not permit anyone to download personal data, programs or software onto any company computer. That computer may become the source of infection for the network or unlinked computers through USB or other data transfer.
- Establish a policy to limit personal use of office computers. Access to selected sites can be limited by whitelisting or blacklisting.
- Do not click on dubious ads enticing users with offers of free prizes.
- Use your home-office computer only for business-related work. Have another computer for your partner, children and friends.

Working with Your Employees

Human nature is hard to police. Regardless of the policies in place, there is always the thought that “it won’t happen this time.” If, as an employer, you feel employees need access to the Internet for personal use, dedicate a separate computer with a separate URL address. You should definitely install the aforementioned controls on all your computers. This action not only backs up your commitment to policies regarding personal use of company computers, but also reduces risk with little cost to your business.

Never Let Your Guard Down

Regardless of the software purchased to defend against hackers, the serious game of attempting to beat the system goes on 24 hours a day *from all over the world.* Precaution is the word of the decade.

MANAGEMENT

Preparing to Sell Your Business

Getting out of a business requires as much planning as getting into it.

Whether you are an owner/manager considering “getting out of the business” because you are reaching retirement age or because you are interested in trying another endeavour, selling a business should not be a spur-of-the-moment decision. Such a big move should be a staged process that ensures optimization of sale price to provide additional funds for retirement or entry into a new business venture. Professionals involved in buying and selling businesses agree that, unless a fire sale is essential, the process of selling should be planned two to three years in advance and should include the following strategies.

Obtain a Valuation

Make sure the selling price is realistic. You obviously want to receive the highest price possible for the business while the buyer wishes to purchase your business for as little as possible. Once you decide to sell the business, get it evaluated. This process can be

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a sobering but realistic starting point. Outside assistance is required. There are many methods of business valuation, some more suited to one type of business and some more suited to another. Here are two of the most common:

Capitalized Past Earnings

This method examines the company's history of earnings before interest, taxes, depreciation and amortization (EBITDA) then calculates the operating cash flow that needs to be generated each year normalized for unusual swings in revenue or expenses. The cash flow figure is capitalized by a multiple that reflects a reasonable rate of return given the risk profile of the business.

Discounted Cash Flow

This method discounts to present value the expected future streams of revenues and expenses. The applicable discount rate will reflect the risk anticipated in generating those revenues and expenses: the greater the risk, the higher the discount rate and the lower the value of the company.

Both methods establish sufficient cash flow as a major risk component for valuation.

A business valuation provides a range of possible selling prices. Should the valuation be lower than your expectations, work to reduce the perceived risk by improving both the financial and physical image of the company.

First Appearances

The financial statements are not the only things looked at by a potential buyer. The physical look of the business has an enormous impact of how your business is perceived and valued. Refurbish the physical surroundings: paint buildings inside and out, reseal or replace asphalt driveways, fix fences and spruce up the entrance way with new signs or gates to create a good first impression.

Moveable assets must be clean and in good working order. Fix mechanical defects and have service logs and safety certifications ready for inspection.

Get rid of obsolete inventory. Old inventory presents a disposal cost for the new buyer and suggests your business is out of touch with the market and uncertain of client needs.

Supplier and Customer Contracts

Vet your customers and suppliers. Consider locking in quality suppliers and customers with long-term contracts. The contracted suppliers will provide security of supply and the contracted customers will provide an assured revenue stream to the purchaser. Supplier and customer lists with up-to-date business addresses, contact names, email addresses, telephone and other numbers provide confidence to the purchaser.

Key Employees

Stability is crucial to all businesses. Purchasers need to know that key employees are not going to leave because of new management. Employment contracts with sales reps, purchasing agents, mechanics, technicians, or finance staff help the purchaser understand costs and obligations while providing assurance to the employees that they have a future with the new venture.

Regulatory

Whatever your business, staff must be constantly aware that regulatory compliance is an essential part of day-to-day operations: safety certificates, environmental approval, municipal permits, licensing, corporate tax filings, or cross-border papers must always be up to date. This awareness reduces last-minute surprises such as back taxes, or liens and holds on property for failure to comply with municipal, provincial or federal regulations such as obtaining final approval to build an addition or install new electrical wiring. Such unresolved issues could delay the sale. Giving the potential purchaser confidence that you are a good corporate steward removes the worry that unnecessary time, energy and funds might have to be expended to clear up lingering regulatory matters in the future.

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Financial

Because purchasers want a company with a positive cash flow and a reasonable return on investment, you should methodically review the financial statements and supporting data for the last three years. By building on your historical strengths and fixing the weaknesses you can enhance performance over the next three years and thereby improve the selling price. Concentrate on the following:

Revenue Stream: Analyse sales by profit line or customer. Use the information to find areas that need improvement in order to increase revenue.

Expenditure Trends within the Cost of Goods: Product-line return analysis is a good place to start. Understanding the gross margin by product or service line allows a company to determine those product lines that need to be dropped or perhaps given a price increase.

Prospective buyers are concerned about your cash flow.

Statement of Cash Flow: Cash flow is a major concern to the prospective investor because it indicates the amount of equity to be raised not only to purchase the business but also to provide working capital after the buyout. From your point of view as a seller, analysing month-to-month cash flow will highlight slack collection procedures, direct you to revamp payable strategies and refine the timing of inventory purchases or capital-asset acquisitions. The better this information looks to you, as seller, the better it looks to the purchaser.

Administrative Costs: Even though administrative costs on their own are usually a small part of overall operating costs, most owner remuneration is included in this sector. Break out the amounts paid to yourself as owner/manager, your spouse and any other family members on staff, since purchasers want to know not only what funds they can expect to receive, but also whether the manner of payment to the current owners and immediate family are designed to minimize personal income tax payments. This information enables purchasers to determine whether the company makes sufficient profit to pay the new owner *and* hire new non-family employees.

Plan Ahead and Take Your Time

Selling a business is as much about preparation and anticipation of the buyer's needs as it is about the price you want for your business. Getting your business ready for sale should take place over a two-to-three-year period. This time frame enables the seller to show the business at its best while providing the purchaser with the confidence to offer a price that is fair to both parties.

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